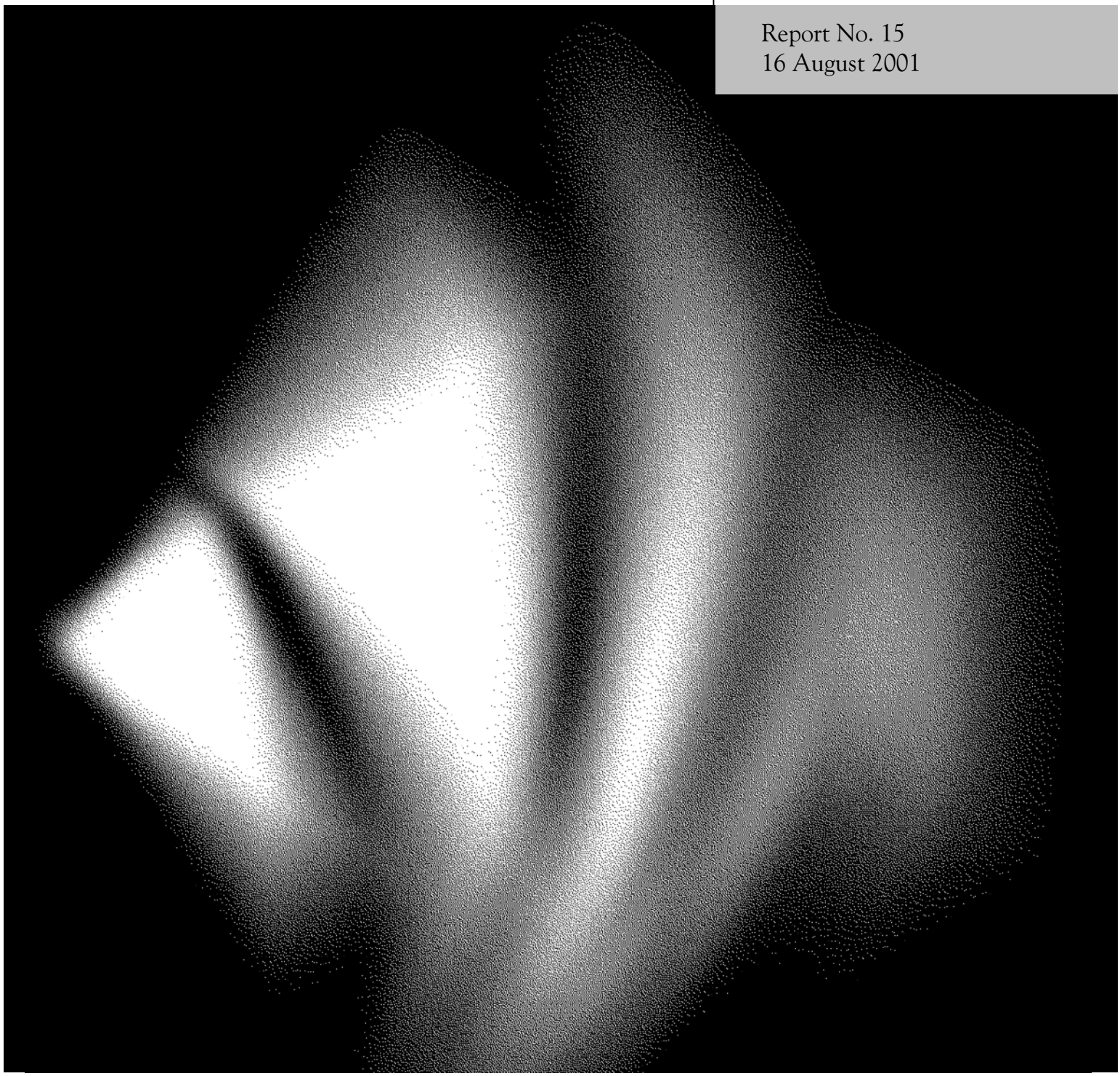
PRODUCTIVITY COMMISSION

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:

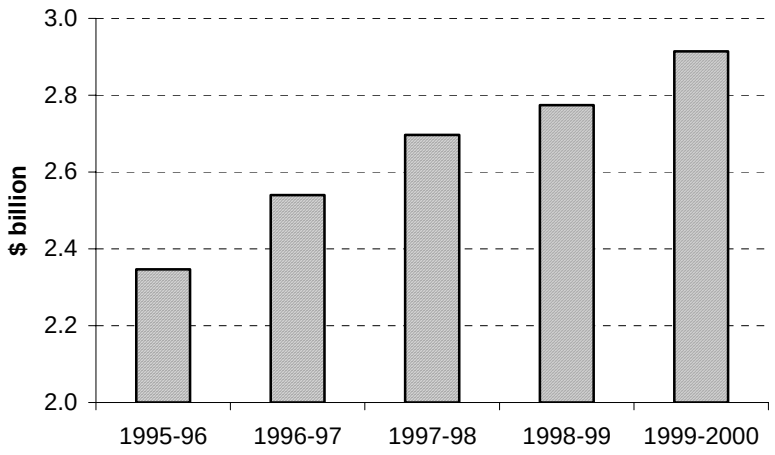
- generally, avoiding cross-subsidies;
- ensuring transparency and accountability; and
- undertaking industry consultation.

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.

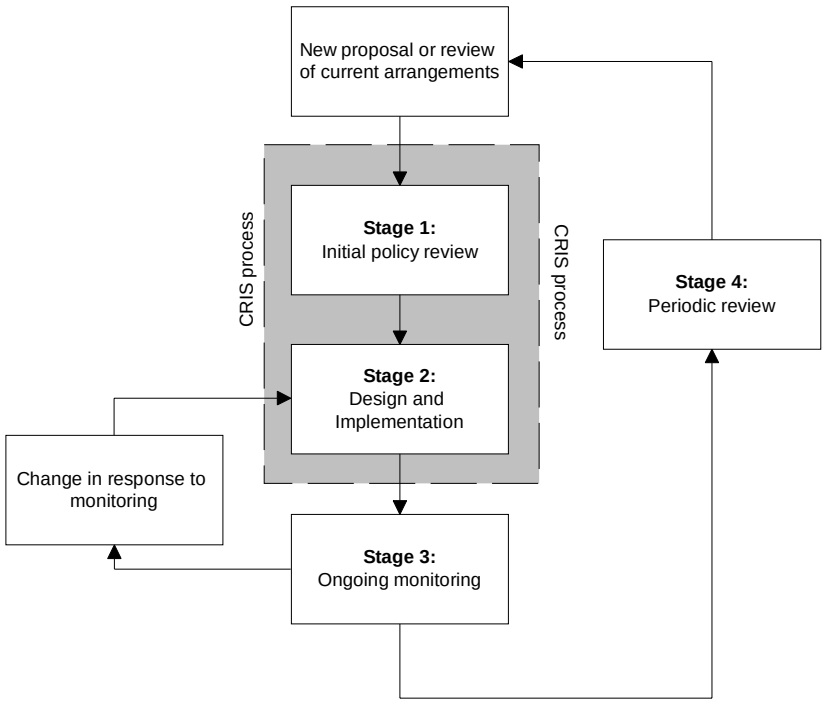
The Guidelines involve the production of a Cost Recovery Impact Statement.

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.

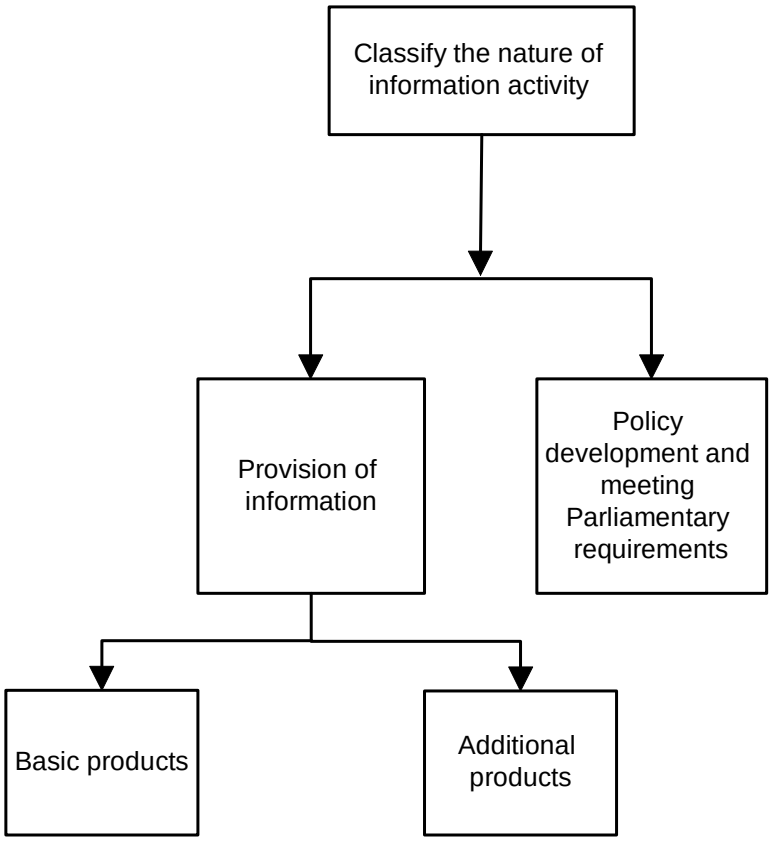
Processes for assessing cost recovery



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

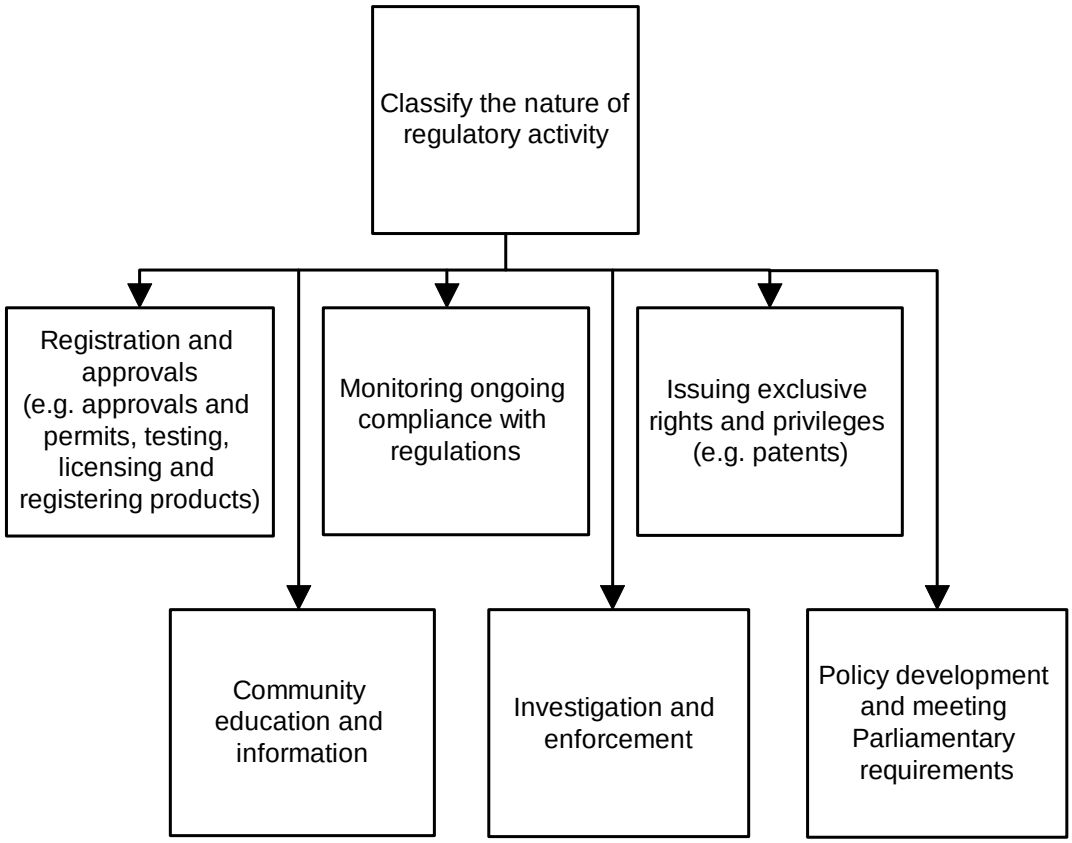


Classifying regulatory activities is complex.

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.

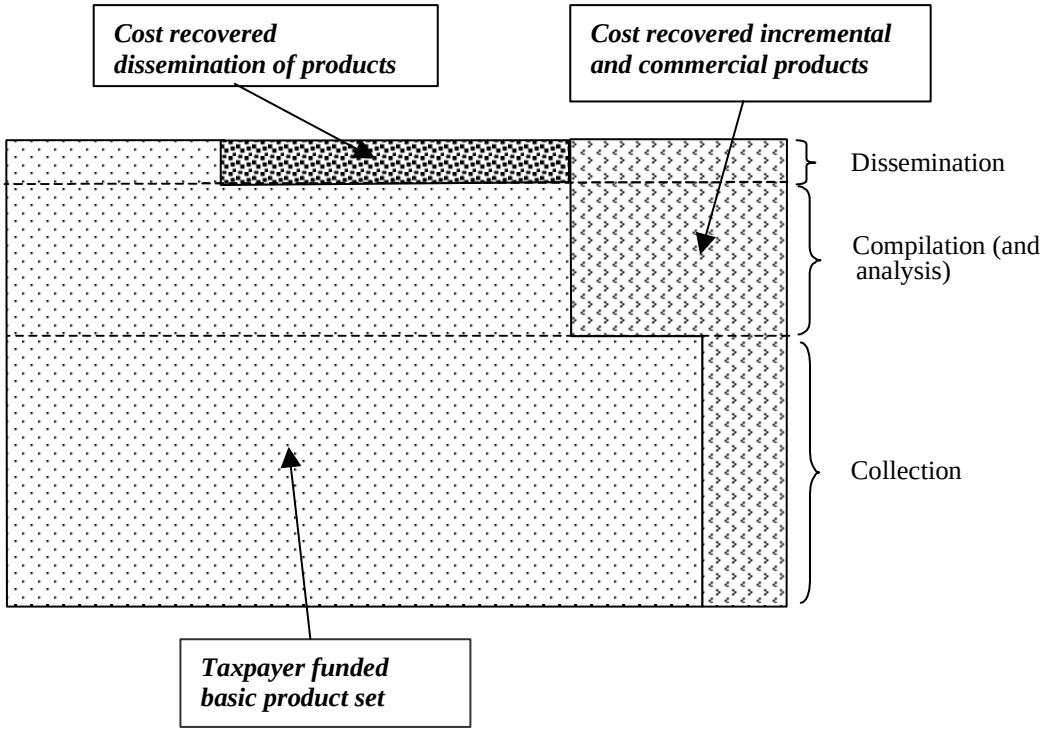
Some information products that do not meet these tests may nevertheless be funded from general taxation revenue, but only if the government explicitly decides that there are other significant policy reasons for doing so. Where these situations do not arise and information products benefit only particular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

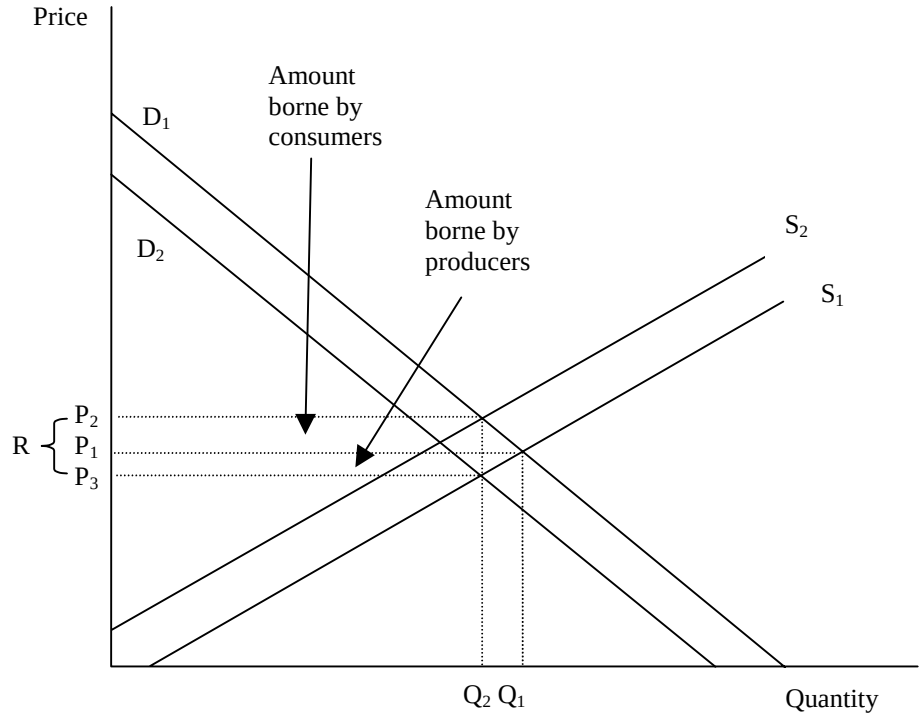
> … cost recovery from a diverse group of beneficiaries may still be possible. For example, charging the suppliers to such a group is often an efficient way to charge those who ultimately benefit. Depending on the extent to which businesses can pass on the costs, any increase in business costs will be 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.

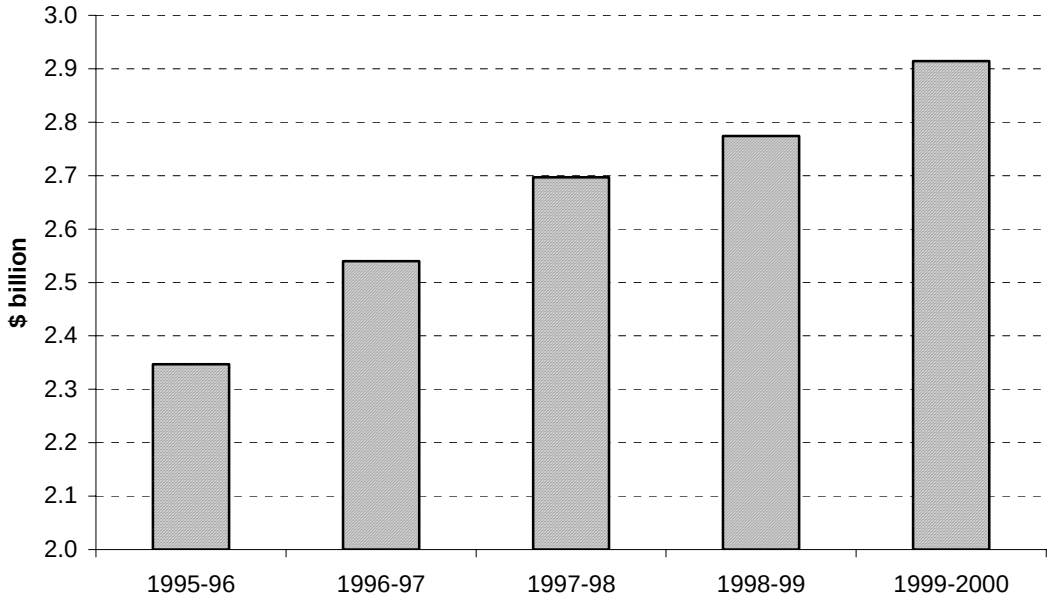
4.1 Introduction

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]**



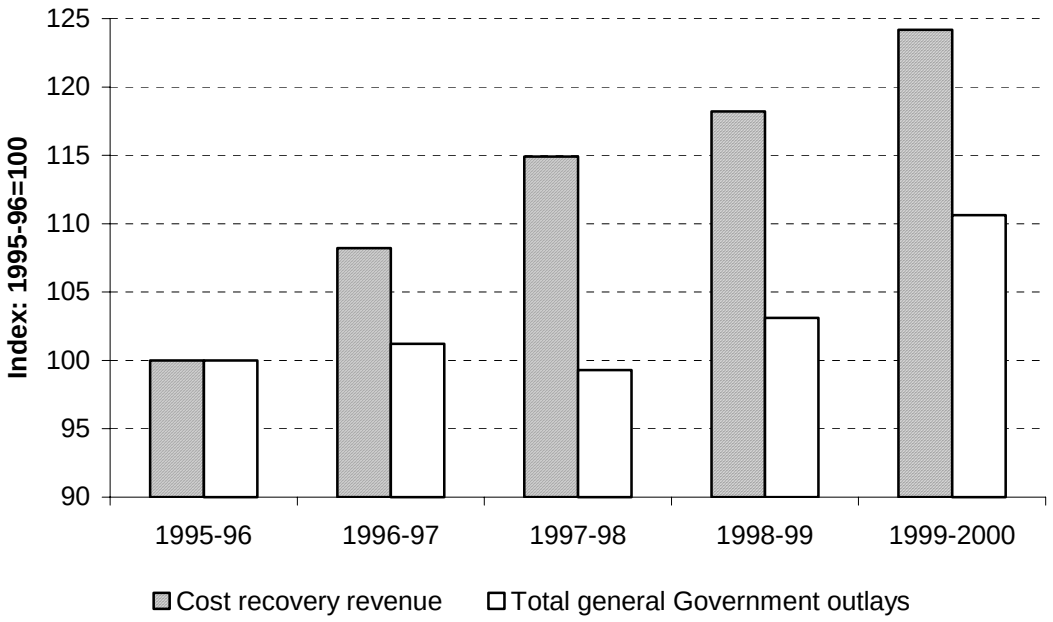
a Cost recovery revenues are based on agencies' own estimates. Revenues include only those of: (1) agencies that responded to the Commission's questionnaire; and (2) agencies that reported cost recovery revenues for all five years. Revenues include transactions both between agencies and between agencies 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:

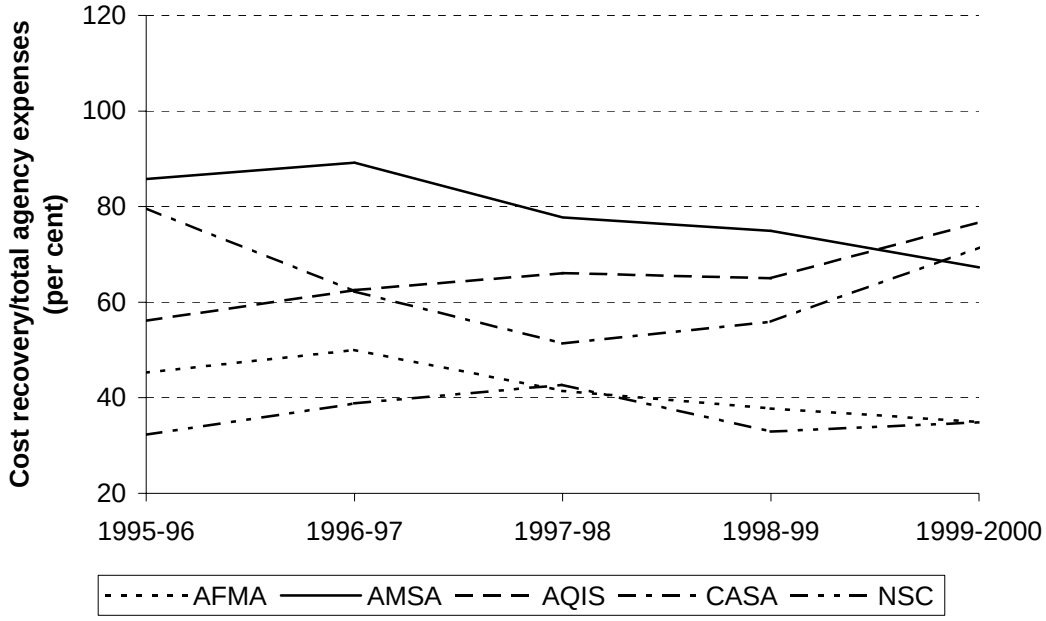
> … levies are calculated on the basis of budgeted recoverable costs for managing each fishery adjusted by any variances in recoverable costs for that fishery from the previous year. Consequently, levies for each fishery change every year and can increase or decrease significantly if there are significant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

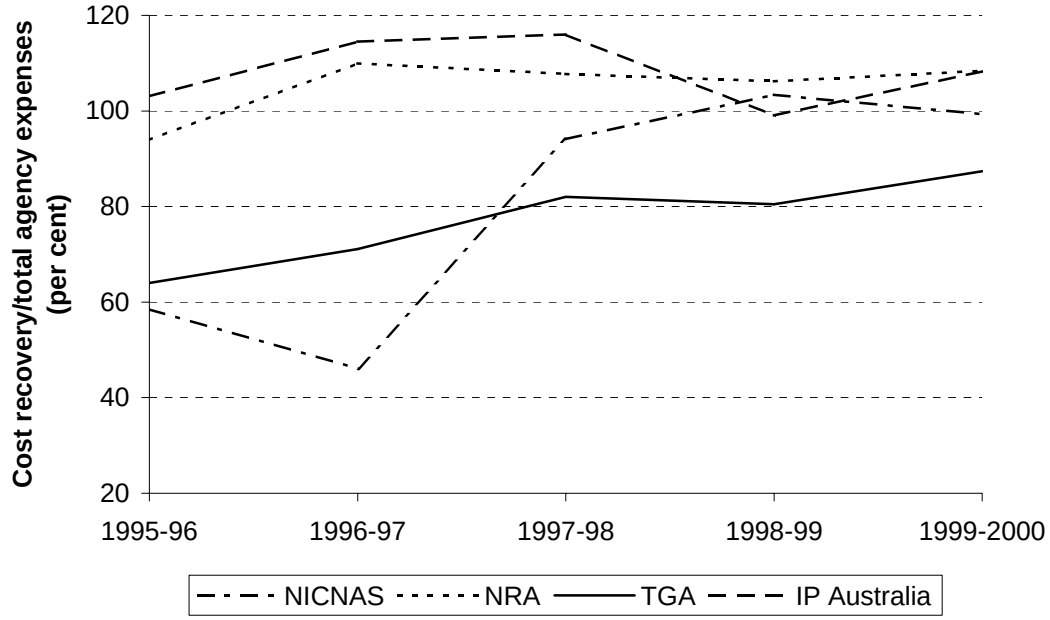
Data source: PC estimates based on questionnaire (part I) responses.

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**

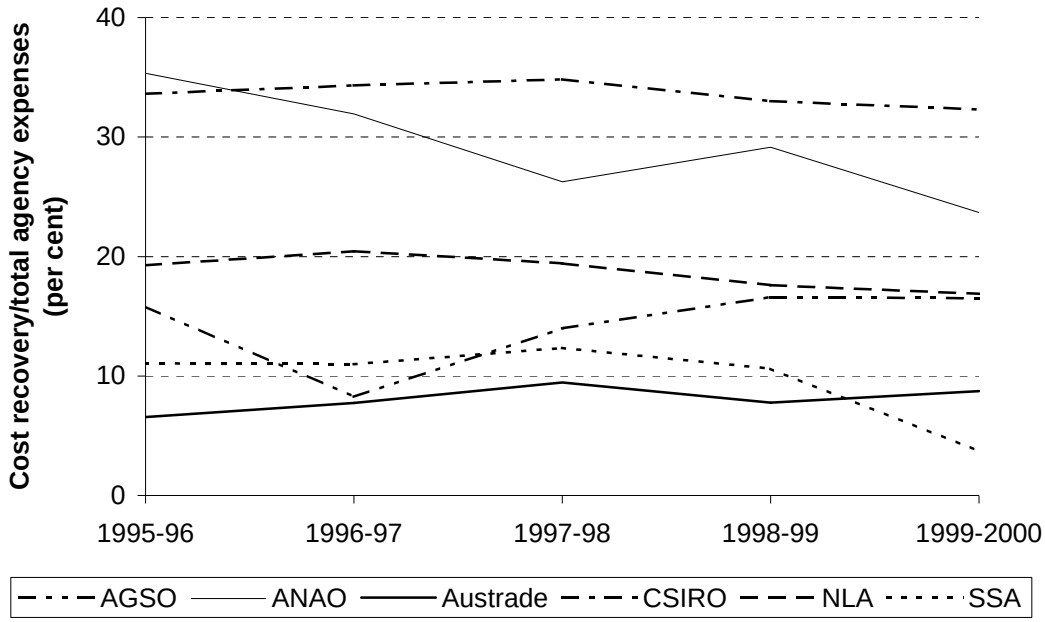
Agency [a]	*Cost recovery revenue* [b]	*Cost recovery/total expenses*	*Agency cost recovery target?*
	$m	%	
ABARE	11.2	51.1[c]	No
ABS	21.5	8.4	No
AGSO	12.1	16.5	Yes
ANAO	10.8	23.8	No
AUSLIG	4.7	14.2	No
Austrade	28.8	8.8	No
BoM	35.3	17.4	No
CSIRO	250.4	32.3	Yes
NLA	8.6	16.9	No
ScreenSound Australia	1.8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

PART TWO

PROPOSED INFORMATION AGENCY GUIDELINES

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Proposed information agency Guidelines

These Guidelines were prepared by the Productivity Commission. Policy makers and agencies applying these Guidelines may wish to consult the Commission's report, Cost recovery by Government agencies (2001) for more detail and background information. The full report is available from AusInfo and on the Commission's website at www.pc.gov.au.

WHAT are these Guidelines?

These Guidelines provide a framework to assist policy makers and agencies to design and implement appropriate cost recovery arrangements.

A key output of applying the Guidelines is a Cost Recovery Impact Statement (CRIS). An independent review body assesses this CRIS. The CRIS and the independent assessment are then forwarded to the body responsible for deciding what action will be taken. Following that, the CRIS and independent assessment become public documents, published on the agency's web site and summarised in the agency's annual report and Portfolio Budget Statements.

WHO should use these Guidelines?

These Guidelines apply to Commonwealth information agencies — that is, agencies whose primary purpose is to collect, compile and disseminate information, as well as 'cultural institutions' and archives. These Guidelines are designed to address cost recovery of information products. Agencies may also wish to draw on these Guidelines, to the extent relevant, when developing inter-agency or inter-governmental charging arrangements. The Guidelines are not written to be applied to government business enterprises.

There is another set of Guidelines for regulatory agencies. Such agencies primarily administer regulations, although they may also collect and disseminate some information.

If agencies are unsure about which Guidelines to apply, then they should consult with the body responsible for independently assessing the CRIS process.

WHAT is cost recovery?

Cost recovery is recovery of some or all of the costs of a particular activity. Commonwealth Government cost recovery charges fall into two broad categories: fees for goods and services; and 'cost recovery' taxes (primarily levies, but also excises and customs duties).

Cost recovery is different from general taxation. Some levies or taxes are used to raise cost recovery revenues, but the direct link — or 'earmarking' — between the revenue and the funding of a specific activity distinguishes such cost recovery taxes from general taxation.

Many payments are not cost recovery for the purposes of these Guidelines. Exclusions include:

- general taxation (but not specific-purpose levies and taxes);
- commercial arrangements by government business enterprises in contestable markets;
- repayments of loans to the Commonwealth under various policies;
- asset sales, including the sale of rights to access resources;
- fines and pecuniary penalties; and
- payments to non-Commonwealth bodies where Commonwealth policies may affect prices (for example, the Pharmaceutical Benefits Scheme and the co-payment of medical fees under Medicare).

If agencies are unsure about whether the charges they impose amount to cost recovery, then they should consult with the body responsible for independently assessing the CRIS process.

WHY have cost recovery?

Cost recovery can provide an important means of improving the efficiency with which information products are produced and consumed. Cost recovery may also improve equity by ensuring that those who request additional information bear the costs.

However, 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.

Information agencies undertake a range of activities and produce a range of products, and cost recovery is not appropriate for all of these. Therefore, a mix of taxpayer funded (basic) products and cost recovered (additional) products would be expected for most information agencies.

WHEN should these Guidelines be applied?

Commonwealth information agencies should apply these Guidelines when:

- undertaking reviews consistent with the Government's five-year review schedule for existing cost recovery arrangements;
- new cost recovery arrangements are proposed;
- significant amendments to existing arrangements are being considered; and
- periodic reviews of cost recovery arrangements are required.

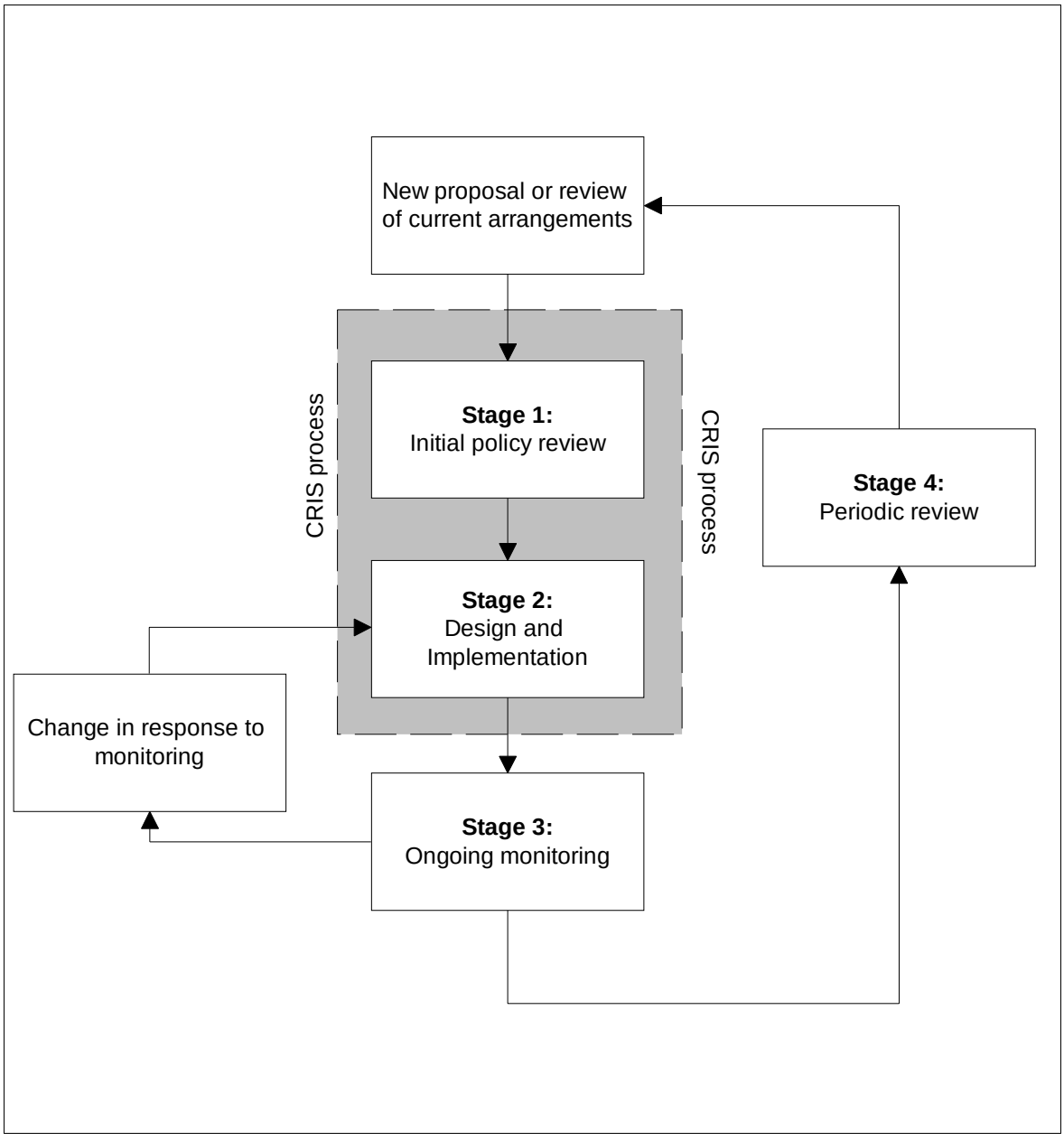
The Guidelines should be applied to all significant cost recovery arrangements. However, minor variations to existing arrangements may be exempted from review.

If agencies are unsure about whether the Guidelines apply to a particular cost recovery arrangement, then they should consult with the body responsible for independently assessing the CRIS process.

Overview of the process

These Guidelines adopt a four-stage process for determining the appropriate approach to cost recovery for information activities and products (figure 1).

Figure 1 **Process for assessing cost recovery**



Stage 1 **Initial policy review**

The stage 1 policy review considers the following questions:

- Which of the agency's objectives are relevant to the information activities or products 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?

Stage 2 **Design and implementation**

If cost recovery is appropriate, stage 2 considers the following questions:

- Who should pay cost recovery charges?
- Should cost recovery charges be imposed using fees or levies?
- What legal authority is necessary to impose the charges?
- Which issues should any legislation address?
- Which costs should the charges include?
- 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 (discussed in the following section).

Stage 3 **Ongoing monitoring**

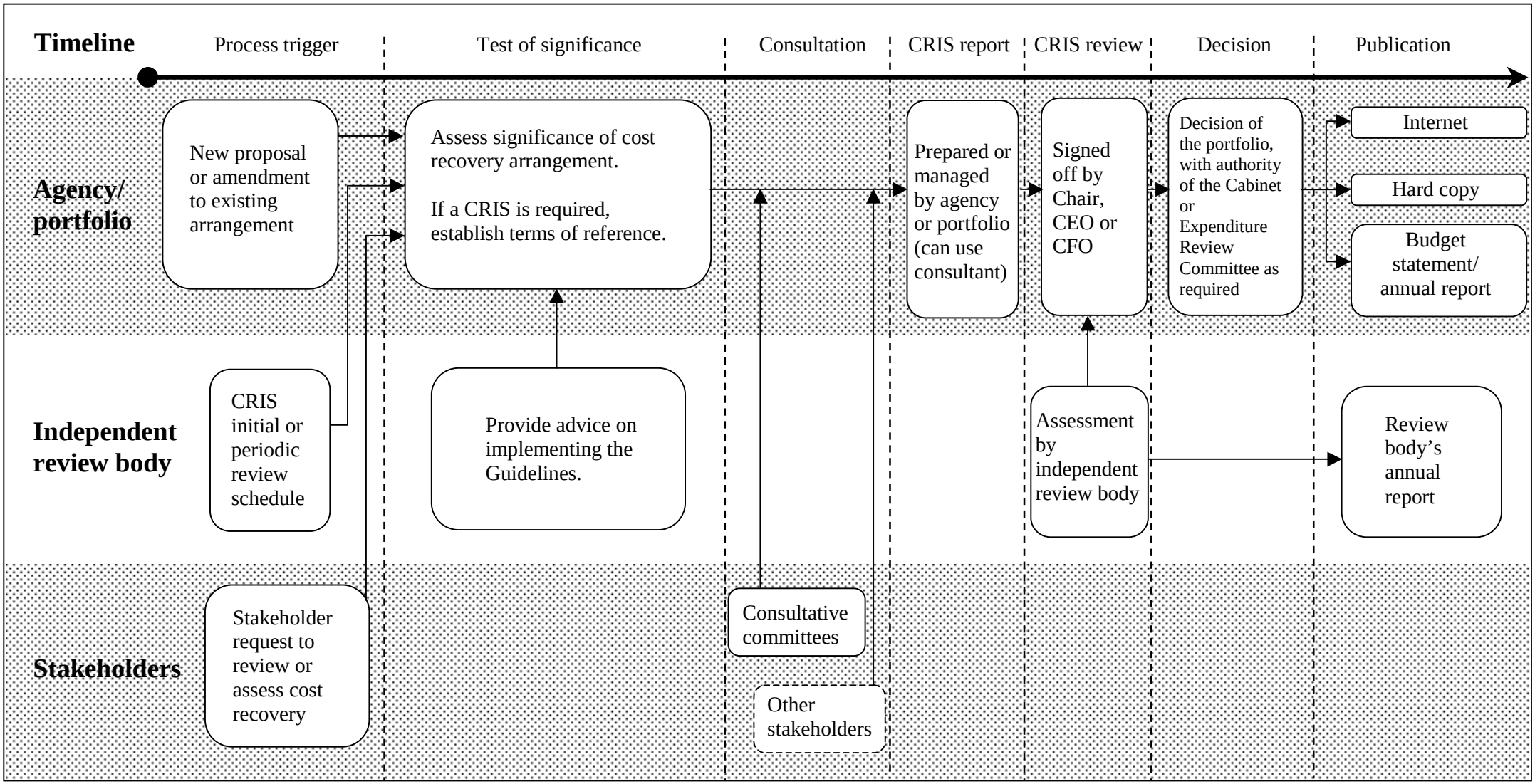
Stage 3 provides for ongoing scrutiny of cost recovery arrangements using the monitoring mechanisms determined as part of stage 1. Ongoing monitoring provides an opportunity for continual improvement in cost recovery arrangements.

Stage 4 **Periodic review**

At least every 10 years, the appropriateness of cost recovery, the design of any cost recovery charges and the adequacy of monitoring arrangements need to be reviewed, to determine whether changes are necessary.

Stage 4 involves the preparation of a CRIS that reconsiders the issues in stages 1 and 2.

Figure 2 **CRIS process summary**



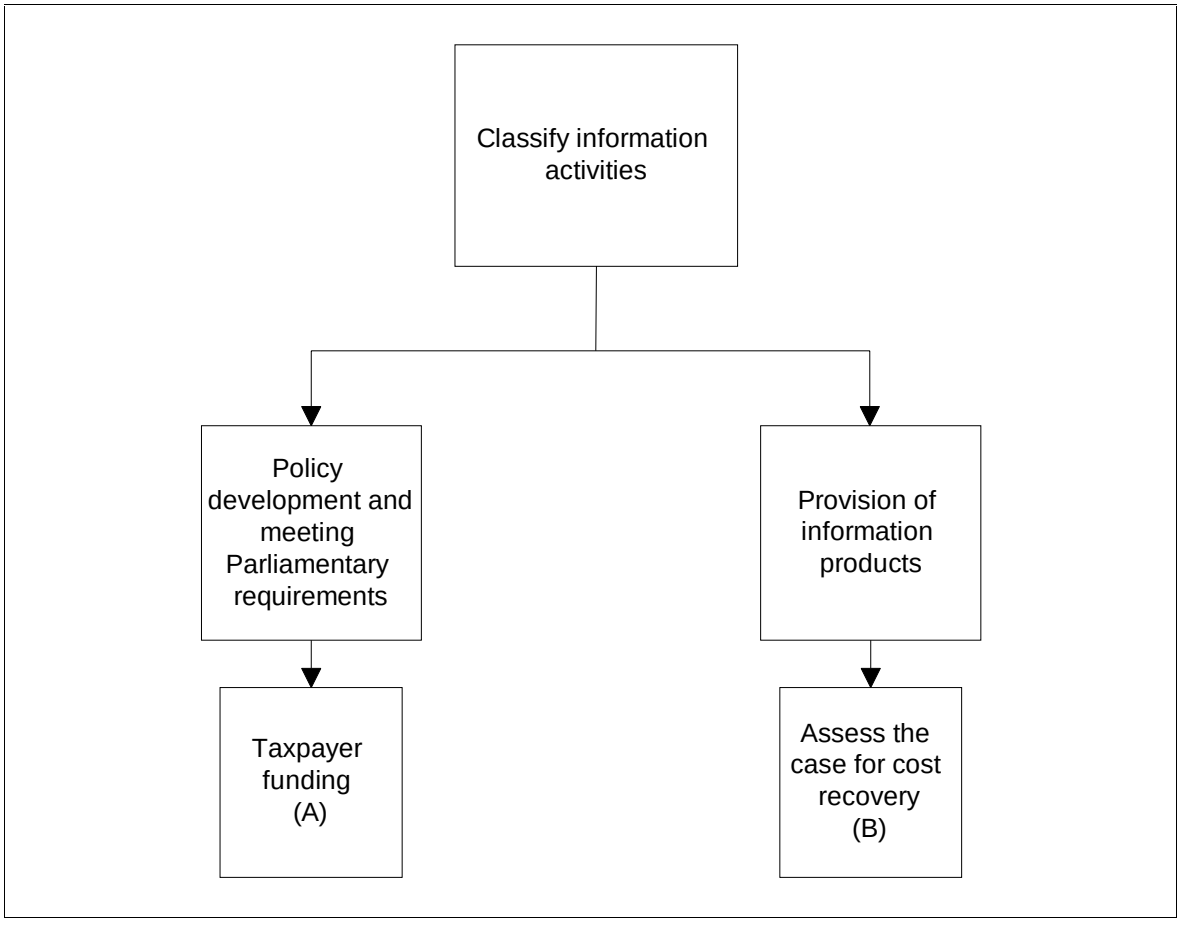
Cost Recovery Impact Statement (CRIS)

To apply the Guidelines, information agencies need to prepare a Cost Recovery Impact Statement (CRIS). The CRIS is a written report by the agency and/or the policy maker, which addresses the issues discussed in stages 1 and 2 of these Guidelines. The CRIS process is summarised in figure 2 and examined in more detail in attachment A.

The following are the most important characteristics of the CRIS:

- It should normally address all of the issues posed in the Guidelines. If the cost recovery proposal is of lesser significance or some issues are not relevant to an agency, a less comprehensive CRIS could be undertaken, but the reasons for doing so should be explained.
- It should include a consultation statement describing how stakeholders were consulted.
- It should be signed off by the Chair, Chief Executive Officer or Chief Financial Officer of the agency to certify that the Guidelines have been adequately applied.
- It should be assessed by an independent review body.
- It should be made publicly available, along with the independent assessment.

Figure 3 **Classification of information activities and products**



Stage 1
Policy review

It is rare for all of an agency's activities and products to have identical characteristics. It is not possible, therefore, to assess the appropriate level of cost recovery on an agency-wide basis. Rather, an agency should assess the case for cost recovery for each activity or product.

Which of the agency's objectives are relevant to the information activities or products being considered for cost recovery?

It is important for an agency to be aware of the agency objectives relevant to each activity or product to:

- judge whether cost recovery is consistent with these objectives; and
- ensure that cost recovery is not undertaken simply to earn revenue.

When more than one activity or product is being considered for cost recovery, it may be useful to group those with similar characteristics or objectives. These groups need to be small enough so the types of activity within a group have common characteristics and objectives, but large enough to make the review process manageable.

Activities undertaken by information agencies will usually fall into one of two broad classifications: 'Policy development and meeting Parliamentary requirements' and 'Provision of information products' (figure 3).

In general, the products provided by information agencies result from a combination of information collection, compilation and storage, analysis and enhancement, and dissemination.

Should cost recovery be introduced?

The next step is to determine whether the agency should charge for all or some of its activities or products. The following discussion looks more closely at the classifications in figure 3 and outlines how to assess the appropriate level of cost recovery.

A Policy development and meeting Parliamentary requirements

These activities include:

- reporting to Parliament;
- advising Parliament on issues where the agency has expertise;
- answering Parliamentary questions;
- briefing Ministers and responding to their correspondence;
- undertaking financial reporting; and
- complying with international treaties.

They also include policy work such as defining and refining the agency's objectives, and liaising and consulting with international organisations. They do not include providing information products to other Government agencies.

Most of these activities should be taxpayer funded. Providing services to Government results from the need to maintain a strong democratic process, more than from the information needs of customers. The community, through Parliament, benefits from these activities.

Also, the Government sets policies across all areas of the economy. It does not require sectors not subject to cost recovery to pay for policy development directly, so it is inappropriate to impose these costs on areas that are subject to cost recovery.

The CRIS must clearly justify circumstances in which these activities are to be cost recovered.

B Provision of information products

The two steps in considering whether to impose cost recovery for information products are:

- determining which products should be taxpayer funded (basic product set) (figure 4); and

- establishing the approach to cost recovery for other products (additional products) (figure 5).

Determining the basic product set

An information agency cannot decide alone what level of taxpayer funding it will receive. This decision is made by the Government, but should be informed by discussions between the Government and the agency. The principles outlined in the Guidelines can help identify products for which taxpayer funding is appropriate.

A useful distinction that may inform this process is that between:

- ***general information products produced for the Australian community; and***
- ***information products produced at the request of specific groups or individuals.***

Box 1 **Public and private goods**

Public goods exist where provision for one person means the good or service is available to all people at no additional cost. Public goods are said to have two main economic characteristics: they are non-rivalrous (that is, consumption by one person will not diminish consumption by others); and they are non-excludable (that is, it is difficult to exclude anyone from benefiting from the good). Given that exclusion would be physically impossible or economically infeasible, these goods are unlikely to be provided to a sufficient extent by the private market. The nature of public goods makes it difficult to assess the extent of demand for them. It is ultimately a matter of judgment whether demand is sufficient to warrant government provision.

This definition of 'public good' is important in economics. It should not be confused with phrases such as 'good for the public', 'public interest' or 'publicly produced goods'.

A **private good** is both 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, providing it is profitable to do so.

There are few 'pure' public goods, but a range of goods have a mix of public and private good characteristics. Many information products, for example, are non-rivalrous (that is, information, once collected and compiled, can be used by many people without affecting the cost of collection and compilation). While it may be technically possible to exclude some people from using this information, it will be neither socially nor economically desirable if charging is likely to unduly deter potential users. Therefore, in assessing the public good characteristics of information products, it is often more important to assess the product's degree of rivalry than to assess the technical ability to exclude.

The questions in figure 4 identify those products that should be taxpayer funded according to three criteria:

- they have 'public good' characteristics (box 1);
- they generate significant spillover benefits to the broader community; and/or
- there are other policy reasons for taxpayer funding.

Figure 4 **Assessing funding for information products**

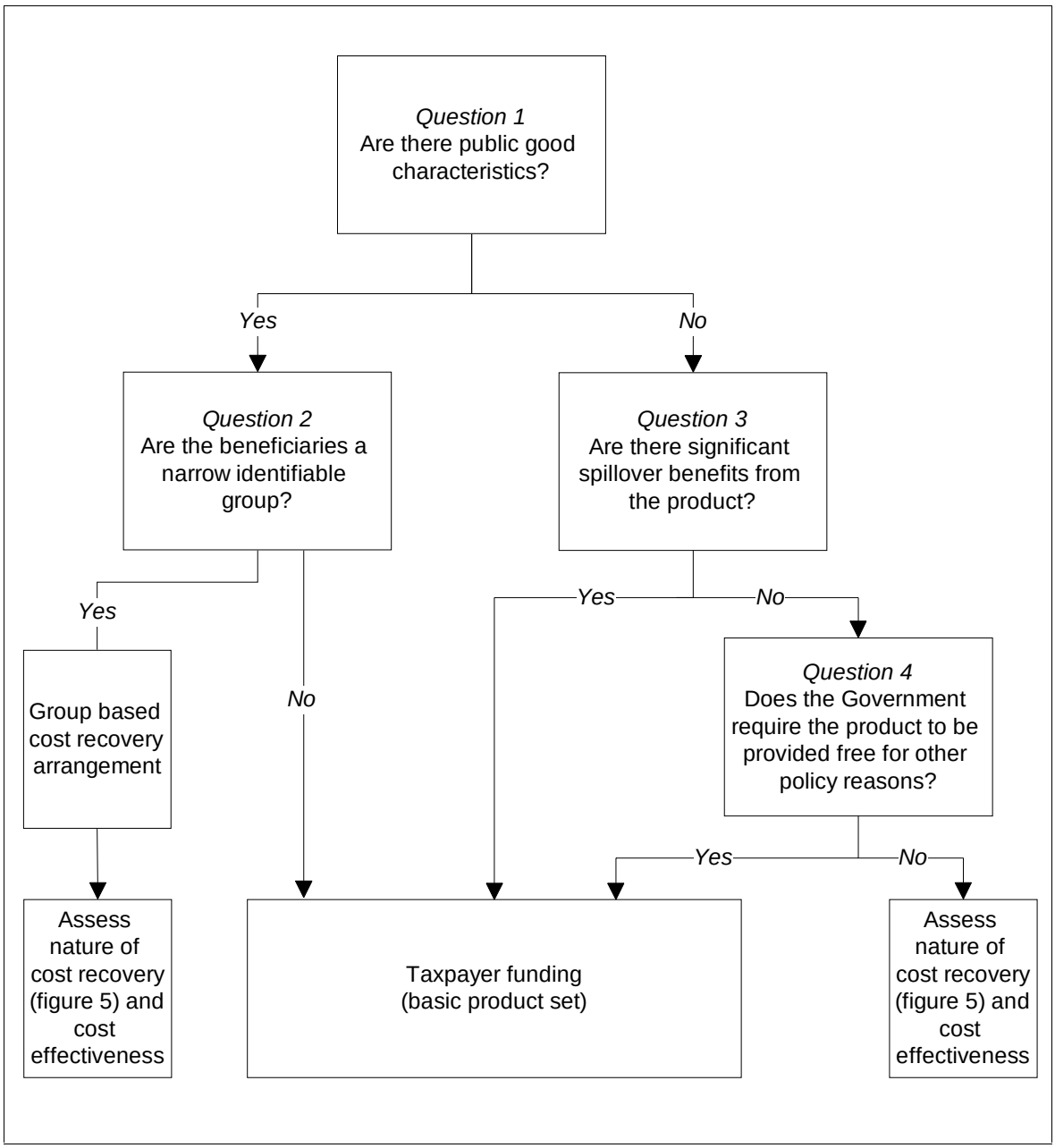


Figure 4, question 1 *Are there public good characteristics?*	The assessment of whether a group of products has public good characteristics is not clearcut. Agencies need to judge whether, on balance, the public good characteristics are significant enough to make it undesirable to charge for those products. Judgements about public goods typically consider two characteristics of the product: its level of rivalness and its level of excludability.

Is the product rivalrous?	A product is non-rivalrous when one person using the product has no impact on others' ability to use that product. The number of users can be increased at virtually zero cost. Most general information fits into this category. Information agencies produce a range of products, some of which will be rivalrous and others non-rivalrous. Once information is collected and compiled, many people can use it without affecting the costs of collection or compilation. Such information, distributed via the media, is non-rivalrous. Many people can listen to the radio without affecting others' ability to use the information. The rivalness of information distributed by other methods, such as the Internet, will depend on the level of capacity in the system and the level of demand (attachment B). A publication, however, may be rivalrous, because several people cannot use the same publication simultaneously. In assessing rivalness the key question is whether more users of the product will increase the cost of provision. **Yes: If the product is *rivalrous*, then it is not a public good and the assessment should consider spillover benefits. Go to Q3.** **No: If the product is *non-rivalrous*, then the next step is to consider whether it is possible and desirable to exclude users and charge for the product.**

Is the product excludable?	In the case of a pure public good it is impossible to exclude people from using the product. However, in other cases, exclusion may be technically possible but undesirable. Two factors are important in assessing excludability. *Is it impossible to exclude people from using the product?* This occurs in a narrow range of circumstances. For example, once information has been released to the media it is virtually impossible to prohibit others from accessing that information. *Is it economically efficient to exclude people from using the product?* This assessment looks at whether the benefits from charging outweigh the reduced use of the information. A number of factors influence the magnitude of these benefits and losses, such as the responsiveness of customers to changes in price, the level of taxpayer funding that would be required to substitute for cost recovery, and the efficiency costs of general taxation relative to those of cost recovery charges. While, in most cases, the collection costs of establishing a cost recovery regime are likely to be small, they should be taken into account, particularly where the case for introducing cost recovery is borderline. **Yes: If it is possible and desirable to exclude users from the product, then it is not a public good and the assessment should consider spillover benefits. Go to Q3.** **No: If it is not possible, or it is possible but not desirable to exclude people from the product, then go to Q2.**

Figure 4, question 2 *Are the beneficiaries a narrow identifiable group?*	Some products with public good characteristics are used only by a small group such as an industry or a specific consumer group. If it is possible to identify the group using the information product, then it may be possible to develop a levy mechanism that applies only to its members. In other cases, an industry association or other representative group may provide another avenue for recovering costs from most or all users of the product. **Yes: Go to figure 5 to assess the nature of cost recovery for additional information products, to determine which costs the levy should recover.** **No: Fund the information product from general tax revenue.**

Figure 4, question 3 *Are there significant spillover benefits from the product?*	The presence of significant spillover benefits strengthens the argument for taxpayer funding even where there are no public good characteristics. An information product will generate spillover benefits if one person having access to the information also benefits other unrelated parties. For example, weather information on storm conditions or fire risks allows the affected groups to prepare for possible problems and substantially reduces the costs to the general community of dealing with the results of storm or fire damage. The spillover benefits need to result directly from the availability of the information, rather than from activities (such as research) that incorporate the information. For example, health data may be used to assess trends in the incidence of specific diseases, and this assessment could have spillover benefits in improved planning of health infrastructure and reduced health costs. However, the Government needs to consider these benefits when it develops policies on funding health research, not on information provision. The benefits do not justify taxpayer funding for the information products themselves. **Yes: Fund the information product from general tax revenue.** **No: Go to Q4 to determine whether any government funding is justified to achieve other policy objectives.**

Figure 4, question 4 *Does the Government require the product to be provided free for other policy reasons?*	Cost recovery may be inconsistent with the Government's objectives for the agency, such as where cost recovery may hinder an objective that requires some forms of information to be disseminated as widely as possible. International agreements too may constrain the ability of Commonwealth agencies to set cost recovery charges. Where appropriate, agencies should consult with the Department of Foreign Affairs and Trade to ascertain whether any international agreements are relevant to the products they are considering cost recovering. When the Government decides to require an agency to provide an information product free of charge, it should articulate the policy reasons behind this decision. **Yes: Fund the information product from general tax revenue.** **No: Go to figure 5 to assess the nature of cost recovery for additional information products.**

Determining the basic product set (continued)

The products that emerge from the above set of questions as being appropriate for taxpayer funding are the *basic product set*. Such products will be taxpayer funded because they have public good characteristics (and the beneficiaries are not a narrow identifiable group), they have significant spillover benefits or they contribute to other Government policy objectives.

Recovering the cost of additional products

An information agency may wish to provide information products outside the taxpayer funded basic product set, consistent with its charter. These additional products should be assessed for cost recovery using the principles outlined below. Assessment should be on a case by case basis, with regard to the efficiency and cost effectiveness of charging. Charges will not be efficient and cost effective if:

- ***it is difficult to establish a charge that accurately links the cost of a product to the users of that product; or***
- ***the charge is costly to collect because it is difficult to identify and bill each user of the product.***

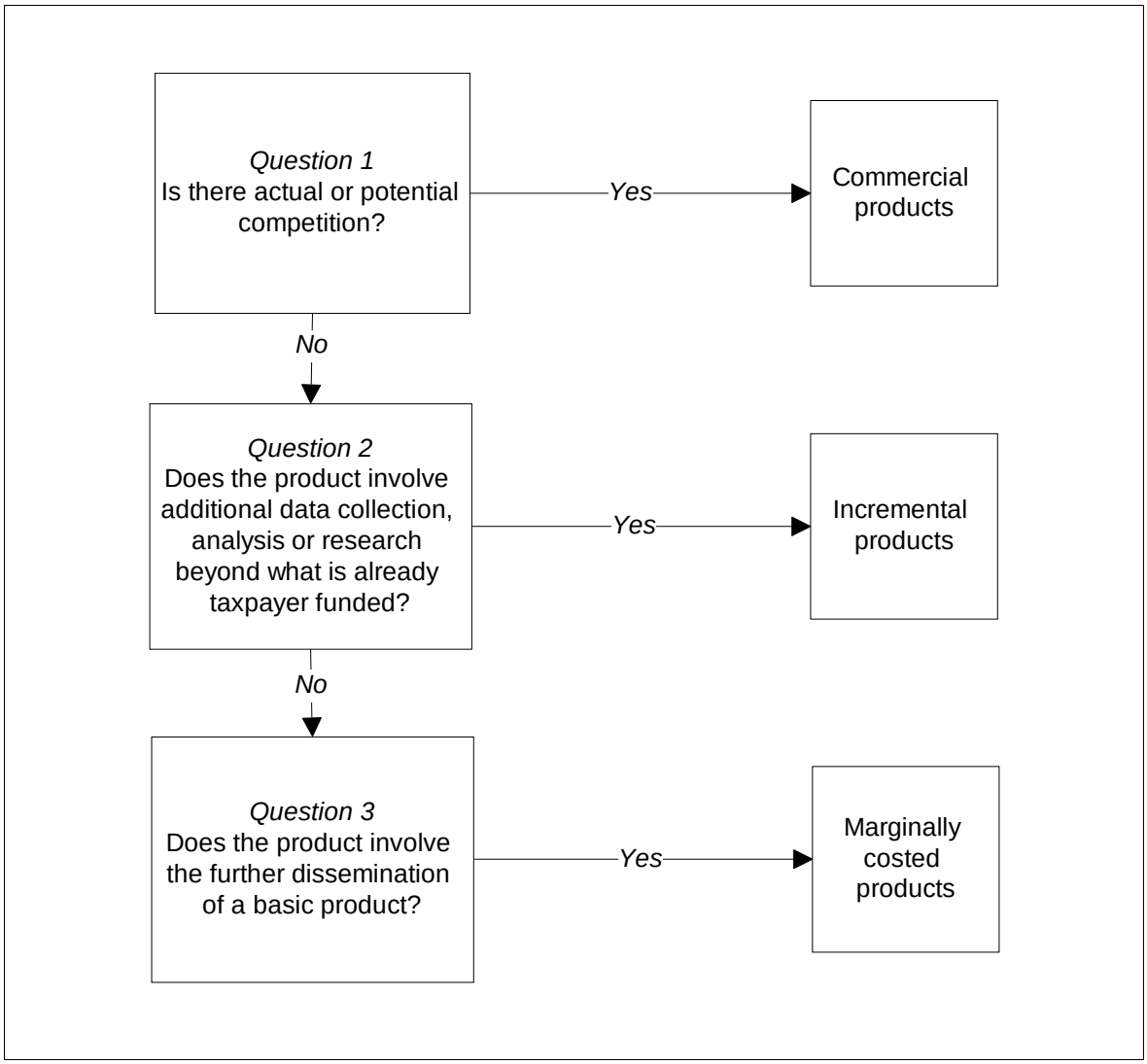
Figure 5 illustrates the questions agencies should answer to determine the extent of cost recovery for additional products.

Figure 5, question 1 *Is there actual or potential competition?*	There is actual or potential competition when the information agency's product is available from private sector providers or when the private sector could provide that product relatively easily. **Yes: Cost recovery consistent with the competitive neutrality guidelines of the Commonwealth Competitive Neutrality Complaints Office.** **No: Go to Q2.**

Figure 5, question 2 *Does the product involve additional data collection, analysis or research beyond what is already taxpayer funded?*	Incremental products are those for which additional work has been undertaken to modify taxpayer funded information to meet the demands of a specific client or group. The additional work could involve: • extending a data collection; • expanding research to cover new issues; and/or • undertaking additional analysis or manipulation of the information. **Yes: Cost recovery based on the incremental cost of the additional products (discussed further in stage 2).** **No: Go to Q3.**

Figure 5, question 3 *Does the product involve the further dissemination of a basic product?*	Usually, some dissemination of the basic product set is taxpayer funded. However, users may want additional access to the information either using distribution methods that are not taxpayer funded or having greater access to the information than was intended to be taxpayer funded (for example, people may wish to hold private copies of publications). **Yes: Cost recovery based on the marginal cost of distribution (discussed further in stage 2).**

Figure 5 **Assessing the nature of cost recovery for additional information products**



Application of the Guidelines up to this point should result in an agency being able to:

- ***classify its activities and products;***
- ***distinguish between the basic product set and additional products; and***
- ***assess the nature of cost recovery for additional products.***

The next steps in the stage 1 policy review are to determine:

- ***what mechanisms should be used for ongoing monitoring (including stakeholder consultation); and***
- ***the appropriate period between cost recovery reviews.***

What mechanisms, including consultation, should be used for ongoing monitoring of the efficiency and effectiveness of cost recovery arrangements?

The CRIS should examine and recommend mechanisms for ongoing monitoring that are appropriate for the circumstances of an agency. In all cases, ongoing monitoring is a joint responsibility between the agency, stakeholders and the Government.

The extent of ongoing monitoring will depend on the significance of the cost recovery arrangements. Such monitoring would include the agency's internal information collection and efficiency measures, and appropriate external arrangements. For significant cost recovery arrangements, it would include the appropriateness of the agency's existing consultative mechanisms and their ability to scrutinise cost recovery issues. Ongoing monitoring is discussed further in stage 3.

How long (not more than 10 years) before cost recovery arrangements should be reviewed again?

An agency's circumstances will change. This means that cost recovery arrangements that were once appropriate may no longer be justified. A periodic review of all existing arrangements is therefore required, covering the appropriateness of cost recovery, the design of any cost recovery charges and the adequacy of monitoring arrangements. The CRIS should recommend a date for this review, no later than 10 years from the date of the initial CRIS.

Stage 2
Design and implementation

Charges can be collected in a variety of ways and based on different measures of costs. Agencies should choose the appropriate approach for a particular product by:

- linking the charge or charges as closely as possible to the product to be cost recovered;
- designing a system that is cost effective to calculate, collect and enforce;
- designing a system where the compliance costs of paying the charges are not excessive;
- balancing certainty with the flexibility to modify the approach to cost recovery if ongoing monitoring (stage 3) indicates that this is desirable;
- ensuring all aspects of the charging mechanism are consistent with the policy objectives of the agency; and
- designing a charging mechanism that is not inconsistent with other Government policies.

Who should pay cost recovery charges?

As discussed in stage 1, the basic product set is taxpayer funded. Most other products are funded through a fee charged to the individual or organisation using those products. In some cases, the fee is charged to an organisation that represents the final users of the product (for example, universities may buy data on behalf of their staff). Also, some products may be funded by a levy or other charging arrangement that is targeted at an identifiable group that uses the product.

Should cost recovery charges be imposed using fees or levies?

Cost recovery charges can be introduced using:

- a fee that charges individuals, firms or other users of information products directly for the costs of providing the product; or

Should cost recovery charges be imposed using fees or levies? (continued)

- a levy on a group of individuals, firms or other users of information products (legally a form of taxation). Levies need to be established using a tax Act.

In most cases, information agencies will use fees to charge for their cost recovered products. This is the preferred approach unless the CRIS clearly identifies why a levy would be more appropriate. For instance, a levy could be used for information products that have public good characteristics and are provided to a narrow identifiable group.

What legal authority is necessary to impose the charges?

All cost recovery charges (both fees and levies) should have appropriate legal authority. This not only ensures the validity of the charges, but also provides accountability and transparency. Particular Constitutional requirements govern the introduction of a levy or tax.

Those agencies considering cost recovery arrangements should seek legal advice on appropriate legal authority for their charges.

Which issues should any legislation address?

Agencies should consider the level of specific guidance on cost recovery charges to be included in legislation or any regulations attached to that legislation. Such legislation could either specify the details (level, rates etc.) of the cost recovery charges or provide guidance on the desirable characteristics of the charges.

In designing any legislation, the agency should balance the level of certainty with the need for flexibility. While providing a high degree of certainty, legislated charges may be difficult to change in response to issues raised in ongoing monitoring.

Which costs should the charges include?

As noted in figure 5, agencies may provide three different types of cost recovered product.

- **Commercial products**, which the private sector could provide. These products may draw on the agency's basic product set but also include a substantial enhancement.
- I**ncremental products**, that only the information agency can provide. These products build on or enhance the agency's basic product set.
- **Marginally costed products**, which only the information agency can provide. These products involve further dissemination of existing taxpayer funded products.

The basic product set should be taxpayer funded. All products to be cost recovered should recoup at least the additional direct costs incurred beyond those of the basic product set. Capital and overhead costs, on the other hand, should be recovered for only some cost recovered products.

- For commercial products, where there is actual or potential competition, cost recovery charges should be consistent with the competitive neutrality guidelines released by the Commonwealth Competitive Neutrality Complaints Office.
- The charges for incremental products should be based on incremental cost and should include those capital costs and overheads that arise as a result of providing the incremental product (or that would not have been incurred if the incremental product were not provided).
- For marginally costed dissemination (for example, where additional copies of an information product are required), charges should not include any capital or overhead costs, only the direct costs such as labour and materials.

How should charges be structured?

Most charges for information agencies will be direct fees designed to collect the incremental or marginal cost of products. However, in some areas, complex issues may arise:

- How to charge for a non-rivalrous product when the additional cost of others using the product is very low?[1]
- How to charge for a new product when the future demand for that product is unclear?
- How to charge for an incremental product that has large fixed costs (such as data collection or storage) and whether pricing differentials should be used to allocate those overheads between customers?
- How to charge for products provided to other Commonwealth agencies and other levels of government?

These matters require a degree of judgement. The guiding principle should be that agencies maximise the community's use of information while minimising their call on taxpayer funding for products outside the basic product set. CRISs should clearly explain how agencies have made these judgements. Attachment C discusses some selected charging issues.

How should costs be calculated and allocated?

Once the agency has decided on the structure of prices, its next step is to calculate and allocate the costs of the products. The full cost of each product is the value of all resources used or consumed in providing that output, and it includes direct, indirect and capital costs (box 2).

The estimation and allocation of costs should follow several key principles:

[1] Many information products are non-rivalrous and often it will be inappropriate to charge for these products, so they form part of the taxpayer funded basic product set. This question arises only after the agency has concluded that taxpayer funding is not appropriate.

How should costs be calculated and allocated? (continued)

- Cost estimates should be based on the efficient costs (box 3), not actual costs.
- Costing systems should be transparent (box 4).

If capital costs and overheads are included in charges, then agencies also need to:

- develop a method to calculate all aspects of capital costs and consider the appropriateness of a capital use charge (box 5); and
- develop a method to distribute capital and overhead costs among activities (box 6).

Box 2 **Cost definitions**

Direct costs are costs that can be directly and unequivocally attributed to a product. They include labour (including on-costs) and materials used to deliver products.

Indirect costs are costs that are not directly attributable to a product and are often referred to as overheads. They can include corporate services costs, such as the costs of the Chief Executive Officer's salary, financial services, human resources, records management and information technology.

Capital costs comprise the user cost of capital and depreciation. The user cost of capital represents the opportunity cost of funds tied up in the capital used to deliver products. It is the rate of return that must be earned to justify retaining the assets in the medium to long term. Depreciation reflects the portions of assets consumed each period in the production of output.

Fixed costs are costs that do not vary with output. Rent and capital are usually fixed costs in the short run.

Variable costs vary with output and typically include direct labour and materials.

Common or joint costs remain unchanged as the production of different products is varied. These costs are incurred if any one of the products is provided. For example, the cost of a telephone line remains unchanged whether it is used for local or long distance calls.

Source: CCNCO (Commonwealth Competitive Neutrality Complaints Office) 1998a*, Cost Allocation and Pricing*, CCNCO Research paper, Productivity Commission, Canberra.

Box 3 **Efficient costs**

While cost recovery can promote efficiency by instilling cost consciousness in the agency and its customers, poorly designed arrangements can create incentives for 'cost padding' and inefficiency. Therefore, cost recovery arrangements need to ensure prices are based on the minimum cost necessary to deliver the product and still maintain quality over time.

If products are not provided efficiently, then the agency should reduce cost recovery charges to reflect efficient costs. This applies to direct, capital and overhead costs.

Efficient costs are particularly important when measuring capital costs. Often agencies are accused by users of 'gold plating' (that is, installing assets that are unnecessarily large or sophisticated relative to the needs of users). In that event, even a modest rate of return on capital could lead to the agency charging artificially high capital costs.

It is not a simple matter to establish efficient costs. In some cases, it is possible to benchmark the agency, both domestically and overseas, to determine the 'reasonableness' of its costs. Market testing or contracting out some aspects of the agency's activities are also good ways of gauging efficiency.

Box 4 **Transparency**

Transparency is a key means of improving the efficiency and accountability of agencies. It requires agencies to articulate clearly their broad objectives and to explain how their activities, products and approaches to cost recovery (including costing systems) contribute to those objectives. Transparency also requires consultation with stakeholders.

'Commercial in confidence' is not usually a sufficient reason for withholding costing information for most of the products of information agencies. Only a small proportion of the products of these agencies are commercial in nature. Overall, the benefits of transparency greatly outweigh any commercial considerations.

Therefore, to meet their transparency obligations, agencies should be required to: adopt costing models sufficiently detailed to allow the Parliament, the Government and stakeholders to analyse their production costs; make public their costing models and actual costs, and how those costs relate to prices; and provide information on how capital costs are calculated and how capital costs and overheads are allocated among products.

Box 5 **Calculating capital costs**

The appropriate approach to calculating capital costs may differ among agencies. Therefore, agencies need to justify the method used to determine capital costs and depreciation.

In general, the approach chosen needs to balance:

- the costs of implementing the method chosen;
- optimising asset valuations to remove from the asset base facilities or parts of facilities that are not necessary to produce cost recovered products efficiently;
- accounting for increases or decreases in the value of the asset over time; and
- being able to incorporate changes if feedback from the ongoing monitoring process indicates that such changes are necessary.

The Commonwealth Government levies a capital-use charge on agencies that are wholly or partly funded from general taxation revenue. Agencies are then reimbursed for this charge through their appropriations. The Department of Finance and Administration manages these arrangements. In determining cost recovery charges, agencies need to ensure these charges do not include a capital-use charge on assets that the Government is already funding.

Box 6 **Allocating costs**

All information products to be cost recovered should recoup at least their direct costs. Allocating direct costs to products is relatively straightforward. Allocation becomes more difficult where indirect costs are involved.

For many information agencies, the costs of collecting, compiling and distributing the basic product set account for most of their work and, therefore, most of their overhead and capital costs. For these agencies, taxpayer funding should cover the stand-alone cost of providing the basic product set.

When incremental products are a large part of an agency's activities, the agency should look closely at which capital costs and overheads are attributable to the incremental product. Overhead and capital costs can be distributed in a number of ways. For example, under Fully Distributed Costing, they can be allocated on a *pro rata* basis according to the number of staff involved in producing the product or on the basis of the shares of direct costs devoted to that product. One form of Fully Distributed Costing, Activity Based Costing, is more accurate in how it allocates indirect costs. It links an organisation's outputs to activities used to produce those outputs, which in turn are linked to the organisation's costs.

The appropriate approach to distributing capital and overhead costs can vary depending on the characteristics of the agency. The agency should balance accuracy and precision against the costs of particular methods, and justify the method chosen.

Stage 3
Ongoing monitoring

Once a CRIS has been produced and assessed, and the cost recovery arrangements begin to operate, the agency should introduce effective ongoing monitoring mechanisms to:

- give feedback to the agency so it can adapt its approach to cost recovery in response to changing circumstances;
- ensure fees and levies are based on efficient and transparent costs;
- ensure individual firms or industries do not have undue influence over the agency; and
- reduce the frequency of major reviews of cost recovery arrangements by allowing minor issues to be addressed as they arise.

The agency should respond to any CRIS recommendations on ongoing mechanisms to measure and monitor the effectiveness of cost recovery arrangements. Potential mechanisms include benchmarking, market testing and third party competition. They also include the agency's collection of information on the demand for various products and tracking of changes in demand.

The agency should also respond to any CRIS recommendations on consultation arrangements. 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.

To be effective, a consultative committee should be provided regularly with sufficient information with which to assess the cost recovery arrangements and the efficiency with which the agency conducts the activities for which it cost recovers. To ensure transparency and accountability, the agency should report the

consultative committee's recommendations widely — for instance on agency web sites and in annual reports.

A number of existing Government mechanisms can supplement agency-specific monitoring arrangements. Parliamentary and budgetary scrutiny can help to reduce incentives for 'gold plating' and 'cost padding', and can encourage efficiency in the provision of information products.

Other Government processes can provide information that assists the agency and the government in monitoring and improving cost recovery arrangements. These processes include Australian National Audit Office performance audits, feedback provided by an agency's audit committee and the outcomes of pricing reviews by the Department of Finance and Administration.

Stage 4
Periodic review

It is suggested that no more than 10 years elapse before an agency conducts another CRIS review of its cost recovery arrangements.

Many factors can change over time and affect the appropriate level of cost recovery for information agencies. The need for change can result from new technology, increased competition from overseas providers of information, new international protocols and changes in the demarcation between the Commonwealth and the States in some areas, for example. New technology could make it easier for the private sector or international competitors to provide products originally supplied by only the Australian government sector. This change would not only affect decisions about the level of cost recovery, but also raise a question about whether Government should continue to provide the product.

Developments in technology have increased the range of options for distributing information and decreased the cost of existing modes of dissemination. This means, at a minimum, that costing information on which an agency's cost recovery charges are based can rapidly become obsolete. In some cases, the rationale for cost recovery may become open to question. This could happen if, for instance, new technologies mean that cost recovery is no longer consistent with an agency's objectives.

Where changes are particularly frequent, an agency will need to review the existing arrangements within a shorter timeframe. However, effective ongoing monitoring processes that facilitate continual improvements in efficiency, along with adjustments in response to changing circumstances, reduce the need for frequent periodic reviews (see stage 3).

Attachment A
CRIS process

The Cost Recovery Impact Statement (CRIS) is a central element of these Guidelines. The CRIS process consists of the steps examined in the following sections.

Triggers for the CRIS process

A CRIS should be undertaken when:

- undertaking reviews consistent with the Government's five year review schedule for existing cost recovery arrangements;
- new cost recovery arrangements are proposed;
- significant amendments to existing arrangements are being considered; and
- periodic reviews of cost recovery arrangements are required.

In some cases, an agency may decide to initiate a CRIS based on stakeholder concerns expressed during ongoing monitoring. If the agency is in doubt about the necessity of a CRIS, it should contact the independent review body for advice.[2] It should also contact the independent review body if it believes that its arrangement or proposal is of a 'minor and machinery' nature and should therefore be exempted from a CRIS.

Test of significance

As a general rule, an agency should undertake a detailed, comprehensive and transparent CRIS for significant cost recovery arrangements and proposals. Typically, a full CRIS includes both a policy component and a design and implementation review component. Initial and periodic cost recovery reviews automatically attract this high level of scrutiny.

[2] The role of this body would be similar to that of the Office of Regulation Review, which advises on the degree of significance of proposals for new or amended regulation, and on the level of detail required, as a result, in the Regulation Impact Statement (RIS).

If a cost recovery proposal is of lesser significance, both in terms of the amount of revenue recovered and the impact on the consumers of information products, a less stringent approach may be warranted. This could involve the preparation of a less comprehensive CRIS under which only a selection of the questions set out in the Guidelines would need to be addressed in full. However, the agency would still need to consult with the independent review body to justify this approach. Such a CRIS could apply to proposals where policy issues have been settled and only design and implementation questions remain.

Consultation

The preparation of the CRIS should always involve an appropriate level of consultation with stakeholders. At a minimum, the agency preparing the CRIS document should enter into discussions with existing industry consultative committees. At the discretion of the agency and/or its portfolio, consultation may be extended to other stakeholders and take other forms.

Preparation of the CRIS

Officials of the department, agency, statutory authority or board responsible for a cost recovery proposal are also responsible for ensuring a CRIS is prepared. These bodies may choose to outsource the preparation of a CRIS to an external organisation, such as a specialised consultancy. However, the agency remains responsible for ensuring the questions relevant to the CRIS are adequately addressed in a consultants' report.

As a general rule, a CRIS needs to be prepared *before* any cost recovery measure is introduced.

Assessment of the CRIS

Once completed, the CRIS should be sent to the independent review body for assessment. The independent review body will advise the agency or department in writing on the CRIS's compliance with the Guidelines. The independent review body's assessment and the CRIS should be made publicly available.

If the CRIS does not meet all the necessary requirements, the independent assessment will identify any deficiencies and notify the decision maker. The decision maker may direct the agency to resubmit an amended CRIS.

Decision making

While the agency's management is responsible for implementing the agency's CRIS, the final decision on the suitability of the cost recovery arrangements or proposal may rest with other bodies, such as Cabinet, the Expenditure Review Committee, the board of a statutory authority or the Minister of a portfolio.

Public scrutiny and reporting of the CRIS

The completed CRIS and the independent review assessment should be released for public scrutiny. The public documentation should also include:

- a signed declaration by the agency's Chair, Chief Executive Officer or Chief Financial Officer that the CRIS meets its terms of reference and that the Guidelines have been applied;
- a description and justification of the level of consultation undertaken;
- a summary of the views expressed by those consulted; and
- reasons for any deviation from the Guidelines in the formulation of the cost recovery arrangements.

The CRIS and independent assessment should be made available on the agency websites and in hard copy on request. All the parties that participated in the CRIS process should receive a copy free of charge.

A summary of the contents of the CRIS should be included in the agency's Portfolio Budget Statement and annual report. If Ministerial or Cabinet approval is required for cost recovery by an agency, then evidence of this approval should also appear in the annual report.

In its own Annual Report, the independent review body should report to Parliament on the application of cost recovery by Commonwealth agencies.

Attachment B

Case study: Information on the Internet

The Internet can provide a relatively low cost way of distributing information to a large number of people. It has the added advantage that the data are conveniently available electronically. However, Internet sites are expensive to set up and then to expand as demand increases. The following discussion considers the public good characteristics of information on the Internet.

Usual case

General use clients are low volume, low frequency users. Some will be one-off, but others will visit the site regularly. Most use of the site by these clients will be non-rivalrous. Usually many people will be able to use the site without increasing the cost of delivering the data.

It is technically possible to exclude a person from using an Internet site. Banks, for example, have developed secure Internet sites that restrict access and enable charges to be levied on transactions. For general use clients, charging is not likely to be cost effective because the efficiency gains from charging are likely to be low and, usually, the use of Internet based information by these clients would fall dramatically if charging was introduced. Under these circumstances, distributing information over the Internet has sufficient public good characteristics to warrant taxpayer funding.

Special cases

High volume clients use large amounts of information regularly. They could drive the overall capacity of the Internet site because they will have the greatest effect on the volume of information stored and the speed of processing needed to retrieve and/or manipulate the information. In effect, these clients demand an incremental service, which consists of the extra investment in capacity (beyond what is required by general use clients) needed to meet their demands.

Use of the Internet site by this group may or may not be rivalrous, depending on how the long-term capacity of the site compares with the demands of the users. Charging based on incremental costs may be cost effective if high volume clients can be identified and charged without limiting the availability of information to general use clients.

Time sensitive clients require fast access to new data. This may be the release of new statistical collections or updates on information that changes frequently (such as the weather). If the demand by time sensitive clients results in congestion during peak periods, then the use of the site becomes rivalrous. One person's use of the site may prevent someone else from accessing it or reduce the speed with which they can download information. In these cases, the use of the Internet site does not have public good characteristics. It may be possible to charge for the product by, say, registering clients who want priority access to this information immediately following its release.

Attachment C
Selected charging issues

Charging for non-rival products

For non-rival products, the additional cost of others using the product is low. Thus, it may be difficult to devise a charging approach that recovers the initial cost of providing the service without discouraging subsequent demand. Some ways of structuring prices, such as using access fees or two-part tariffs, will recover costs while minimising the direct charge for the use of additional units of the product.

Policy makers should decide whether, in some cases, it is better to err towards having lower levels of cost recovery, rather than devising the complex and costly charging regimes that may be needed to avoid creating disincentives to requesting and using information.

Charging for products when future demand is unclear

When information agencies are approached to provide a new product, it can be very difficult to estimate the future demand for that product. That is, the request for the product may be a one-off or the first of many such requests. This has implications for the fee that the agency should charge. The charging approach needs to balance:

- recovering the costs of extraction and manipulation;
- not discouraging others from using the information once it has been extracted; and
- not discouraging clients from coming forward with new requests for information that may benefit others.

For one-off requests, the agency should charge the full incremental cost of providing the product. When the request is the first of many, the agency should determine whether it is cost-effective to store the information with a view to meeting subsequent requests. If it is not, the first customer should be charged the full incremental cost of the product and the product should be deleted from the agency's archives.

If the initial request is likely to be followed by many others, then the agency should strive to estimate the size of future demand, possibly using market research techniques. It will then be able to determine whether it is cost effective to store the product for future use (by either other customers or the same customer). Estimates of future demand will also allow the agency to spread the cost over all users and thus to charge more equitably and efficiently.

The charging structure adopted will allocate costs between the client that requests the new product and subsequent users. Different charging structures will have different effects.

- Charges that average costs over all anticipated users of the product may encourage new requests for information products (because charges are less than the incremental cost) but could discourage some subsequent users of that product (because charges are more than the marginal cost of dissemination). The agency also bears the risk that revenues will be too high or too low if its estimates of demand are wrong.
- Charges that reflect the incremental cost of the first client requesting the service and marginal costs for subsequent clients could discourage new requests but will encourage subsequent users of that product. This form of charging provides more certainty in the agency's revenue.

The nature of the information product may help guide the agency on the approach to charging that best suits its circumstances.

Charging for products with large fixed costs

Where there are large fixed costs and hence substantial economies of scale, agencies may be tempted to adopt price discrimination to recover the overhead costs of collecting and compiling information. Price discrimination refers to charging different users different fees for the same product, even though the cost of supply is the same. This pricing policy is made possible by different customers having a different willingness to pay for the same product. This is reflected in their differing reactions to price changes. For instance, airlines charge business travellers more than they charge holiday makers because the former are more willing to pay and less sensitive to price increases.

There are examples of agencies using price discrimination. ScreenSound Australia, for instance, charges large media companies more than it charges private individuals, reflecting the difference in the two groups' perceived ability to pay.

Price discrimination can only work in limited circumstances where the person paying the lower price cannot onsell to other users and customers cannot select to fall into one or another category. For instance, a media conglomerate should not be able to pass itself off as an individual customer. Price discrimination also requires the agency to identify customers' ability to pay with some precision. This is likely to be difficult for large agencies with many products.

The objective of cost recovery is not to maximise revenue. Charges are intended to recover the cost of non-taxpayer funded activities while encouraging the use of information products. Therefore, any use of price discrimination needs to be treated cautiously. If an agency is already pricing products at marginal cost, then there should be no scope for price discrimination.

Charging for products between agencies

The Guidelines provide general principles that could be relevant to structuring inter-agency charges. Where one or both of the agencies involved in inter-agency transactions also provides services to purchasers outside the Commonwealth Government, the inter-agency arrangements need to be transparent to avoid the introduction of cost shifting and cross-subsidies between the Government and non-government parties. This means that charges should be set on the same basis for both Government and other clients.

To the extent that transactions between Commonwealth agencies reflect transfers of budget funding (and the structure of Government), inter-agency charges can reflect budget allocations more than cost recovery. Nonetheless, the proper location of costs brings efficiency and accountability benefits. The principles underlying appropriate cost recovery could be usefully applied to inter-agency transactions, even where they are governed by explicit contracts or by other 'arm's-length' arrangements. Therefore, agencies may wish to refer to the Guidelines when structuring charges in these circumstances.

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. Again, the Guidelines may provide some assistance in this area.

PROPOSED REGULATORY AGENCY GUIDELINES

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Proposed regulatory agency Guidelines

These Guidelines were prepared by the Productivity Commission. Policy makers and agencies applying these Guidelines may wish to consult the Commission's report, Cost recovery by Government agencies (2001) for more detail and background information. The full report is available from AusInfo and on the Commission's web site at www.pc.gov.au.

WHAT are these Guidelines?

These Guidelines provide a framework to assist policy makers and agencies to design and implement appropriate cost recovery arrangements.

A key output of applying the Guidelines is a Cost Recovery Impact Statement (CRIS) or a Regulation Impact Statement (RIS). An independent review body assesses this CRIS or RIS. The CRIS or RIS and the independent assessment are then forwarded to the body responsible for deciding what action will be taken. Following that, the CRIS or RIS and independent assessment become public documents, published on the agency's web site and summarised in the agency's annual report and Portfolio Budget Statements.

WHO should use these Guidelines?

These Guidelines apply to Commonwealth regulatory agencies — that is, agencies whose primary purpose is to administer regulations (although they may also be involved in collecting and disseminating some information). Agencies may also wish to draw on these Guidelines, to the extent relevant, when developing inter-agency or inter-governmental charging arrangements. The Guidelines are not written to be applied to government business enterprises.

There is another set of Guidelines for information agencies. Such agencies primarily collect, compile and disseminate information products.

If agencies are unsure about which Guidelines to apply, then they should consult with the body responsible for independently assessing the CRIS or RIS process.

WHAT is cost recovery?

Cost recovery is recovery of some or all of the costs of a particular activity. Commonwealth Government cost recovery charges fall into two broad categories: fees for goods and services; and 'cost recovery' taxes (primarily levies, but also excises and customs duties).

Cost recovery is different from general taxation. Some levies or taxes are used to raise cost recovery revenues, but the direct link — or 'earmarking' — between the revenue and the funding of a specific activity distinguishes such cost recovery taxes from general taxation.

Many payments are not cost recovery for the purposes of these Guidelines. Exclusions include:

- general taxation (but not specific-purpose levies and taxes);
- commercial arrangements by government business enterprises in contestable markets;
- repayments of loans to the Commonwealth under various policies;
- asset sales, including the sale of rights to access resources;
- fines and pecuniary penalties; and
- payments to non-Commonwealth bodies where Commonwealth policies may affect prices (for example, the Pharmaceutical Benefits Scheme and the co-payment of medical fees under Medicare).

If agencies are unsure about whether the fees or levies they impose amount to cost recovery, then they should consult with the body responsible for independently assessing the CRIS or RIS process.

WHY have cost recovery?

Used appropriately, cost recovery can improve economic efficiency. Cost recovery may also have equity effects. It may improve equity by ensuring that those who use regulated products bear the costs. For regulatory agencies these broad principles suggest that the price of regulated products should incorporate all of the costs of bringing them to market, including the administrative costs of regulation.

However, cost recovery may not be warranted where:

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

Regulatory agencies undertake a range of activities and cost recovery is not appropriate for all of these. Therefore, a mix of cost recovered and taxpayer funded activities would be expected for most regulatory agencies.

WHEN should these Guidelines be applied?

Commonwealth regulatory agencies should apply these Guidelines when:

- undertaking reviews consistent with the Government's five-year review schedule for existing cost recovery arrangements;
- new cost recovery arrangements are proposed;
- significant amendments to existing arrangements are being considered; and
- periodic reviews of cost recovery arrangements are required.

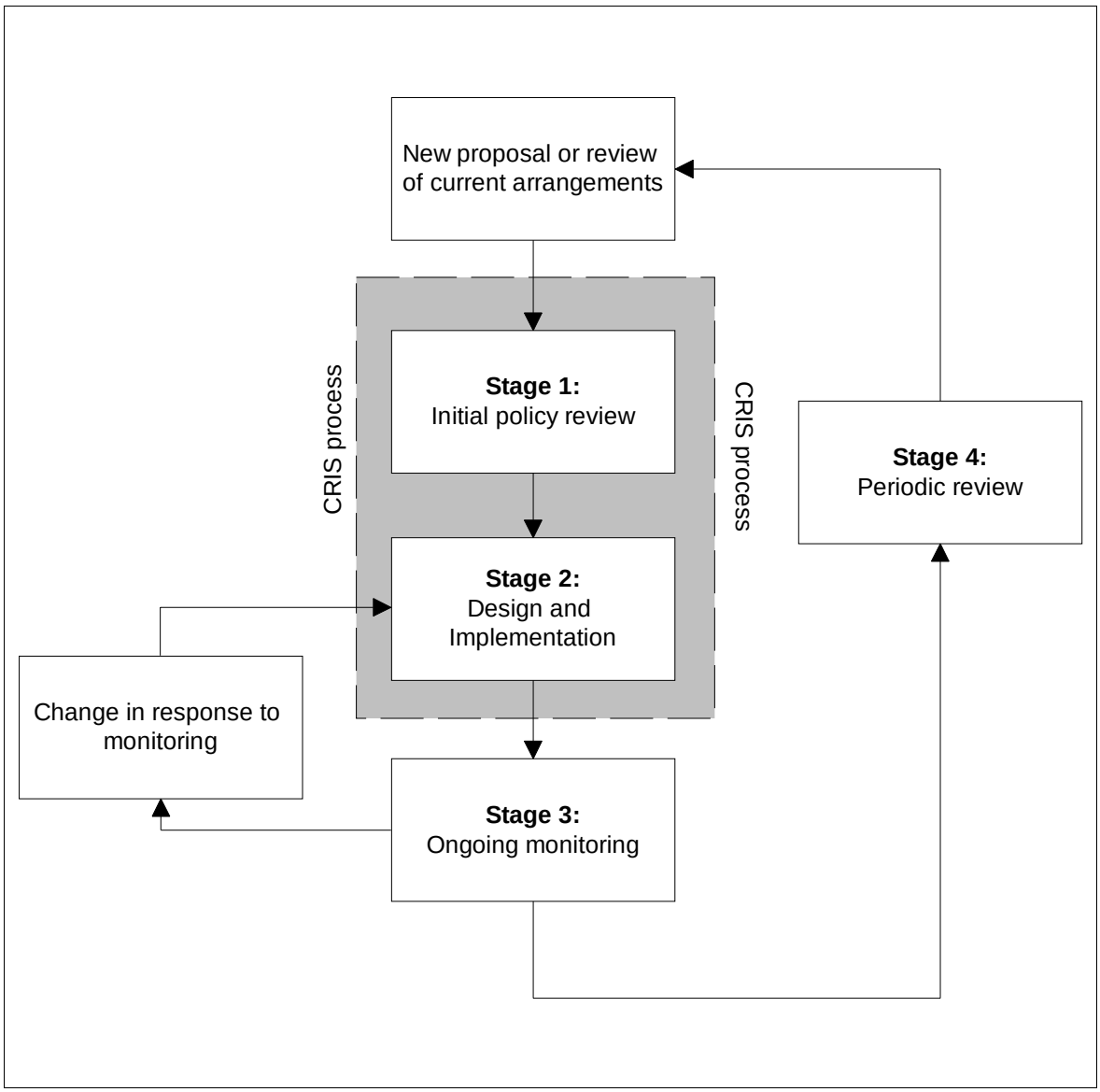
The Guidelines should be applied to all significant cost recovery arrangements. However, minor variations to existing arrangements may be exempted from review.

If agencies are unsure about whether the Guidelines apply to a particular cost recovery arrangement, then they should consult with the body responsible for independently assessing the CRIS or RIS process.

Overview of the process

These Guidelines adopt a four-stage process for determining the appropriate approach to cost recovery for regulatory activities (figure 1).

Figure 1 **Process for assessing cost recovery**



Stage 1 **Initial policy review**

The stage 1 policy review considers the following questions:

- Which of the agency's objectives are relevant to the activities or products 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?

Stage 2 **Design and implementation**

If cost recovery is appropriate, stage 2 considers the following questions:

- Who should pay cost recovery charges?
- Should cost recovery charges be imposed using fees or levies?
- What legal authority is necessary to impose the charges?
- Which issues should any legislation address?
- Which costs should the charges include?
- 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 (discussed in the following section).

Stage 3 **Ongoing monitoring**

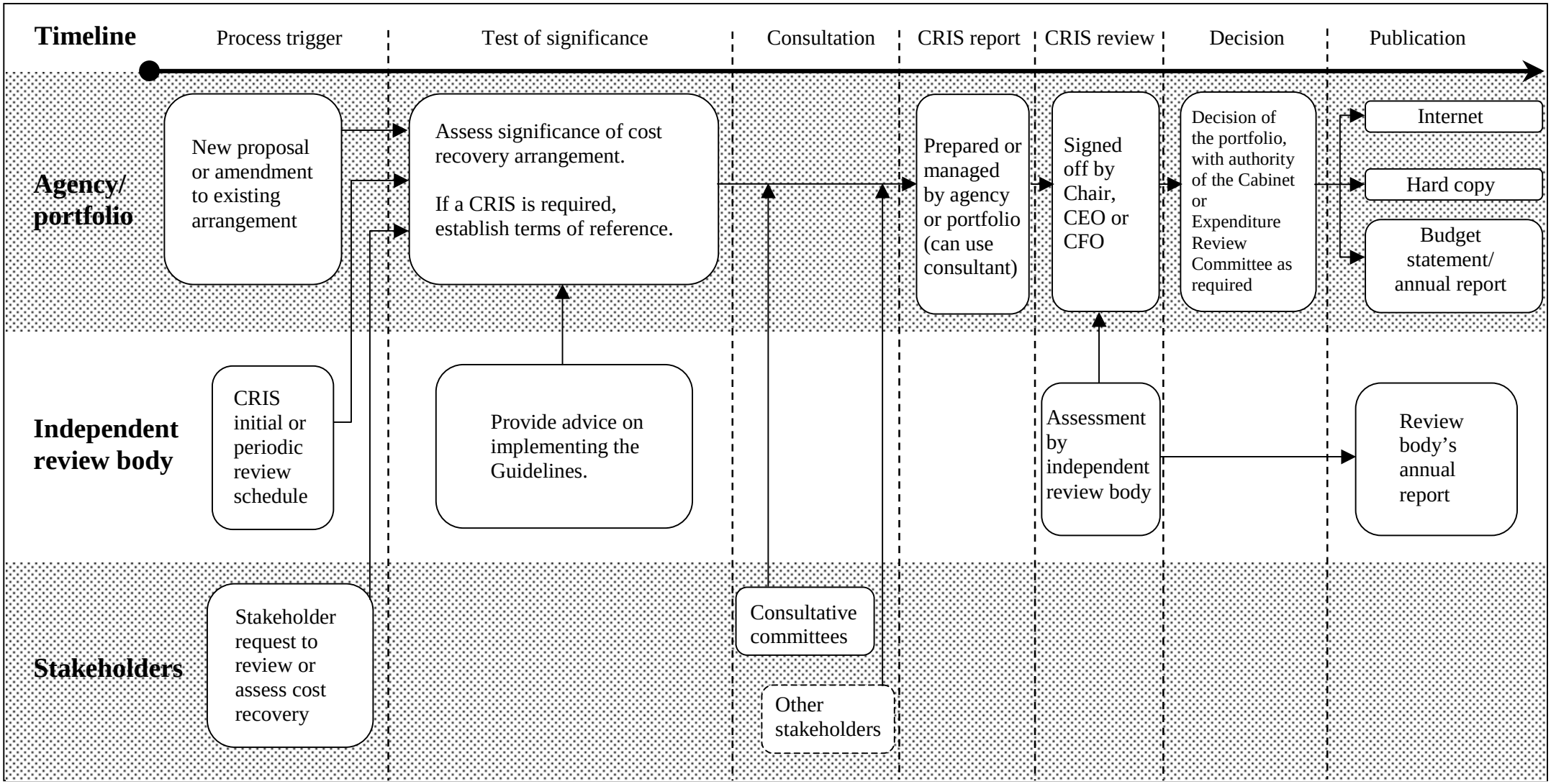
Stage 3 provides for ongoing scrutiny of cost recovery arrangements using the monitoring mechanisms determined as part of stage 1. Ongoing monitoring provides an opportunity for continual improvement in cost recovery arrangements.

Stage 4 **Periodic review**

At least every 10 years, the appropriateness of cost recovery, the design of any cost recovery charges and the adequacy of monitoring arrangements need to be reviewed, to determine whether changes are necessary.

Stage 4 involves the preparation of a CRIS that reconsiders the issues in stages 1 and 2.

Figure 2 **CRIS process summary**



Cost Recovery Impact Statement (CRIS)

To apply the Guidelines, regulatory agencies need to prepare a Cost Recovery Impact Statement (CRIS) or a Regulation Impact Statement (RIS). The CRIS or RIS is a written report by the agency and/or the policy maker, which addresses the issues discussed in stages 1 and 2 of these Guidelines. The CRIS process is summarised in figure 2 and examined in more detail in attachment A.

The following are the most important characteristics of the CRIS:

- It should normally address all of the issues posed in the Guidelines. If the cost recovery proposal is of lesser significance or some issues are not relevant to an agency, a less comprehensive CRIS could be undertaken, but the reasons for doing so should be explained.
- It should include a consultation statement describing how stakeholders were consulted.
- It should be signed off by the Chair, Chief Executive Officer or Chief Financial Officer of the agency to certify that the Guidelines have been adequately applied.
- It should be assessed by an independent review body.
- It should be made publicly available, along with the independent assessment.

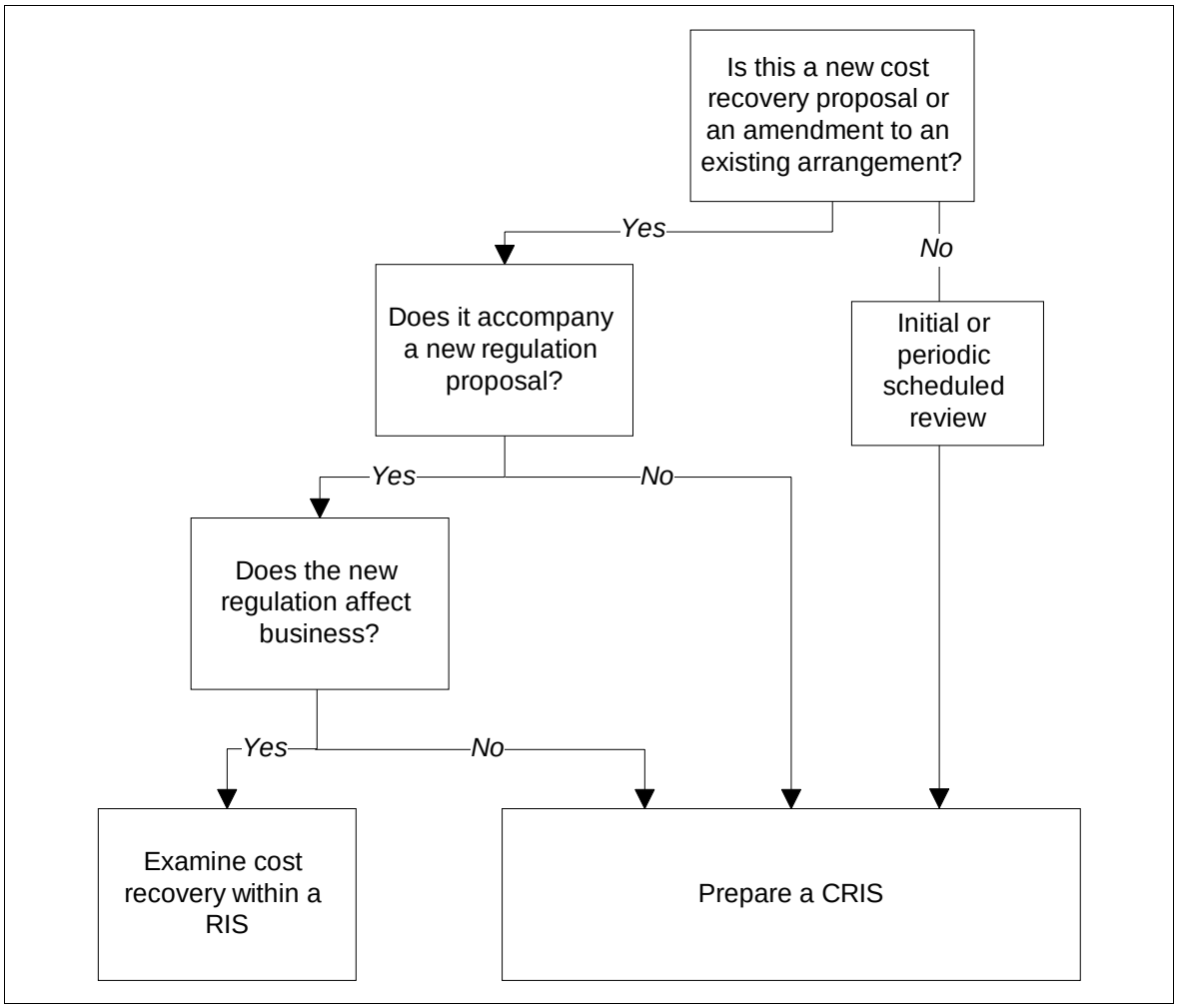
Relationship between the CRIS and the RIS

A RIS is required for proposed regulation (or amendment to regulation) that affects business. The RIS is examined by the Office of Regulation Review (ORR). A regulatory agency required to prepare a RIS does not need to prepare a separate CRIS (figure 3). The RIS will incorporate the requirements of the CRIS identified in the Guidelines. The cost recovery analysis segment of the RIS should be clearly identified, so that it can be subsequently reviewed in isolation from the regulation.

A CRIS will be necessary where:

- the agency is undertaking an initial or periodic review of its cost recovery arrangements, without an associated review of regulation;
- the new or amended cost recovery proposal is introduced administratively rather than through regulation; or
- the cost recovery proposal affects individuals, not businesses.

Figure 3 **Choosing between a CRIS and a RIS**



Stage 1
Policy review

It is rare for all of an agency's activities to have identical characteristics. It is not possible, therefore, to assess the appropriate level of cost recovery on an agency-wide basis. Rather, an agency should assess the case for cost recovery for each activity.

Which of the agency's objectives are relevant to the activities being considered for cost recovery?

It is important to clarify the objectives of the regulations and any non-regulatory activities an agency may undertake. This assists agencies and stakeholders to:

- understand the purpose of the activity and who benefits;
- assess whether adopting cost recovery would undermine the objectives of the activity; and
- if cost recovery is appropriate, choose an approach to charging that is consistent with the objectives of the activity.

When more than one activity is being considered for cost recovery, it may be useful to group those with similar characteristics or objectives. These groups need to be small enough so the types of activity within a group have common characteristics or objectives, but large enough to make the review process manageable.

In addition, it is often useful to distinguish between different stages in the regulatory process. In particular, when looking at regulatory activities, it is important to separate pre-market and post-market regulation. Pre-market regulation activities (regulations with which firms or products must comply before a product can be offered for sale)

Which of the agency's objectives are relevant to the activities being considered for cost recovery? (continued)

involve registration and approvals, or issuing exclusive rights and privileges. Post-market activities (regulations with which firms or products must comply after a product is available for sale) involve monitoring compliance with regulations, investigation and enforcement.

It may also be useful to break down the activities further according to the various industry sectors regulated by the agency. Activities affecting competing sectors should be treated as a group so the design of the charges does not affect competition between sectors.

Regulatory agencies that also provide information and education products will need to consider these separately. Figure 4 assists decision makers in classifying the groups of activities they undertake.

Should cost recovery be introduced?

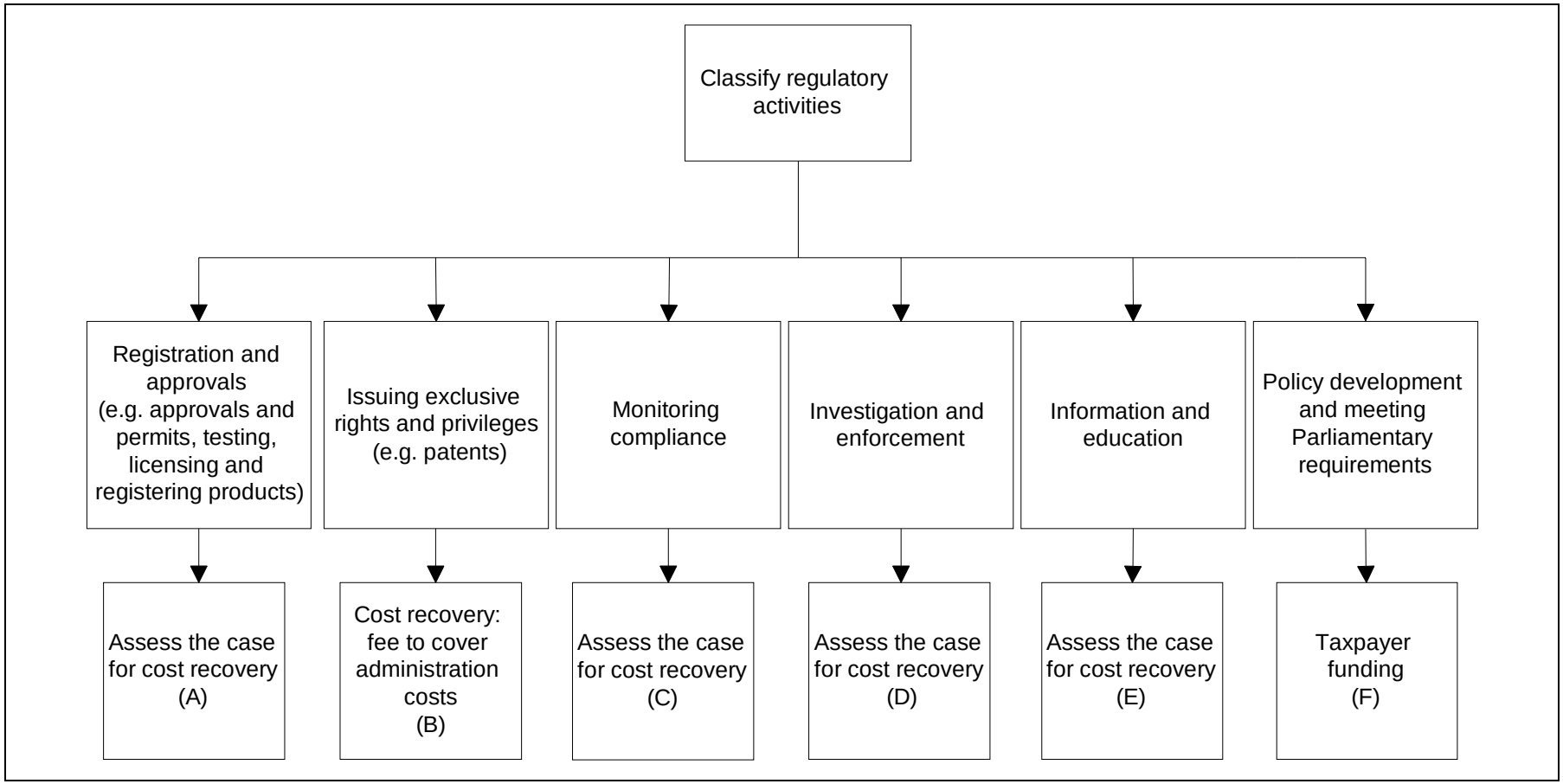
The next step is to determine whether the agency should charge for all or some of its activities. The following discussion looks more closely at each of the classifications in figure 4 and outlines how to assess the appropriate level of cost recovery.

A Registration and approvals

This type of activity includes:

- inspecting and approving premises, such as abattoir inspections by the Australian Quarantine and Inspection Service;
- registering firms or individuals before they can sell particular products or services, and renewing such registrations, such as the Australian Securities and Investments Commission licensing investment advisers and managed investment funds before they can trade;
- approving products before they are sold in Australia, such as the Therapeutic Goods Administration process for evaluating high risk prescription medicines;
- listing products on a register and maintaining that register, such as the Therapeutic Goods Administration process for listing complementary healthcare products;

Figure 4 **Classification of activities**



- assessing and approving existing businesses to undertake particular activities that otherwise may be prohibited, such as Australian Competition and Consumer Commission authorisations; and
- rating or classifying products, such as the Office of Film and Literature Classification film ratings.

Figure 5 illustrates the questions that need to be considered to determine whether cost recovery should apply to such activities.

Figure 5 **Registration and approvals**

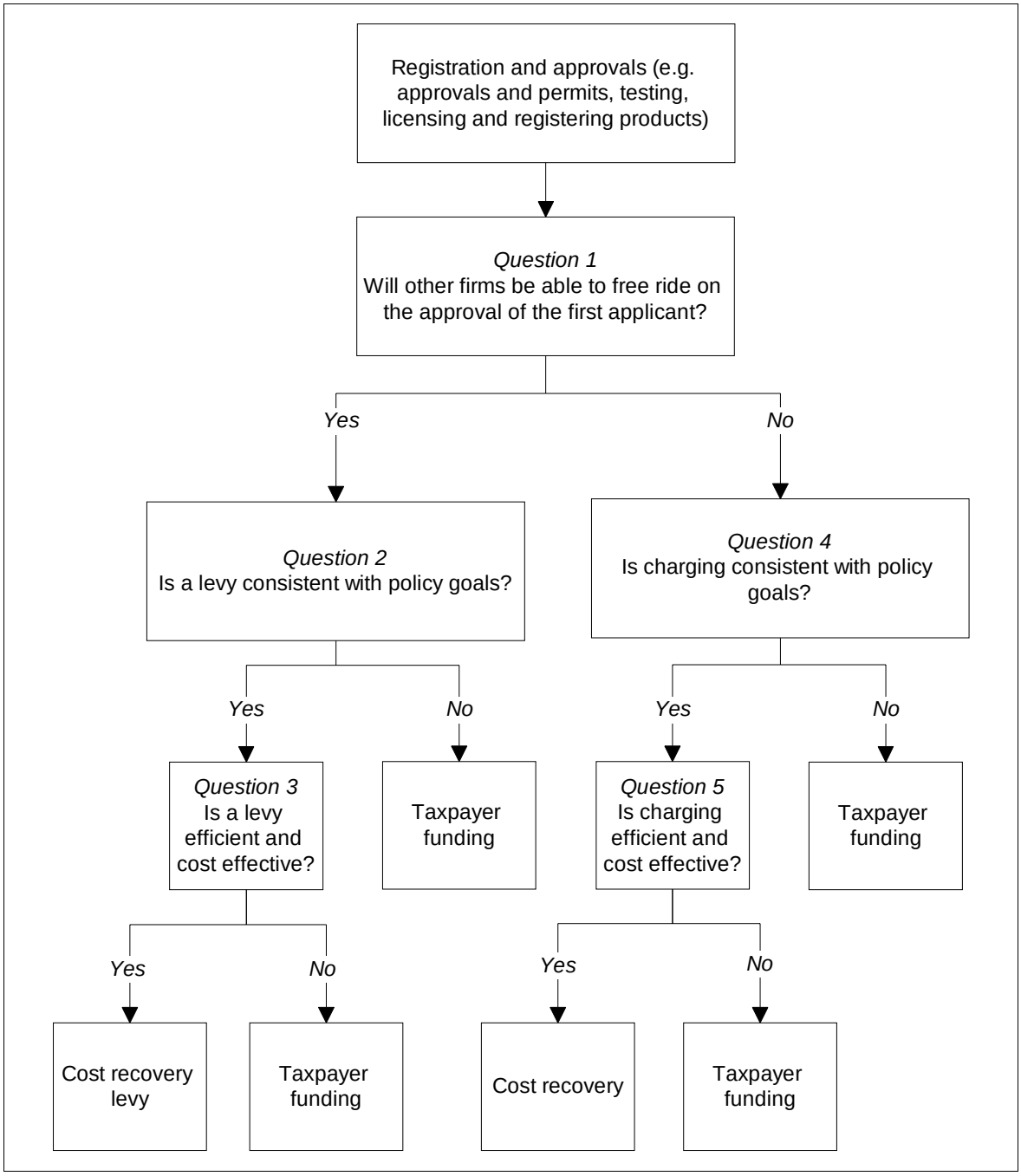


Figure 5, question 1 *Will other firms be able to free ride on the approval of the first applicant?*	Charging for the assessment of new products can encourage firms to avoid the costs of approvals by waiting for others to seek approval first (thus 'free riding' on the approval of others). This is a problem for pre-market approvals (before the product is offered for sale) when the regulator requires the first new example of a product to go through a more onerous and costly process than that for subsequent examples. Charging for such approvals would penalise the first firm that introduces a new product to Australian customers and impair innovation and product development. Examples of this type of regulation include the approval of a new food standard and the approval of a new complementary health care substance, where any firm can use the new approved substance in their products. For the approval of the first example of a new product, cost recovery could be appropriate if the firm receives an 'exclusive capturable commercial benefit' (through patents, for instance). This test is similar to that applied by ANZFA to charging for the approval of food standards. **Yes: Go to Q2.** **No: Go to Q4.**

Figure 5, question 2 *Are levies consistent with policy goals?*	Even where free rider effects make it undesirable to charge a direct fee for registrations or approvals, it may be appropriate to cost recover these regulatory activities using a levy.[1] But, in some rare cases, imposing a levy could reduce the effectiveness of the regulation or undermine the objectives of the regulation. **Yes: Go to Q3.** **No: Fund the regulatory activity from general tax revenue.**

Figure 5, question 3 *Is a levy efficient and cost effective?*	To design an efficient levy, the agency needs to be able to identify accurately a base for imposing the levy that reflects the cost of regulation and targets the firms creating the need for the regulatory activity. For example, it may be inappropriate to levy the whole industry if only a small group of firms creates the need for the regulation, and this group cannot be individually charged. In this event, a levy would have few advantages over general taxation. Even if a levy is efficient, it may not be appropriate if it is very costly or complex to collect. **Yes: Use a levy to charge the regulated firms or individuals.** **No: Fund the regulatory activity from general tax revenue.**

[1] A fee charges individual firms or consumers for particular activities; in contrast, a levy is imposed across a group of firms or consumers and is equivalent to a tax. The term 'charge' refers to both fees and levies.

Figure 5, question 4 *Is charging consistent with policy goals?*	This question considers both fees and levies. Charging can be inconsistent with policy goals if it significantly increases the cost of enforcement. For example, charging to list products on a register could create incentives for firms to avoid registration, thus increasing the costs of enforcement and reducing the usefulness of the register. It may also be appropriate to consider whether a fee is needed to discourage frivolous or vexatious demand. **Yes: Go to Q5.** **No: Fund the regulatory activity from general tax revenue.**

Figure 5, question 5 *Is charging efficient and cost effective?*	Because they are directly related to costs, fees should be the preferred approach if they are efficient, consistent with policy goals and cost effective. A fee will not be efficient and cost effective if: • it is difficult to establish a fee that accurately links the costs of the activities to the regulated firms or individuals; or • the fee is costly to collect because it is difficult to identify and bill each regulated firm or individual. If the decision on whether a fee is cost effective is borderline then it may be appropriate to consider whether a fee is needed to discourage frivolous or vexatious demand. If a fee is not cost effective then a levy could be considered. Assessing whether a levy is efficient and cost effective is discussed under question 3. **Yes: Fund the regulatory activity from cost recovery charges.** **No: Fund the regulatory activity from general tax revenue.**

B Issuing exclusive rights and privileges

The second type of regulatory activity, depicted in figure 4, is the issuing of legally exclusive rights and privileges. One common example is the issue of a patent. Issuing licences to use the radio frequency spectrum, and exploration and mining licences are other examples. Cost recovery in this context refers only to the collection of the cost of administering the licence system, not to the collection of any revenue generated from selling licences.

Patents are designed to ensure those who invest in researching and developing a new product are able to recoup those costs once the product is ready for sale. As a result, the process of issuing patents, as with other exclusive rights, provides firms with an 'exclusive capturable commercial benefit'; therefore, where practical, those that obtain the exclusive right should pay for the cost of administering this regulation.

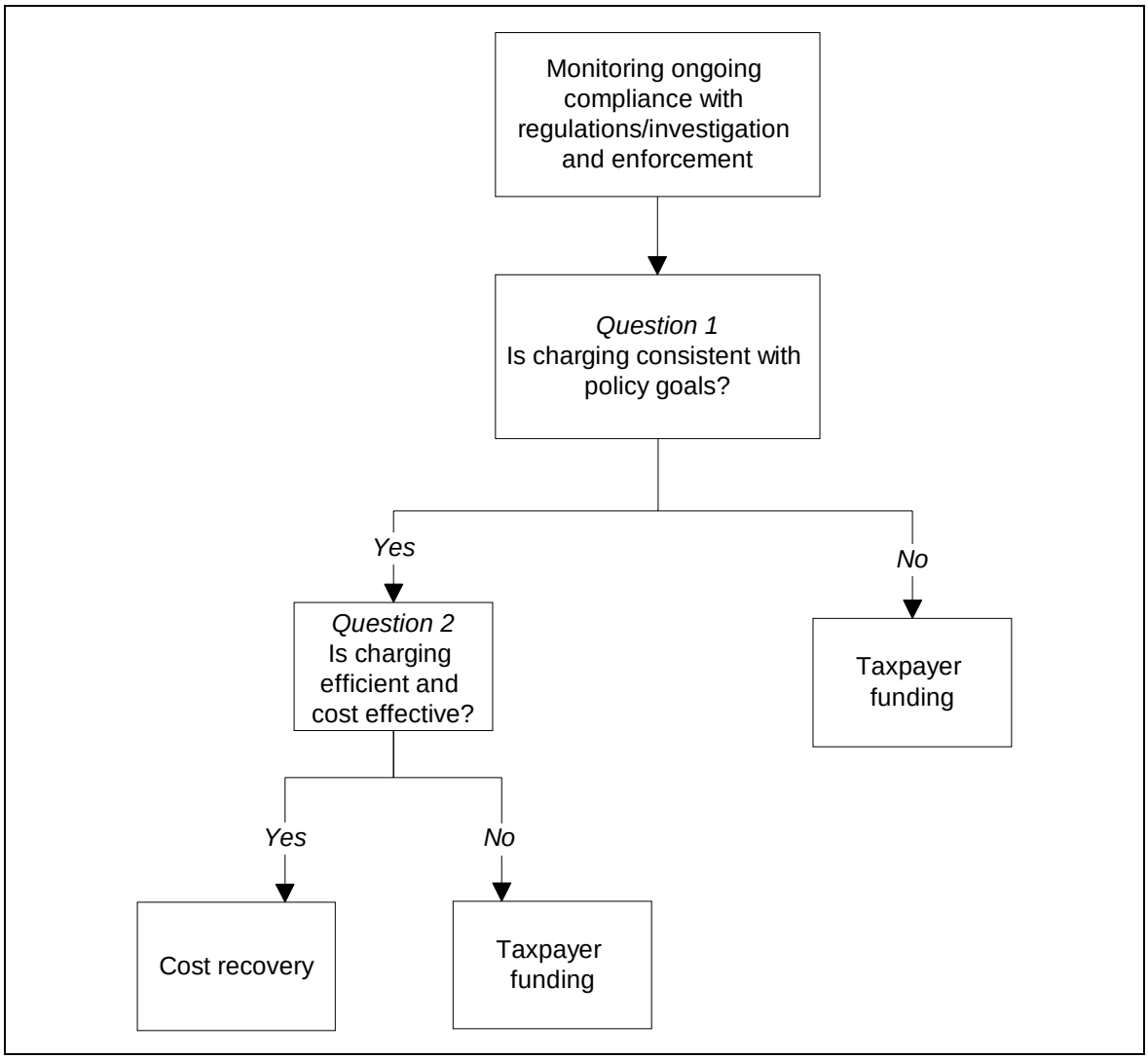
This 'exclusive capturable commercial benefit' means that cost recovery is unlikely to undermine the goals of the regulation. In most cases it is cost effective to charge for issuing an exclusive right because the recipient needs to apply for the right. Therefore, costs are generally recovered via fees.

C Monitoring ongoing compliance with regulations

Such activities include:

- regularly collecting and assessing information to check compliance with standards, such as the Australian Prudential Regulation Authority's regular reviews of the financial statements of institutions to monitor their liquidity levels;

Figure 6 **Monitoring ongoing compliance, and investigation and enforcement**



- conducting random audits to monitor compliance, such as the Civil Aviation Safety Authority's monitoring of airlines' compliance with aircraft safety standards; and
- managing complaints handling mechanisms, such as the Australian Securities and Investments Commission's oversight of the operation of the Superannuation Complaints Tribunal.

Figure 6 illustrates the questions that need to be considered when investigating the appropriate levels of cost recovery for these activities.

Figure 6, question 1 *Is charging consistent with policy goals?*	In some cases involving the monitoring of compliance, charging fees would be counterproductive. For example, charging financial institutions to investigate their financial viability could exacerbate any difficulties they face. Where direct fees are inconsistent with policy goals, the agency should consider imposing levies. In this way, the industry would pay the costs of activities such as random audits. A levy could undermine policy objectives if it encouraged firms to misrepresent the nature of their business to avoid the levy and thus also avoid the regulation. The agency should not use cost recovery charges if they significantly reduce the effectiveness of the regulation or the level of compliance. **Yes: Go to Q2.** **No: Fund the regulatory activity from general tax revenue.**

Figure 6, question 2 *Is charging efficient and cost effective?*	In some areas of compliance monitoring, charges are unlikely to be efficient and cost effective. It may be difficult to link services to particular firms or identifiable groups; for example, it may be impractical to determine a basis for charging for monitoring compliance with broad based legislation, such as the *Trade Practices Act 1974*. As a result, an efficient charge is difficult to establish, or if it can be established, it is likely to be costly to implement. The same principles apply to assessing the efficiency and cost effectiveness of fees and levies for monitoring compliance as apply to registration and approvals (discussed under questions 3 and 5 of figure 5). **Yes: Fund the regulatory activity from cost recovery charges.** **No: Fund the regulatory activity from general tax revenue.**

D Investigation and enforcement

Such activities include:

- conducting product recalls, such as the Australia New Zealand Food Authority's recalls of food products;
- investigating complaints or evidence of non-compliance, such as the Australian Communications Authority's investigation of recurring problems in telecommunications; and
- prosecuting companies that breach standards, such as the Office of the Gene Technology Regulator's enforcement of licence conditions.

Figure 6 illustrates the questions that need to be considered when investigating the appropriate levels of cost recovery for these activities.

Figure 6, question 1 *Is charging consistent with policy goals?*	In many cases involving investigation and enforcement, charging fees would be counterproductive. For example, charging individual companies for product recalls may discourage them from notifying the regulator of faulty or dangerous products. Where direct charges are inconsistent with policy goals, the agency should consider levies if there is an identifiable group that could be levied. However, in some cases, a levy could also undermine policy objectives. For example, in legal proceedings, the court normally awards costs after considering the circumstances of the case. If an agency can automatically recover its legal costs from industry, then the discipline of potentially having costs awarded against it is reduced. In general, cost recovery charges should not be used if they would reduce the effectiveness of the regulation or the level of compliance. **Yes: Go to Q2.** **No: Fund the regulatory activity from general tax revenue.**

Figure 6, question 2 *Is charging efficient and cost effective?*	Charges are unlikely to be efficient and cost effective in some areas of investigation and enforcement. It may be difficult to link services to particular firms or identifiable groups. Again, the principles for assessing the efficiency and cost effectiveness of fees and levies for investigation and enforcement activities are the same as those applying under questions 3 and 5 for figure 5. For example, while a direct fee would be inconsistent with policy objectives in the case of product recalls, a levy might be both consistent with policy objectives and cost effective. **Yes: Fund the regulatory activity from cost recovery charges.** **No: Fund the regulatory activity from general tax revenue.**

E Information and education

In some cases, regulatory agencies collect, compile, analyse and disseminate information. For example, the Australian Securities and Investments Commission compulsorily acquires financial information from Australian companies, which it compiles in a register and makes available to the public. Similarly, the Therapeutic Goods Administration provides information to doctors on drugs and therapeutic goods and to consumers on how to interpret the information provided on drug labels. Some regulatory agencies also provide educational services, for example through publications and seminars.

The steps in considering whether to impose cost recovery for information products are:

- determining which products should be taxpayer funded (basic product set) (figure 7); and
- establishing the approach to cost recovery for other products (additional products) (figure 8).

Determining the basic product set

The questions in figure 7 identify those products that should be taxpayer funded according to three criteria:

- they have 'public good' characteristics;
- they generate significant spillover benefits to the broader community; and/or
- there are other policy reasons for taxpayer funding.

Figure 7 **Assessing funding for information products**

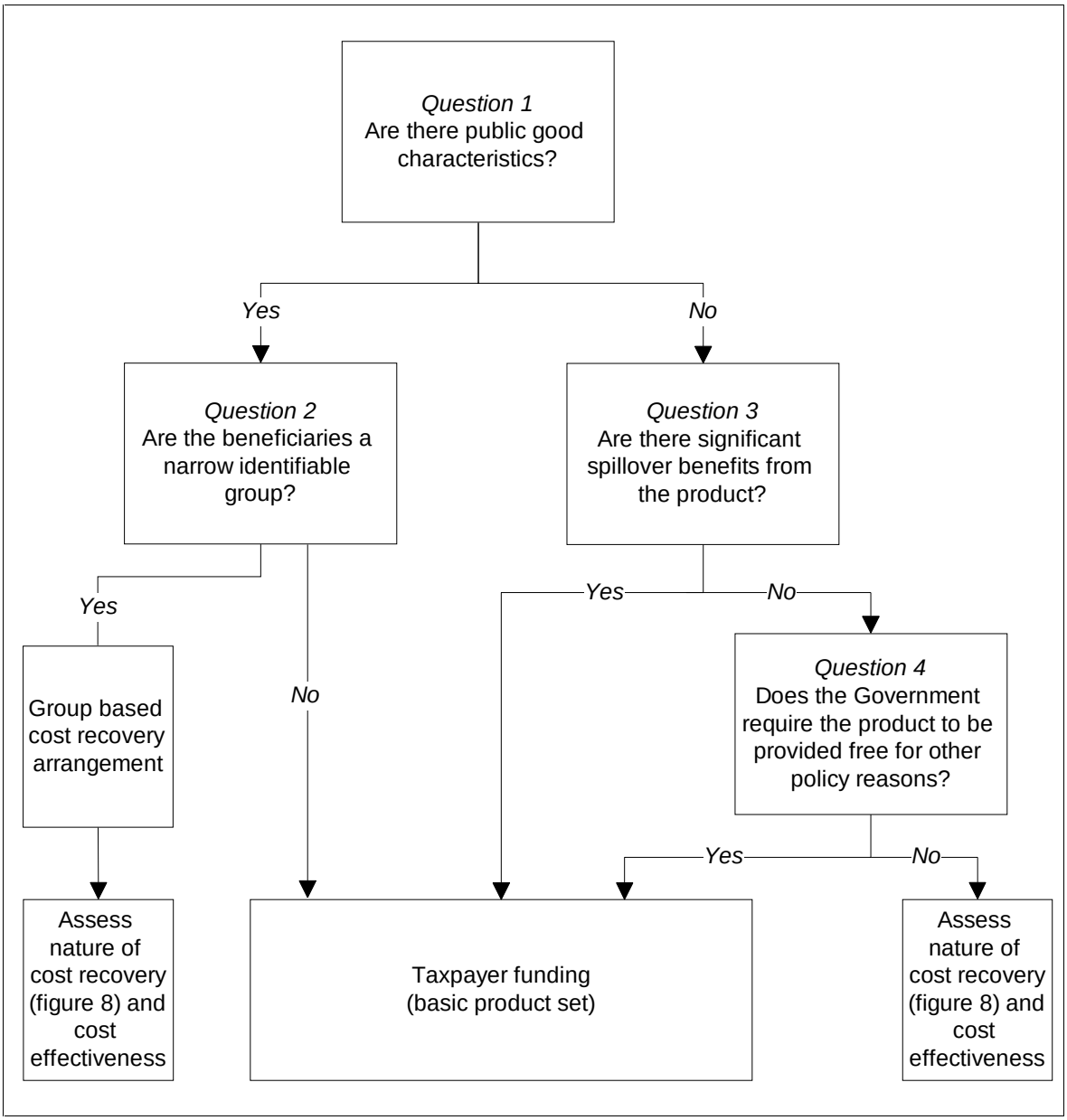


Figure 7, Question 1 *Are there public good characteristics?*	The assessment of whether a group of products has public good characteristics is not clearcut. Agencies need to judge whether, on balance, the public good characteristics are significant enough to make it undesirable to charge for those products. Judgements about public goods typically consider two characteristics of the product: its level of rivalness and its level of excludability.

Is the product rivalrous?	A product is non-rivalrous when one person using the product has no impact on others' ability to use that product. The number of users can be increased at virtually zero cost. Most general information fits into this category. Regulatory agencies produce a range of information products, some of which will be rivalrous and others non-rivalrous. Once information is collected and compiled, many people can use it without affecting the costs of collection or compilation. Such information, distributed via the media, is non-rivalrous. Many people can listen to the radio without affecting others' ability to use the information. A publication, however, may be rivalrous, because several people cannot use the same publication simultaneously. In assessing rivalness the key question is whether more users of the product will increase the cost of provision. **Yes: If the product is *rivalrous* it is not a public good and the assessment should consider spillover benefits. Go to Q3.** **No: If the product is *non-rivalrous,* then the next step is to consider whether it is possible and desirable to exclude users and charge for the product.**

Is the product excludable?	In the case of a pure public good it is impossible to exclude people from using the product. However, in other cases, exclusion may be technically possible but undesirable. Two factors are important in assessing excludability. *Is it impossible to exclude people from using the product?* This occurs in a narrow range of circumstances; for example, once information has been released to the media, it is virtually impossible to prohibit others from accessing that information. *Is it economically efficient to exclude people from using the product?* This assessment looks at whether the benefits from charging outweigh the reduced use of the information. A number of factors influence the magnitude of these benefits and losses, such as the responsiveness of customers to changes in price, the level of taxpayer funding that would be required to substitute for cost recovery, and the efficiency costs of general taxation relative to those of cost recovery charges. While, in most cases, the costs of establishing a cost recovery regime are likely to be small, they should be taken into account, particularly where the case for introducing cost recovery is borderline. **Yes: If it is possible and desirable to exclude users from the product, then it is not a public good and the assessment should consider spillover benefits. Go to Q3.** **No: If it is not possible, or it is possible but not desirable, to exclude people from the product, then go to Q2.**

Figure 7, question 2 *Are the beneficiaries a narrow identifiable group?*	Some products with public good characteristics are used only by a small group such as an industry or a specific consumer group. If it is possible to identify the group using the information product, then it may be possible to develop a levy mechanism that applies to only its members. In other cases, an industry association or other representative group may provide another avenue for recovering costs from most or all users of the product. **Yes: Go to figure 8 on assessing the nature of cost recovery for additional information products, to determine which costs the levy should recover.** **No: Fund the information product from general tax revenue.**

Figure 7, question 3 *Are there significant spillover benefits from the product?*	The presence of significant spillover benefits strengthens the argument for taxpayer funding even where there are no public good characteristics. An information product will generate spillover benefits if one person having access to the information also benefits other unrelated parties. For example, information on companies can increase confidence in Australia's system of business regulation. This confidence could provide spillover benefits to other businesses as a result of greater predictability and certainty in the general economy. The spillover benefits need to result from the availability of the information directly, rather than from activities such as research that incorporate the information. For example, one company could use air safety information to research and develop new safety procedures. These new procedures could be copied by other organisations, having spillover benefits to the whole industry. However, the Government needs to consider these benefits when its develops policies on funding aviation research, not on information provision. The benefits do not justify taxpayer funding for the information products themselves. **Yes: Fund the information product from general tax revenue.** **No: Go to Q4 to determine whether any government funding is justified to achieve other policy objectives.**

Figure 7, question 4 *Does the Government require the product to be provided free for other policy reasons?*	Cost recovery may be inconsistent with Government objectives for the agency. For example, cost recovery may hinder an objective that requires some forms of information to be disseminated as widely as possible. When the Government decides to require an agency to provide an information product free of charge, it should articulate the policy reasons behind this decision. **Yes: Fund the information product from general tax revenue.** **No: Go to figure 8 to assess the nature of cost recovery for additional information products.**

Determining the basic product set (continued)

The products that emerge from the above set of questions as being appropriate for taxpayer funding are the *basic product set*. Such products will be taxpayer funded because they have public goods characteristics (and the beneficiaries are not a narrow identifiable group), they have significant spillover benefits or they contribute to other Government policy objectives.

Recovering the cost of additional products

A regulatory agency may wish to provide information products outside the taxpayer funded basic product set, consistent with its charter. It should assess these additional products for cost recovery using the principles outlined below. Assessment should be on a case by case basis, with regard to the efficiency and cost effectiveness of charging. Charges will not be efficient and cost effective if:

- it is difficult to establish a charge that links accurately the cost of a product to the users of that product; or
- the charge is costly to collect because it is difficult to identify and bill each user of the product.

Figure 8 illustrates the questions agencies should answer to determine the extent of cost recovery for additional products.

Figure 8, question 1 *Is there actual or potential competition?*	There is actual or potential competition when the agency's information or education product is available from private sector providers or when the private sector could provide that product relatively easily. **Yes: Cost recovery consistent with the competitive neutrality guidelines of the Commonwealth Competitive Neutrality Complaints Office.** **No: Go to Q2.**

Figure 8, question 2 *Does the product involve additional data collection, analysis or research beyond what is already taxpayer funded?*	Incremental products are those for which additional work has been undertaken to modify taxpayer funded information to meet the demands of a specific client or group. The additional work could involve: • extending a data collection; • expanding research to cover new issues; and/or • undertaking additional analysis or manipulation of the information. **Yes: Cost recovery based on the incremental cost of the additional products.** **No: Go to Q3.**

Figure 8 **Assessing the nature of cost recovery for additional products**

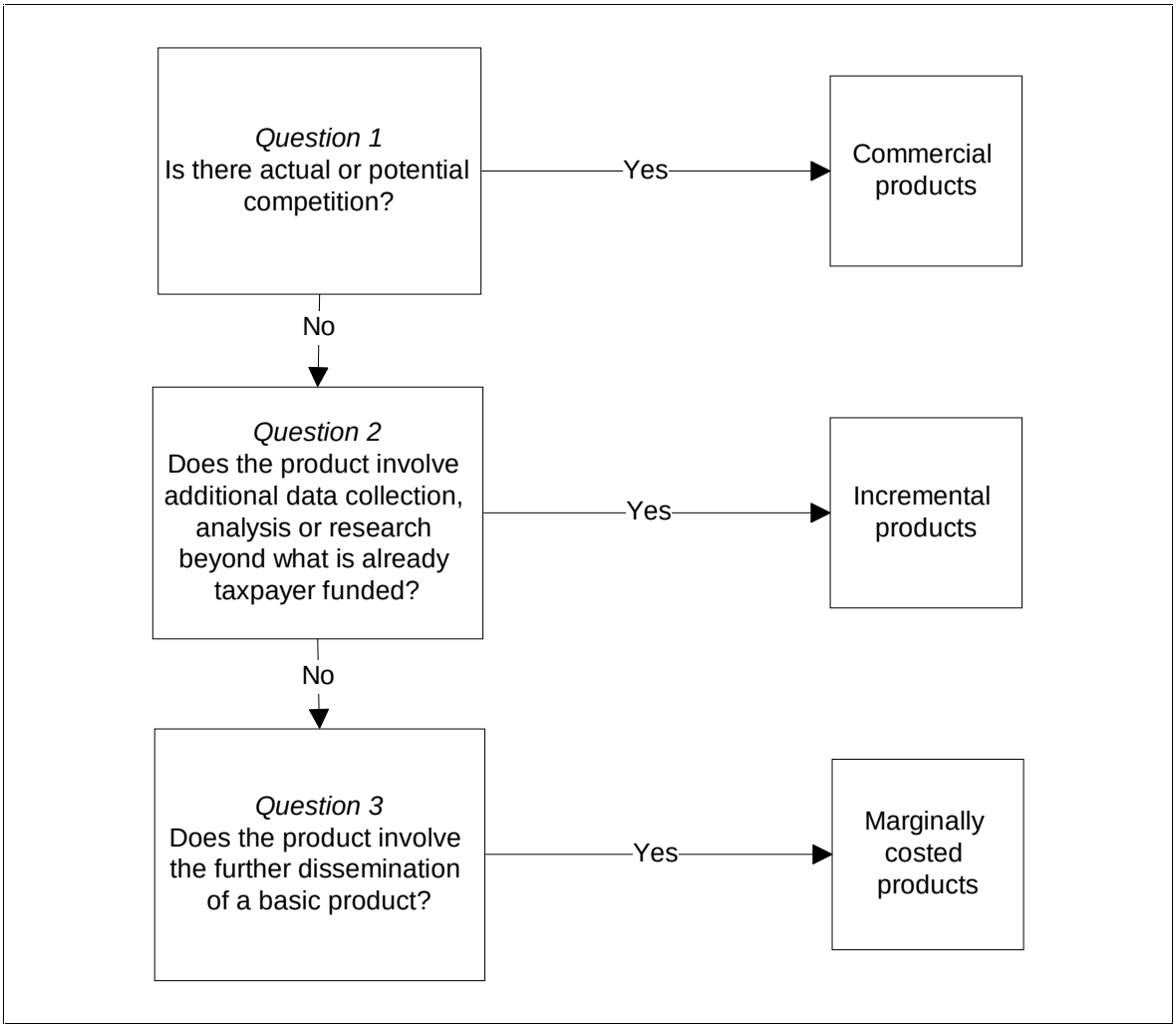


Figure 8, question 3 *Does the product involve the further dissemination of a basic product?*	Usually, some dissemination of the basic product set is taxpayer funded. However, users may want additional access to the information either using distribution methods that are not taxpayer funded or having greater access to the information than was intended to be taxpayer funded (for example, people may wish to hold private copies of publications).
	Yes: Cost recovery based on marginal cost of distribution.

F Policy development and meeting Parliamentary requirements

These activities include:

- reporting to Parliament;
- advising Parliament on issues on which the agency has expertise;
- answering Parliamentary questions;
- briefing Ministers and responding to their correspondence;
- financial reporting; and
- complying with international treaties.

They also include policy work, such as defining and refining the agency's objectives and regulation needed to meet those objectives, and liaising and consulting with international organisations. They do not include providing products or services to other Government agencies.

Taxpayers should fund most of these activities. Providing services to Government results from the need to maintain a strong democratic process, more than from the need for regulation. The community, through Parliament, benefits from these activities.

Also, Government sets policies across all areas of the economy. It does not require sectors not subject to cost recovery to pay for policy development directly and it is inappropriate to impose these costs on areas subject to cost recovery.

The CRIS or RIS must clearly justify any cost recovery of these activities.

Application of the Guidelines up to this point should result in an agency being able to:

- ***classify its activities and products; and***
- ***decide when cost recovery is appropriate.***

The next steps in the stage 1 policy review are to determine:

- ***what mechanisms should be used for ongoing monitoring (including stakeholder consultation); and***
- ***the appropriate period between cost recovery reviews.***

What mechanisms, including consultation, should be used for ongoing monitoring of the efficiency and effectiveness of cost recovery arrangements?

The CRIS or RIS should examine and recommend mechanisms for ongoing monitoring that are appropriate for the individual circumstances of an agency. In all cases, ongoing monitoring is a joint responsibility between the agency, stakeholders and the Government.

The extent of ongoing monitoring will depend on the significance of the cost recovery arrangements and the impact they have on regulated firms. Such monitoring would include the agency's internal information collection and efficiency measures, and appropriate external arrangements. For significant cost recovery arrangements, it would include the appropriateness of the agency's existing consultative mechanisms and their ability to scrutinise cost recovery issues. Ongoing monitoring is discussed further in stage 3.

How long (not more than 10 years) before the cost recovery arrangements should be reviewed again?

An agency's circumstances will change. This means that cost recovery arrangements that were once appropriate may no longer be justified. A periodic review of all existing arrangements is therefore required, covering the appropriateness of cost recovery, the design of any cost recovery charges and the adequacy of monitoring arrangements. The CRIS or RIS should recommend a date for this review, no later than 10 years from the date of the initial CRIS or RIS.

Stage 2
Design and implementation

Charges can be collected in a variety of ways and based on different measures of costs. Agencies should choose the appropriate approach for a particular situation by:

- linking the charge or charges as closely as possible to the activity or product to be cost recovered;
- designing a system that is cost effective to calculate, collect and enforce;
- designing a system where the compliance costs of paying the charges are not excessive;
- balancing certainty with the flexibility to modify the approach to cost recovery if ongoing monitoring (stage 3) indicates that this is desirable;
- ensuring all aspects of the charging mechanism are consistent with the policy objectives of the agency; and
- designing a charging mechanism that is not inconsistent with other Government policies.

Who should pay cost recovery charges?

As a general principle the price of each regulated activity or product should incorporate the cost of regulation, subject to the caveats of efficiency, cost effectiveness and consistency with policy objectives.

This improves economic efficiency by ensuring that consumers and producers of regulated products recognise the administrative costs involved in regulation.

Charging the regulated firms is usually the most practical approach to setting cost recovery charges — particularly where the regulatory services needed differ substantially between firms. This is because, for example, the cost of assessments can vary according to the time and effort needed to undertake

Who should pay cost recovery charges? (continued)

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 fees, and conceivably require different fees for different products, or for similar products marketed by different firms. Charging regulated firms for the regulatory activities would reflect costs more directly.

For information products, those in the basic product set would be taxpayer funded, as discussed in stage 1.

Should cost recovery charges be imposed using fees or levies?

The choice between fees and levies has already been considered, to some extent, in the discussion of whether cost recovery is appropriate (see, for example, figure 5 on registrations and approvals). Overall, cost recovery charges can be introduced using:

- a fee that charges individuals or firms directly for the costs of providing the activity; or
- a levy on a group of individuals or firms (legally a form of taxation). Levies need to be established using a tax Act.

When cost recovery is appropriate, charges should be based on fees, as long as they are efficient, cost effective and consistent with the policy objectives of the agency. Levies have a range of problems. Because they are not so closely linked to the costs of individual activities, levies do not have the efficiency advantages of fees. They may also place less direct pressure on the agency to improve efficiency. Therefore, it is desirable, where possible, to charge for activities directly through fees.

Where levies are used, they should be closely linked to costs and focused on recovering costs from only those groups of firms or individuals that create the need for regulation. If this is not possible, then the efficiency advantages of a levy over general

Should cost recovery charges be imposed using fees or levies? (continued)

taxation are less clear.

For information products agencies should usually use fees to charge for their cost recovered products. This is the preferred approach unless the CRIS clearly identifies reasons why a levy would be more appropriate.

What legal authority is necessary to impose the charges?

All cost recovery charges (both fees and levies) should have appropriate legal authority. This not only ensures the validity of the charges, but also provides accountability and transparency. Particular Constitutional requirements govern the introduction of a levy or tax.

Those agencies considering cost recovery arrangements should seek legal advice on appropriate legal authority for their charges.

In addition, international obligations (for example, governing the sharing of information) could constrain the application of cost recovery charges. Where appropriate, agencies should consult with the Department of Foreign Affairs and Trade to ascertain whether any such obligations are relevant to the activities to be cost recovered.

Which issues should any legislation address?

Agencies should consider the level of specific guidance on cost recovery charges to be included in legislation or any regulations attached to that legislation. Such legislation could either specify the details (level, rates etc.) of the cost recovery charges or provide guidance on the desirable characteristics of the charges.

In designing any legislation, the agency should balance the level of certainty with the need for flexibility. While providing a high degree of certainty, legislated charges may be difficult to change in response to issues raised in ongoing monitoring.

Which costs should the charges include?

Cost recovery charges ideally should reflect the costs of undertaking individual activities. As far as possible, the agency should identify costs against particular activities to minimise the need to distribute overhead costs arbitrarily among activities.

A very precise approach to charging can be costly. In nearly all cases, an agency will need some proxy system to split overhead costs among the activities being charged.

How should charges be structured?

To determine the best pricing structure, agencies need a good understanding of the cost drivers behind particular activities. Costs will usually depend on factors such as the complexity of the regulated product, the standards applied, the riskiness of the product (and thus the intensity of the testing process) and the amount of information that needs to be analysed to undertake the assessment.

Cost recovery agencies may have insufficient information to formulate prices that reflect those cost drivers precisely; therefore, an agency will often need to use a proxy for the costs that are attributable to a particular firm in the industry. Such proxies include:

- classifying firms or products into groups that reflect the riskiness of each group and, thus, the agency's effort in regulating the group; and
- the size of the firm.

Attachment B lists some complex issues in the designing of cost recovery charges for regulatory activities.

How should costs be calculated and allocated?

Once the agency has decided on the structure of prices, its next step is to calculate and allocate the costs of the activity. The full cost of each activity is the value of all resources used or consumed in providing that output, and it includes direct, indirect

How should costs be calculated and allocated? (continued)

and capital costs (box 1).

The estimation and allocation of costs should follow several key principles:

- Cost estimates should be based on efficient costs (box 2), not actual costs.
- Costing systems should be transparent (box 3).

If capital costs and overheads are included in charges, then agencies also need to:

- develop a method to calculate all aspects of capital costs and consider the appropriateness of a capital use charge (box 4); and
- develop a method to distribute capital and overhead costs among activities (box 5).

Box 1 **Cost definitions**

Direct costs are costs that can be attributed directly and unequivocally to an activity. They include labour (including on-costs) and materials used to deliver products.

Indirect costs are costs that are not directly attributable to an activity and are often referred to as overheads. They can include corporate services costs, such as the costs of the Chief Executive Officer's salary, financial services, human resources, records management and information technology.

Capital costs comprise the user cost of capital and depreciation. The user cost of capital represents the opportunity cost of funds tied up in the capital used to deliver products. It is the rate of return that must be earned to justify retaining the assets in the medium to long term. Depreciation reflects the portions of assets consumed each period in the production of output.

Fixed costs are costs that do not vary with output. Rent and capital are usually fixed costs in the short run.

Variable costs vary with the output and typically include direct labour and materials.

Common or joint costs remain unchanged as the activities undertaken are varied. These costs are incurred if any one of the activities are carried out. For example, the cost of a telephone line remains unchanged whether it is used for local or long distance calls.

Source: CCNCO (Commonwealth Competitive Neutrality Complaints Office) 1998a*, Cost Allocation and Pricing*, CCNCO Research paper, Productivity Commission, Canberra.

Box 2 **Efficient costs**

While cost recovery can promote efficiency by instilling cost consciousness in the agency and its customers, poorly designed arrangements can create incentives for 'cost padding' and inefficiency. Therefore, cost recovery arrangements need to ensure prices are based on the minimum cost necessary to deliver the product and still maintain quality over time.

If regulatory activities are not undertaken efficiently, then the agency should reduce cost recovery charges to reflect efficient costs. This applies to direct, capital and overhead costs.

Efficient costs are particularly important when measuring capital costs. Often agencies are accused by users of 'gold plating' (that is, installing assets that are unnecessarily large or sophisticated relative to the needs of users). In that event, even a modest rate of return on capital could lead to the agency charging artificially high capital costs.

It is not a simple matter to establish efficient costs. In some cases, it is possible to benchmark the agency, both domestically and overseas, to determine the 'reasonableness' of its costs. Market testing or contracting out some aspects of the agency's activities are also good ways of gauging efficiency.

Box 3 **Transparency**

Transparency is a key means of improving the efficiency and accountability of agencies. It requires agencies to articulate clearly their broad objectives and explain how their activities and approaches to cost recovery, including costing systems, contribute to those objectives. Transparency also requires consultation with stakeholders.

'Commercial in confidence' is not usually a sufficient reason for withholding costing information for most of the products of regulatory agencies. Generally, these agencies have a statutory monopoly over their activities and do not compete in a commercial market. Overall, the benefits of transparency greatly outweigh any commercial considerations.

Therefore, to meet their transparency obligations, agencies should be required to: adopt costing models sufficiently detailed to allow the Parliament, the Government and stakeholders to analyse their production costs; make public their costing models and actual costs, and how those costs relate to prices; and provide information on how capital costs are calculated, and how capital costs and overheads are allocated among activities.

Box 4 **Calculating capital costs**

The appropriate approach to calculating capital costs may differ among agencies. Therefore, agencies need to justify the method used to determine capital costs and depreciation.

In general, the approach chosen needs to balance:

- the costs of implementing the method chosen;
- optimising asset valuations to remove from the asset base facilities or parts of facilities that are not necessary to undertake cost recovered activities efficiently;
- accounting for increases or decreases in the value of the asset over time; and
- being able to incorporate changes if feedback from the ongoing monitoring process indicates that such changes are necessary.

The Commonwealth Government levies a capital-use charge on agencies that are wholly or partly funded from general taxation revenue. Agencies are then reimbursed for this charge through their appropriations. The Department of Finance and Administration manages these arrangements. In determining cost recovery charges, agencies need to ensure these charges do not include a capital-use charge on assets that the Government is already funding.

Box 5 **Allocating costs**

All regulatory activities to be cost recovered should recoup at least their direct costs. Allocating direct costs to an activity is relatively straightforward. Allocation becomes more difficult where indirect costs are involved.

When fees or levies are imposed across a significant proportion of an agency's activities, they should include both the direct costs of the activities and the overhead and capital costs. If cost recovered activities are a small proportion of the agency's activities, and they have little effect on the agency's overheads or capital expenditure, then the agency should recover only the direct costs of these activities. If taxpayer funded activities are only a small proportion of the agency's activities, then the Government should meet only the direct costs of these activities.

Overhead and capital costs can be distributed in a number of ways. For example, under Fully Distributed Costing, they can be allocated on a *pro rata* basis according to the number of staff involved in the activity or on the basis of the shares of direct costs devoted to the activity. One form of Fully Distributed Costing, Activity Based Costing, is more accurate in how it allocates indirect costs. It links an organisation's outputs to activities used to produce those outputs, which in turn are linked to the organisation's costs.

The appropriate approach to distributing capital and overhead costs can vary depending on the characteristics of the agency. The agency should balance accuracy and precision against the costs of particular methods, and justify the method chosen.

Stage 3
Ongoing monitoring

Once a CRIS or RIS has been produced and assessed, and the cost recovery arrangements begin to operate, the agency should introduce effective ongoing monitoring mechanisms to:

- give feedback to the agency so it can adapt its approaches to cost recovery in response to changing circumstances;
- ensure fees and levies are based on efficient and transparent costs;
- ensure individual firms or industries do not have undue influence over the agency; and
- reduce the frequency of major reviews of cost recovery arrangements by allowing minor issues to be addressed as they arise.

The agency should respond to any CRIS or RIS recommendations on ongoing mechanisms to measure and monitor the effectiveness of cost recovery arrangements. Potential mechanisms include benchmarking, market testing and third party competition.

The agency should also respond to any CRIS or RIS recommendations on consultation arrangements. 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.

To be effective, a consultative committee should be provided regularly with sufficient information with which to assess the cost recovery arrangements and the efficiency with which the agency conducts the activities for which it cost recovers. To ensure transparency and accountability, the agency should report the

consultative committee's recommendations widely — for instance, on agency web sites and in annual reports.

A number of existing Government mechanisms supplement agency-specific monitoring arrangements. Parliamentary and budgetary 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.

Other Government processes can provide information that assists the agency and the Government in monitoring and improving cost recovery arrangements. These processes include Australian National Audit Office performance audits, feedback provided by an agency's audit committee, and the outcomes of pricing reviews of the Department of Finance and Administration.

Stage 4
Periodic review

It is suggested that no more than 10 years elapse before an agency conducts another CRIS or RIS review of its cost recovery arrangements.

Many factors can change over time and affect the appropriate level of cost recovery for regulatory activities. New products can emerge, for example, that were not envisaged under the original regulation, resulting in a need to change the scope of the products regulated and, therefore, the scope of cost recovery arrangements. Community attitudes can change too, affecting the level of risk that the community is willing to accept and thus the appropriate level of regulation. Also, new technology can affect the costs and methods of testing regulated products, with implications for the agency's approach to cost recovery.

Where changes are particularly frequent, an agency will need to review the existing arrangements within a shorter timeframe. However, effective ongoing monitoring processes that facilitate continual improvements in efficiency, along with adjustments in response to changing circumstances, reduce the need for frequent periodic reviews (see stage 3).

Attachment A
CRIS process

The Cost Recovery Impact Statement (CRIS) is a central element of these Guidelines. The CRIS process consists of the steps examined in the following sections. Agencies that submit a cost recovery proposal as part of a regulatory proposal will need to implement these steps as part of their Regulation Impact Statement (RIS). Agencies that prepare a RIS are not required to prepare a separate CRIS.

Triggers for the CRIS process

A CRIS should be undertaken when:

- undertaking reviews consistent with the Government's five year review schedule for existing cost recovery arrangements;
- new cost recovery arrangements are proposed;
- significant amendments to existing arrangements are being considered; and
- periodic reviews of cost recovery arrangements are required.

In some cases, an agency may decide to initiate a CRIS based on stakeholder concerns expressed during ongoing monitoring. If the agency is in doubt about the necessity of a CRIS, it should contact the independent review body for advice.[2] It should also contact the independent review body if it believes that its arrangement or proposal is of a 'minor and machinery' nature and should therefore be exempted from a CRIS.

Test of significance

As a general rule, an agency should undertake a detailed, comprehensive and transparent CRIS for significant cost recovery arrangements and proposals.

[2] The role of this body would be similar to that of the Office of Regulation Review, which advises on the degree of significance of proposals for new or amended regulation, and on the level of detail required, as a result, in the RIS.

Typically, a full CRIS includes both a policy component and a design and implementation review component. Initial and periodic cost recovery reviews would automatically attract this high level of scrutiny.

If a cost recovery proposal is of lesser significance, both in terms of the amount of revenue recovered and the impact on regulated firms or individuals, a less stringent approach might be warranted. This could involve the preparation of a less comprehensive CRIS under which only a selection of the questions set out in the Guidelines would need to be addressed in full. However, the agency would still need to consult with the independent review body to justify this approach. Such a CRIS could apply to proposals where policy issues have been settled and only design and implementation questions remain.

Consultation

The preparation of the CRIS should always involve an appropriate level of consultation with stakeholders. At a minimum, the agency preparing the CRIS document should enter into discussions with existing industry consultative committees. At the discretion of the agency and/or its portfolio, consultation may be extended to other stakeholders and take other forms.

Preparation of the CRIS

Officials of the department, agency, statutory authority or board responsible for a cost recovery proposal are also responsible for ensuring a CRIS is prepared. These bodies may choose to outsource the preparation of a CRIS to an external organisation, such as a specialised consultancy. However, the agency remains responsible for ensuring the questions relevant to the CRIS are adequately addressed in a consultant's report.

As a general rule, a CRIS needs to be prepared *before* any cost recovery measure is introduced.

Assessment of the CRIS

Once completed, the CRIS should be sent to the independent review body for assessment. The independent review body will advise the agency or department in writing on the CRIS's compliance with the Guidelines. The independent review body's assessment and the CRIS should be made publicly available.

If the CRIS does not meet all the necessary requirements, the independent assessment will identify any deficiencies and notify the decision maker. The decision maker may direct the agency to resubmit an amended CRIS.

Decision making

While the agency's management is responsible for implementing the agency's CRIS, the final decision on the suitability of the cost recovery arrangements or proposal may rest with other bodies, such as Cabinet, the Expenditure Review Committee, the board of a statutory authority or the Minister of a portfolio.

Public scrutiny and reporting of the CRIS

The completed CRIS and the independent review assessment should be released for public scrutiny. The public documentation should also include:

- a signed declaration by the agency's Chair, Chief Executive Officer or Chief Financial Officer that the CRIS meets its terms of reference and that the Guidelines have been applied;
- a description and justification of the level of consultation undertaken;
- a summary of the views expressed by those consulted; and
- reasons for any deviation from the Guidelines in the formulation of the cost recovery arrangements.

The CRIS and independent assessment should be made available on the agency websites and in hard copy upon request. All the parties that participated in the CRIS process should receive a copy free of charge.

A summary of the contents of the CRIS should be included in the agency's Portfolio Budget Statement and annual report. If Ministerial or Cabinet approval is required for cost recovery by an agency, then evidence of this approval should be attached to the CRIS.

In its own annual report, the independent review body should report to Parliament on the application of cost recovery by Commonwealth regulatory agencies.

Attachment B
Selected charging issues

Levy design

Poorly designed levies can create the possibility of cross-subsidies between firms and/or between industries. This possibility arises because a levy (whether a flat or proportional tax) applies to all members of a leviable group equally. If, within that group, some members make less call on the resources of the regulator, then they can end up subsidising those members that require more intensive regulation.

One solution to the risk of inefficient cross-subsidisation is to define narrow leviable bands, based on identified regulatory cost drivers, so those that make similar calls on the regulator's resources pay the same levy.

Regulatory costs can also vary between industries. If a regulator straddles several industries, then the agency needs to consider whether the costs of regulation are the same across industries; for instance, the products of some industries may be more risky than others and thus require closer scrutiny by the regulator.

Usually, there will be a minimum below which regulatory costs will not fall. At the other end of the spectrum, regulatory costs are unlikely to expand indefinitely. Thus, an agency should set minimum and maximum levies in some circumstances. However, the setting of thresholds and caps should reflect the cost of regulation so they do not create cross-subsidies.

Start-up costs

There are particular pitfalls and solutions in the treatment of start-up costs. An agency needs to consider two categories of start-up costs:

1. *Agency start-up costs*. If cost recovery charges are designed inappropriately, then excessively high charges could occur in the early years of an agency's operations. This possibility arises for two reasons:

   (a) the agency has to recover 'one-off' establishment costs as they occur or shortly thereafter; and

(b) the agency has to recover establishment and other overhead costs from a relatively small number of early users, leading to abnormally high charges for these users.

2. *Regulated firm start-up cost*. The problems created by excessive early charges would be exacerbated in areas such as a new scientific field, where early entrants consist of mostly researchers and public institutions. Given their lack of commercial orientation in many cases, along with high start-up costs, few innovators are likely to have the capacity to absorb high cost recovery charges.

Both types of start-up costs could lead to the stifling of important scientific work in Australia if agencies recover costs inflexibly over time.

New products

In general, the regulatory approval process for new products precedes their introduction into the marketplace. This raises the possibility that producers (or importers) will be required to pay 'up front' for the approval of a product that may prove to be a commercial failure (or have a short shelf life). Further, because the product has not yet entered the market, the supplier may not have the cash flow necessary to meet the cost recovery charges.

Agencies can avoid this problem by spreading the cost of regulation over the market life of the product, by lowering initial assessment fees and raising ongoing annual fees (based on sales). This 'backloading' has the advantage of giving the producer access to sales revenue to cover regulatory costs. On the other hand, it transfers some of the commercial risk from the firm to the regulator: if the product fails commercially and is withdrawn from sale, then the regulator may be unable to recover all its initial assessment costs. There is also a risk of successful or high volume products subsidising unsuccessful products.

Some agencies have implemented concessional fees for 'low volume', 'minor use' and 'low hazard' products to avoid this problem. Those agencies for which high up-front costs are likely to be an issue should consult with regulated firms to devise a solution that suits their circumstances.

APPENDICES

A Conduct of the inquiry

This appendix outlines the inquiry process and lists the organisations and individuals that have participated.

As in all of its inquiries, the Commission aims to improve the overall performance of the Australian economy. It has regard to the established economic, social, environmental and regional development objectives of governments. The full terms of reference of this inquiry are on page v.

Following receipt of the terms of reference on 16 August 2000, the Commission placed a notice in the press inviting public participation in the inquiry and released an issues paper to assist participants in preparing their submissions. The Commission received 109 submissions before the release of a draft report in April. A further 64 submissions were received following the release of the draft report (a total of 173). Those who made submissions are listed in section A.1.

The Commission also held informal discussions in Sydney, Melbourne and Canberra with the organisations and Commonwealth Government departments and agencies listed in section A.2. This visit program assisted the Commission to obtain a wide understanding of the issues of cost recovery and the views of participants. Commonwealth Government regulatory, administrative and information departments and agencies were also asked to complete a questionnaire to provide the Commission with information on their cost recovery arrangements (see appendix B).

In November and December 2000 the Commission held pre-draft report public hearings in Melbourne, Sydney and Canberra. In addition, the Melbourne public hearings included video conferences with inquiry participants from Adelaide, Perth and Cairns. Following the release of the draft report, a second round of public hearings were held in Melbourne, Sydney and Canberra in June 2001. Participants in the public hearings are listed in section A.3. Submissions and transcripts of the hearings are publicly available.

Two workshops on the draft guidelines were held for regulatory and information agencies respectively during May. Participating agencies in the two workshops are listed in section A.4.

A.1 Submissions received

Participants	*Submission no.*
Agriculture Western Australia	80
Airservices Australia	107
Ansett Holdings Ltd	68
Association of Superannuation Funds of Australia	8, DR135
Australia New Zealand Food Authority	67
Australian Bureau of Agricultural and Resource Economics	56
Australian Bureau of Statistics	36, DR134
Australian Chamber of Commerce and Industry	70, DR136
Australian Chemical Specialties Manufacturers Association	60, DR164
Australian Communications Authority	108, DR127
Australian Competition and Consumer Commission	66, DR140
Australian Customs Service	29
Australian Electoral Commission	73
Australian Federal Police	100, DR146
Australian Fisheries Management Authority	65, 95, DR160
Australian Food and Grocery Council	19, DR145
Australian Geological Survey Organisation	55
Australian Geoscience Council	DR116
Australian Livestock Transporters Association	13
Australian National Audit Office	59
Australian Paint Manufacturers Federation	74
Australian Pharmaceutical Manufacturers Association	14, DR129
Australian Prudential Regulation Authority	21, DR113
Australian Seafood Industry Council	71
Australian Securities and Investment Commission	DR173
Australian Self-Medication Industry	23, 85, 105, DR123
Australian Shareholders Association	DR170

DR - submissions received following the release of the draft report.

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Participants	*Submission no.*
Australian Surveying and Land Information Group	44, DR131
Australian Trade Commission	58, DR149
Australian Transaction Reports and Analysis Centre	22, DR150
Australian Vice-Chancellors' Committee	DR128
Australian Visual Software Distributors Association	18
Avcare	28, 87, DR118
Awin Services Pty Ltd	20, DR119, DR153
Balanced State Development Working Group	DR158
Bessell, Max	DR120
Blackmores Ltd	25, DR114, DR154
Board of Airline Representatives of Australia	54, DR157
Bureau of Meteorology	35, DR142, DR159
Bureau of Tourism Research	92
Cairns Crocodile Farm – Australian Crocodile Traders	79
Centrelink	27
Chemicals and Plastics Action Agenda	15
Civil Aviation Safety Authority	75
Cochlear Ltd	10, 49
Commodore Station Pty Ltd	84
Complementary Healthcare Council of Australia	17, 52, 98, 104, DR117, DR155, DR172
Conference of Asia Pacific Express Carriers	72, DR169
Consumers' Health Forum of Australia	64
Cosmetics, Toiletry and Fragrance Association of Australia	DR166
Council of Small Business Organisations of Australia	93
Commonwealth Scientific and Industrial Research Organisation	88
Cumpston Sarjeant Pty Ltd	77, DR124, DR133
Davis, Peter	2

DR - submissions received following the release of the draft report.

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Participants	*Submission no.*
Department of Agriculture, Fisheries and Forestry — Australia	69, DR151
Department of Education, Training and Youth Affairs	103
Department of Employment, Workplace Relations and Small Business	86
Department of Finance and Administration	38, DR148
Department of Foreign Affairs and Trade	97
Department of Immigration and Multicultural Affairs	53, DR165
Department of Industry, Science and Resources	62
Department of Transport and Regional Services	48
Direct Selling Association of Australia Inc	46
Dwyer Partners	DR141
Electronic International Trade Services Pty Ltd	40
English Australia	6
Environment Australia	76
Environmental Research and Information Consortium Pty Ltd	7, DR139
Geological Survey of Victoria	99
Great Barrier Reef Marine Park Authority	42
Hadlow, R.F.	34, 96
Housing Industry Association	DR115
Industry Working Group on Quarantine	DR121, DR126
Insight EFM Pty Ltd	DR132, DR138
Investment and Financial Services Association	9
IP Australia	57, DR163
J.T. Larkin and Associates	45, DR137
Johnston, Adam	DR112
MariTrade	DR111, DR171
Medical Industry Association of Australia	12, 50, DR122, DR153
Meteorological Service of New Zealand Limited	109

DR - submissions received following the release of the draft report.

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(continued)

Participants	*Submission no.*
Mosman Municipal Council	26
Mount Morgan Shire Council	51
Mundipharma Pty Ltd	81
National Crime Authority	78
National Farmers' Federation	DR162
National Industrial Chemicals Notification and Assessment Scheme	33, DR130
National Library of Australia	5, DR125
National Nutritional Foods Association of New Zealand	11, 106
National Registration Authority for Agricultural and Veterinary Chemicals	39
National Standards Commission	31, 90
Nature's Sunshine Products of Australia Pty Ltd	3
Newcastle Airport Ltd	101
Nhulunbuy Corporation Ltd	4
Northern Territory Geological Survey	32
NRMA Insurance Ltd	37
Office of the Federal Privacy Commissioner	91
Paterson, Mark	43, DR147
Plastics and Chemicals Industries Association	24, DR143
Qantas Airways Ltd	63, DR152
Red Meat Advisory Council	47, DR110, DR156, DR161
Regional Airlines Association of Australia Ltd	61
Regulatory Solutions Pty Ltd	41, 83
ScreenSound Australia	30, DR144
SSL Australia Pty Ltd	16
Therapeutic Goods Administration	89, 94, 102
Tourism Task Force	DR167, DR168
Whiteley Industries Pty Ltd	1, 82

DR - submissions received following the release of the draft report.

A.2 Visits

Organisation
Airservices Australia
Association of Superannuation Funds of Australia
Australia New Zealand Food Authority
Australian Bureau of Statistics
Australian Chamber of Commerce and Industry
Australian Chemical Specialties Manufacturers Association
Australian Communications Authority
Australian Competition and Consumer Commission
Australian Customs Service
Australian Electoral Commission
Australian Fisheries Management Authority
Australian Food and Grocery Council
Australian Geological Survey Organisation
Australian Maritime Safety Authority
Australian National Audit Office
Australian Prudential Regulation Authority
Australian Quarantine and Inspection Service
Australian Securities and Investment Commission
Australian Self-Medication Industry
Australian Surveying and Land Information Group
Australian Trade Commission
Avcare
Blackmores Ltd
Bureau of Meteorology
Business Council of Australia
Centrelink
Civil Aviation Safety Authority
Complementary Healthcare Council of Australia
Council of Small Business Organisations of Australia
Department of Agriculture, Fisheries and Forestry — Australia
Department of Communications, Information Technology and the Arts

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Organisation
Department of Employment, Workplace Relations and Small Business
Department of Environment and Heritage
Department of Finance and Administration
Department of Foreign Affairs and Trade
Department of Health and Aged Care
Department of Immigration and Multicultural Affairs
Department of Industry, Science and Resources
Department of Transport and Regional Services
Freebairn, John
Interim Office of the Gene Technology Regulator
IP Australia
National Farmers' Federation
National Industrial Chemicals Notification and Assessment Scheme
National Library of Australia
National Registration Authority for Agricultural and Veterinary Chemicals
New South Wales Department of Information Technology and Management
New South Wales Treasury
Office of Film and Literature Classification
Office of Regulation Review
Therapeutic Goods Administration

A.3 Public hearing participants

Melbourne, 20 November 2000
Plastics and Chemicals Industries Association
Australian Pharmaceutical Manufacturers Association
Australian Food and Grocery Council
Whistleblowers Melbourne
Aircar Industry
Sydney, 21 November 2000
English Australia
Whiteley Industries Pty Ltd
Medical Industry Association of Australia
Awin Services Pty Ltd
Sydney, 22 November 2000
Association of Superannuation Funds of Australia
Australian Self-Medication Industry
Australian Visual Software Distributors Association
Nature's Sunshine Products of Australia Pty Ltd
Australian Prudential Regulation Authority
Australian Transaction Reports and Analysis Centre
Cochlear Ltd
Chemicals and Plastics Action Agenda
Canberra, 27 November 2000
Direct Selling Association of Australia Inc
Bureau of Meteorology
Complementary Healthcare Council
Paterson, Mark
Department of Transport and Regional Services
Canberra, 28 November 2000
Regulatory Solutions Pty Ltd
Screensound Australia
J.T. Larkin and Associates
National Standards Commission
Avcare

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Canberra, 29 November 2000
Australian Livestock Transporters Association
Hadlow, Robert Frank
Australian Surveying and Land Information Group
Australian Customs Service
National Library of Australia
Australian Geological Survey Organisation
Board of Airline Representatives
Canberra, 5 December 2000
Australian Bureau of Statistics
Council of Small Business Organisations of Australia
Regional Airlines Association of Australia
Australian Bureau of Agricultural and Resource Economics
Department of Immigration and Multicultural Affairs
Australia New Zealand Food Authority
Australian Chemical Specialties Manufacturers Association
Council of Asia Pacific Express Carriers
Department of Finance and Administration
Canberra, 6 December 2000
Australian Seafood Industry Council
Department of Agriculture, Fisheries and Forestry — Australia
Australian Quarantine and Inspection Service
Ansett–Air New Zealand
Australian Fisheries Management Authority
Red Meat Advisory Council
Austrade
Department of Industry, Science and Resources

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Canberra, 7 December 2000
Therapeutic Goods Administration
Australian Chamber of Commerce and Industry
Consumers' Health Forum
Australian Competition and Consumer Commission
Civil Aviation Safety Authority
Qantas Airways Ltd
Environment Australia
IP Australia
Melbourne, 11 December 2000
Cumpston Sarjeant Pty Ltd
Commonwealth Scientific and Industrial Research Organisation, Land and Water (video conference from Adelaide)
Australian Crocodile Traders (video conference from Cairns)
Agriculture Western Australia (video conference from Perth)
Melbourne, 4 June 2001
Avcare
Cumpston Sarjeant Pty Ltd
Bessell, Max
Sydney, 7 June 2001
Australian Pharmaceutical Manufacturers Association
Cosmetic, Toiletry and Fragrance Association of Australia
Australian Self-Medication Industry
Cosmetics Industry Association
Whiteley Industries Pty Ltd
MariTrade
Australian Shareholders Association
Australian Geoscience Council
Sydney, 8 June 2001
Medical Industry Association of Australia
Blackmores Ltd
Tourism Task Force

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Canberra, 13 June 2001
Australian Bureau of Statistics
Paterson, Mark
Australian Chamber of Commerce and Industry
Red Meat Advisory Council
J.T. Larkin and Associates
Complementary Healthcare Council
Plastics and Chemicals Industry Association
Australian Trade Commission
Canberra, 14 June 2001
Environmental Research and Information Consortium Pty Ltd
Insight EFM Pty Ltd
Industry Working Group on Quarantine
ScreenSound Australia
Council of Small Business Organisations of Australia
Canberra, 15 June 2001
Qantas Airways Ltd
Australian Food and Grocery Council
Civil Aviation Safety Authority
Bureau of Meteorology
Dwyer, Terry
Department of Agriculture, Fisheries and Forestry — Australia
Department of Finance and Administration

A.4 Workshop participants

Information agencies – 17 May 2001

Australian Bureau of Agricultural and Resource Economics

Australian Bureau of Statistics

Australian Institute of Health and Welfare

Australian Surveying and Land Information Group

Australian Trade Commission

Bureau of Meteorology

Bureau of Rural Sciences

Bureau of Tourism Research

Commonwealth Scientific and Industrial Research Organisation

Department of Agriculture, Fisheries and Forestry — Australia

Department of Finance and Administration

National Library of Australia

ScreenSound Australia

Regulatory agencies – 18 May 2001

Airservices Australia

Australia New Zealand Food Authority

Australian Communications Authority

Australian Customs Service

Australian Fisheries Management Authority

Australian Maritime Safety Authority

Australian Quarantine and Inspection Service

Australian Securities and Investments Commission

Civil Aviation Safety Authority

Department of Agriculture, Fisheries and Forestry — Australia

Department of Finance and Administration

Department of Immigration and Multicultural Affairs

National Registration Authority for Agricultural and Veterinary Chemicals

Office of the Gene Technology Regulator

Therapeutic Goods Administration

B Commonwealth cost recovery arrangements

The terms of reference require the Commission to report on the nature and extent of current cost recovery arrangements. To meet this requirement, the Commission sent a questionnaire to a large number Commonwealth Government regulatory and information agencies. In total, 127 questionnaires were sent, and the Commission received 99 responses (a response rate of 78 per cent). A copy of the questionnaire, a list of the agencies to which the survey was sent and a list of those who responded are available in appendix J.

The questionnaire has two sections. All agencies were asked to complete part I, which included questions on their total revenues and expenses, as well as their total cost recovery revenue. Those agencies that considered that they undertook cost recovery in 1999-2000 were asked also to complete part II. This section asked agencies to provide information on individual cost recovered activities. Where cost recovery arrangements were similar across activities, agencies were asked to report on these arrangements as a group. This section included questions on the total revenue, cost recovery revenue and expenses of the individual activities. For many agencies, the sum of the individual activities reported in part II differs from the total figure reported in part I. Therefore, care should taken when comparing responses from part I, which are cited in parts of this report, with responses from part II, cited in this appendix.

For presentational reasons, responses have been simplified and the responses to some questions have not been included. The full responses of all agencies that responded (except those that were provided in confidence) are available from the Commission's web site or on request from the Commission.

AAD	Australian Antarctic Division
ABARE	Australian Bureau of Agricultural and Resource Economics
ABS	Australian Bureau of Statistics
ACA	Australian Communications Authority
ACCC	Australian Competition and Consumer Commission
ACS	Australian Customs Service
AEC	Australian Electoral Commission
AFTRS	Australian Film, Television and Radio School
AG	Attorney General's Department
AGA	Australian Government Actuary
AGO	Australian Greenhouse Office
AGS	Australian Government Solicitor
AGSO	Australian Geological Survey Organisation
AIATSIS	Australian Institute of Aboriginal and Torres Strait Islander Studies
AIFS	Australian Institute of Family Studies
AIHW	Australian Institute of Health and Welfare
AIMS	Australian Institute of Marine Science
AFFA	Department of Agriculture, Fisheries and Forestry Australia
AFMA	Australian Fisheries Management Authority
ALRC	Australian Law Reform Commission
AMSA	Australian Maritime Safety Authority
ANAO	Australian National Audit Office
ANTA	Australian National Training Authority
ANSTO	Australian Nuclear Science and Technology Organisation
ANZFA	Australia New Zealand Food Authority
AOFM	Australian Office of Financial Management
APRA	Australian Prudential Regulation Authority
AQIS	Australian Quarantine and Inspection Service
ARPANSA	Australian Radiation Protection and Nuclear Safety Agency
ASA	Airservices Australia
ASC	Australian Sports Commission
ASIC	Australian Securities and Investments Commission
ATC	Australian Tourist Commission

ATO	Australian Taxation Office
ATP	Australian Training Products
ATSB	Australian Transport Safety Bureau
AUSLIG	Australian Surveying and Land Information Group
Austrade	Australian Trade Commission
AVO	Australian Valuation Office
Avstats	Aviation statistics
AWM	Australian War Memorial
BoM	Bureau of Meteorology
BRS	Bureau of Rural Sciences
BTE	Bureau of Transport Economics
BTR	Bureau of Tourism Research
CASA	Civil Aviation Safety Authority
CRICOS	Commonwealth Register of Institutions and Courses for Overseas Students
CSIRO	Commonwealth Scientific and Industrial Research Organisation
CRC	Cooperative Research Centre
CRF	Consolidated Revenue Fund
DAA	Dairy Adjustment Authority
DCITA	Department of Communication, Information Technology and the Arts
DEH	Department of Environment and Heritage
DEWRSB	Department of Employment, Workplace Relations and Small Business
DETYA	Department of Education, Training and Youth Affairs
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
DOFA	Department of Finance and Administration
DTRS	Department of Transport and Regional Services
DVA	Department of Veterans Affairs
FaCS	Department of Family and Community Services
FMA	*Financial Management and Accountability Act 1997*
GBRMPA	Great Barrier Reef Marine Park Authority

HIC	Health Insurance Commission
ICAO	International Civil Aviation Organisation
IPA	IP Australia
ITSA	Insolvency and Trustee Services Australia
MARA	Migration Agents Registration Authority
MIFCo	Maritime Industry Finance Company Limited
MRT	Migration Review Tribunal
NCA	National Capital Authority
NCC	National Competition Council
NICNAS	National Industrial Chemicals Notification and Assessment Scheme
NLA	National Library of Australia
NNTT	National Native Title Tribunal
NOOSR	National Office of Overseas Skills Recognition
NRA	National Registration Authority for Agricultural & Veterinary Chemicals
NSC	National Standards Commission
NSTC	National Science and Technology Centre
OPC	Office of Parliamentary Counsel
OPH	Old Parliament House
PC	Productivity Commission
PMC	Passenger Movement Charge
PM&C	Department of Prime Minister and Cabinet
PRISMS	Provider Registration and International Students Management System
PSMPC	Public Service Merit Protection Commission
RBA	Reserve Bank of Australia
RRT	Refugee Review Tribunal
SBS	Special Broadcasting Corporation
SLASO	Space Licensing and Safety Office
SRCC	Safety, Rehabilitation and Compensation Commission
SSA	ScreenSound Australia
TGA	Therapeutic Goods Administration
TPA	*Trade Practices Act 1974*

na Not available

.. Not applicable

— Rounded to zero

All percentages are calculated using unrounded numbers.

B.1 Portfolio: Agriculture, Fisheries and Forestry

Table B.1 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Dairy sub-unit*	Fee	User/Policy	2000	..
	Levies and revenue service	Fee	Beneficiary	1988	Annually
	Plant breeders Rights Scheme	Fee	Policy	1988/1994	Annually
	Product integrity, animal and plant health	Fee	Revenue	1993	Irregularly
	Quota administration	Fee	Policy	1998	..
ABARE		Fee	Policy/User	1989-90	Annually
AFMA		Fee/Levy	Policy/Beneficiary pays	late 80s	Annually
AQIS	*Live Animal Exports*	Fee	na	na	Six monthly
	Grain Exports	Fee/Tax	na	1990(fee), 1963(tax)	Six monthly
	Horticulture Export Program	Fee/Tax	na	early 90s	Six monthly
	Dairy Export Program	Fee/Tax	na	1990	Six monthly
	Fish Export Program	Fee/Tax	na	1991	Six monthly
	Post Entry Animal Quarantine Stations	Fee	na	1991	Six monthly
	International Mail	Fee	na	1997	Six monthly
	Import Clearance Program	Fee	na	1994	Six monthly
	Post Entry Plant Quarantine	Fee	na	1991	Six monthly
	Airports	Fee/PMC	na	1995	Six monthly
	Seaports	Fee	na	1991	Annually
	Meat Inspection Program	Fee/Tax	na	1991	Six monthly
	AQIS Training Services	Fee	na	1993	Six monthly
BRS		Fee	Revenue/Policy	1993	Annually
NRA	*Chemical regulation*	Fees/Levy	Policy	1994	2-3 years

a Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.2 **Revenue 1999-2000**

Agency	Activity/*sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Dairy sub-unit*	0.6	0.6	100.0	0.6	100.0	Yes third party	..
	Levies and revenue service	2.2	2.2	100.0	2.2	100.0	Yes	Adjustment
	Plant breeders Rights Scheme	0.8	0.9	91.3	1.0	82.5	Yes	CRF
	Product integrity, animal and plant health	0.6	8.2	7.4	7.7	7.8	Yes	Refund or Retained
	Quota administration	0.3	0.3	100.0	0.3	100.0	No	..
ABARE		11.2	22.8	49.4	22.0	51.1	Yes	na
AFMA		8.5	23.6	35.8	24.2	34.9	Yes	Adjustment
AQIS	*Live Animal Exports*	1.8	1.8	99.8	1.8	97.4	No	Refund/Retained/ Services
	Grain Exports	6.8	6.8	99.8	6.8	99.8	No	Refund/Retained/ Services
	Horticulture Export Program	4.7	4.7	99.7	5.3	87.7	No	Refund/Retained/ Services
	Dairy Export Program	1.1	1.1	99.7	1.1	99.8	No	Refund/Retained/ Services
	Fish Export Program	3.8	3.8	99.8	3.9	99.1	No	Refund/Retained/ Services
	Post Entry Animal Quarantine Stations	2.7	3.1	83.3	2.9	83.2	No	Retained

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Table B.2 (continued)

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
	International Mail	2.2	2.3	99.8	2.3	98.9	No	Refund/Retained/ Services
	Import Clearance Program	36.4	36.4	100.0	35.1	99.0	No	Industry Reserve Fund
	Post Entry Plant Quarantine	0.3	1.4	21.2	1.4	21.2	No	Retained
	Airports	20.0[c]	20.1	99.8	20.2	99.2	Partially to other agency and CRF	Retained
	Seaports	4.4[c]	4.5	98.3	4.2	103.6	Partially to other agency and CRF	Refund/Retained/ Services
	Meat Inspection Program	54.0	54.0	100.0	53.9	100.0	No	Refund/Retained/ Services
	AQIS Training Services	1.5	1.5	99.1	1.6	94.1	No	Refund/Retained/ Services
BRS		7.6	21.8	34.9	25.0	30.4	Yes	..
NRA	*Chemical regulation*	17.8	18.5	96.0	16.2	109.7	Yes	Adjustment

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **c** This includes revenue obtained from the Passenger Movement Charge. **CR** Cost recovery. **na** Not available. **..** Not applicable.

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

Table B.3 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Dairy sub-unit*	Direct	..	..	No
	Levies and revenue service	Direct/Indirect	Activity based costing	..	No
	Plant breeders Rights Scheme	Direct/Indirect	Activity based costing	Cost less depreciation	No
	Product integrity, animal and plant health	Direct/Indirect	Pro rata	..	..
	Quota administration	Direct/Indirect	Pro rata	..	No
ABARE		Direct/Indirect	Pro rata	na	No
AFMA		Direct/Indirect	Pro rata	Deprival	No
AQIS	*Live Animal Exports*	Direct/Indirect	Cost drivers	na	No
	Grain Exports	Direct/Indirect	Cost drivers	na	No
	Horticulture Export Program	Direct/Indirect	Cost drivers	na	No
	Dairy Export Program	Direct/Indirect	Cost drivers	na	No
	Fish Export Program	Direct/Indirect	Cost drivers	na	No
	Post Entry Animal Quarantine Stations	Direct/Indirect	Cost drivers	na	No
	International Mail	Direct/Indirect	Cost drivers	na	No
	Import Clearance Program	Direct/Indirect	Cost drivers	na	No
	Post Entry Plant Quarantine	Direct/Indirect	Cost drivers	na	No
	Airports	Direct/Indirect	Cost drivers	na	No
	Seaports	Direct/Indirect	Cost drivers	na	No
	Meat Inspection Program	Direct/Indirect	Cost drivers	na	No
	AQIS Training Services	Direct/Indirect	Cost drivers	na	No
BRS		Direct/Indirect	Pro rata	..	Yes
NRA	*Chemical regulation*	Direct/Indirect	Activity based costing	..	No

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.4 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Dairy sub-unit*	Other Act	Govt/industry	Cwealth	Govt/Industry	..
	Levies and revenue service	Other Act	Govt/Industry	na	No ongoing consultation	Yes
	Plant breeders Rights Scheme	FMA/Other Act	Govt/Industry	na	Govt/Industry	Yes
	Product integrity, animal and plant health	FMA	Govt	Cwealth	Consumers	No
	Quota administration	Other Act	Industry	Other	Industry	Yes
ABARE		FMA	Govt	DOFA	Govt	Yes (1995)
AFMA		Tax Act/Other Act	Govt/Industry	Other	Govt/Industry	Yes (1994)
AQIS	*Live Animal Exports*	Other Act	na	na	na	Yes (2000)
	Grain Exports	Tax Act/Other Act	na	na	na	Yes
	Horticulture Export Program	Tax Act/Other Act	na	na	na	Yes (2000)
	Dairy Export Program	Tax Act/Other Act	na	na	na	Yes
	Fish Export Program	Tax Act/Other Act	na	na	na	Yes
	Post Entry Animal Quarantine Stations	Other Act	na	na	na	Yes
	International Mail	Other Act	na	na	na	Yes

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Table B.4 (continued)

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
	Import Clearance Program	Other Act	na	na	na	Yes
	Post Entry Plant Quarantine	Other Act	na	na	na	Yes
	Airports	Other Act	na	na	na	Yes
	Seaports	Other Act	na	na	na	No
	Meat Inspection Program	Tax Act/Other Act	na	na	na	Yes
	AQIS Training Services	FMA	No consultation	na	na	No
BRS		FMA	Govt	na	No ongoing consultation	Yes, internally
NRA	*Chemical regulation*	Tax Act/Other Act	Govt/Industry/ Consumers	na	na	Under review

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.5 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Dairy sub-unit*	AFFA	..	DAA/Centrelink/DEWRSB	AFFA
	Levies and revenue service	AFFA	AFFA	AFFA	AFFA
	Plant breeders Rights Scheme	AFFA	Parliament	AFFA	AFFA
	Product integrity, animal and plant health	AFFA	AFFA	AFFA	AFFA
	Quota administration	AFFA	AFFA	AFFA	AFFA
ABARE		AFFA/ABARE	ABARE	AFFA/ABARE	AFFA/ABARE
AFMA		DOFA/AFFA/AFMA	AFMA	AFMA	AFMA
AQIS	*Live Animal Exports*	na	na	na	na
	Grain Exports	na	na	na	na
	Horticulture Export Program	na	na	na	na
	Dairy Export Program	na	na	na	na
	Fish Export Program	na	na	na	na
	Post Entry Animal Quarantine Stations	na	na	na	na
	International Mail	na	na	na	na
	Import Clearance Program	na	na	na	na
	Post Entry Plant Quarantine	na	na	na	na
	Airports	na	na	na	na
	Seaports	na	na	na	na
	Meat Inspection Program	na	na	na	na
	AQIS Training Services	na	na	na	na
BRS		AFFA	BRS	BRS	BRS
NRA	*Chemical regulation*	AFFA	NRA/AFFA	NRA	NRA

na Not available. **..** Not applicable.

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

B.2 Portfolio: Attorney-General's

Table B.6 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Office of International Law and Office of Legislative Drafting*	Fee	Policy	1992-93	Aligned with AGS
	Australian Protective Service	Fee	Policy	1988	Annually
	Australian Security Vetting Service	Fee	Policy	1996	Annually
ALRC	*Publications*	Fee	Policy	1975	na
	Conference	Fee	Policy	2000	..
	Journal subscriptions	Fee	Policy	1976	1997
ASIO	*Protective security*	Fee	Policy	1993	na
ACS	*Passenger Movement Charge*	Tax	Revenue	1978	Ad hoc
	Import processing charges	Tax	Revenue	April 1997	Bi-annually
	S. 31 Charges	Fees	User	Various dates	Ad hoc
ITSA	*Issue of a Bankruptcy Notice, exercise of Official Receiver powers*	Fee/Levy	User	Long standing	Never
NNTT	*Information, claim lodgement, geospatial services*	Fees	Revenue/Services	1994, 2000	6 monthly (geospatial)
OPC	*Training course*	Fee	Demand/Services	1994	Annually

[a] Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.7 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Office of International Law and Office of Legislative Drafting*	1.1	1.1	100.0	na	na	No	Retained by AG
	Australian Protective Service	63.5	63.5	100.0	62.5	101.6	No	Retained by APS
	Australian Security Vetting Service	1.5	1.5	100.0	na	na	No	Retained by AG.
ALRC	*Publications*	—	—	100.0	na	na	No	..
	Conference	0.1	0.1	100.0	0.1	77.7	No	..
	Journal subscriptions	—	—	100.0	na	na	No	..
ASIO	*Protective security*	0.3	67.0	0.5	na	na	No	..
ACS	*Passenger Movement Charge*	226.1[c]	226.1	100.0	124.5[d]	159.0	Yes	All revenue goes directly to CRF
	Import Processing charges	73.1	73.1	100.0	72.6	101.0	Yes	Adjustment
	s. 31 FMA charges	20.4	20.4	100.0	na	na	No	na
ITSA	*Issue of a Bankruptcy Notice, exercise of Official Receiver powers*	18.8	41.9	44.8	41.2	45.5	Most not earmarked	..
NNTT	*Information, claim lodgement, geospatial services*	0.1	22.3	0.5	23.3	0.5	About 50%	..
OPC	*Training course*	—	6.4	0.5	6.4	0.5	Yes	..

[a] Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. [b] Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. [c] Revenue is collected by ACS on behalf of DIMA/AQIS and ACS. [d] This relates to ACS expenses only. Both DIMA and AQIS also incurr costs on PMC but these are not known to ACS. **na** Not available. **..** Not applicable. — Rounds to zero.

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

Table B.8 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Office of International Law and Office of Legislative Drafting*	Direct/Indirect	Pro rata (direct)	Deprival	Yes
	Australian Protective Service	Direct/Indirect	Pro rata (direct)	Deprival	No, but pay dividend to DOFA
	Australian Security Vetting Service	Direct/Indirect	Pro rata	Deprival	Yes
ALRC	*Publications*	..	..	..	..
	Conference	Partial	..	..	..
	Journal subscriptions	Partial	..	..	..
ASIO	*Protective security*	Direct	..	Historic/Deprival	No
ACS	*Passenger Movement Charge*	Direct/Indirect	Activity based costing	Historic/Deprival	No
	Import Processing charges	Direct/Indirect	Activity based costing	Historic/Deprival	No
	s. 31 charges	Direct/Indirect	Activity based costing	Historic/Deprival	No
ITSA	*Issue of a Bankruptcy Notice, exercise of Official Receiver powers*	..	..	..	..
NNTT	*Information, claim lodgement, geospatial services*	Direct/Indirect	Pro rata to direct	..	..
OPC	*Training course*	na	..	na	na

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.9 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Office of International Law and Office of Legislative Drafting*	FMA (s.31)	Govt	None	No ongoing consultation	No
	Australian Protective Service	FMA (s.20)	Govt	None	No ongoing consultation	No
	Australian Security Vetting Service	FMA (s.31)	Govt	None	No ongoing consultation	No
ALRC	*Publications*	na	No consultation	None	No ongoing consultation	Yes (1990)
	Conference	na	No consultation	None	No ongoing consultation	No
	Journal subscriptions	na	No consultation	None	No ongoing consultation	1999-2000
ASIO	*Protective security*	na	na	na	No ongoing consultation	Reviews by external commercial parties
ACS	*Passenger Movement Charge*	Tax Act	Govt/Industry	Internal	Industry	ANAO (1996, 2001)
	Import Processing Charges	Tax Act	Govt/Industry	Internal	Industry	Industry (Bi-annually); ANAO (1998)
	S. 31 charges	FMA Act	Consumers	DOFA	na	No
ITSA	*Issue of a Bankruptcy Notice, exercise of Official Receiver powers*	Other Act	Industry	None	No ongoing consultation	No
NNTT	*Information, claim lodgement, geospatial services*	FMA/Other Act/ No Act	Govt	AGS advice	Govt	Currently underway (search fees)
OPC	*Training course*	FMA	No consultation	DOFA/ ANAO	No ongoing consultation	No

[a] FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.10 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Office of International Law and Office of Legislative Drafting*	Govt	AG	AG	AG
	Australian Protective Service	Govt	AG	AG	AG
	Australian Security Vetting Service	Govt	AG	AG	AG
ALRC	*Publications*	ALRC	ALRC	ALRC	ALRC
	Conference	ALRC	ALRC	ALRC	ALRC
	Journal subscriptions	ALRC	ALRC	ALRC	ALRC
ASIO	*Protective security*	ASIO	ASIO	ASIO	ASIO
ACS	*Passgener Movement Charge*	Govt	Govt/ACS	ACS/DIMA/ AQIS	ACS
	Import Processing Charges	Govt	Govt/ACS/ Industry	ACS	ACS
	S. 31 charges	ACS	ACS	ACS	ACS
ITSA	*Issue of a Bankruptcy Notice, exercise of Official Receiver powers*	ITSA	Parliament	ITSA	ITSA
NNTT	*Information, claim lodgement, geospatial services*	Govt/NNTT	Govt/NNTT	NNTT	NNTT
OPC	*Training course*	OPC	OPC	OPC	OPC

na Not available. **..** Not applicable.

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

B.3 Portfolio: Communication, Information Technology and the Arts

Table B.11 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often are charges changed/reviewed*
Department	*Cultural activities*[b]	Fee	Policy	1996	Annually (NSTC)
	Artbank	Fee	Policy	1985	Annually
ACA	*Annual Licence Carrier Charge*	Levy	Beneficiary	1991	Annually
	Spectrum Maintenance Component	Levy	Policy/Demand/User	1995	Bi-annually
	Administrative	Fee	Policy/Demand/User	1995	Bi-annually
AFTRS		Fee	Policy	1973	na
NLA	*Kinetica*	Fee	Policy	1999	Annually
	Sale of Goods and Services	Fee	Demand	1960	Annually
SSA		Fee	Revenue/Service	1983	Irregularly
SBS		Fee	Policy	1995-96	Annually

a Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **b** Entry fees to OPH and NSTC. **na** Not available. **..** Not applicable.

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

Table B.12 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Cultural activities*	1.8	18.1	9.9	15.0	12.0	Yes	..
	Artbank	1.7	3.6	47.2	2.9	58.6	No	Retained
ACA	*Annual Licence Carrier Charge*	18.5	18.5	100.0	18.4	100.5	No	Retained
	Spectrum Maintenance Component	24.5	24.5	100.0	30.0	81.3	No	Retained
	Administrative	5.9	5.9	100.0	6.5	90.8	No	Retained
AFTRS		1.1	19.4	5.7	20.1	5.5	No	na
NLA	*Kinetica*	6.0	8.3	72.3	7.9	75.9	No	Adjustment/ Services/Retained
	Sale of Goods and Services	2.5	222.9	1.1	43.1	5.8	No	..
SSA		1.8	48.6	3.5	47.5	3.6	Yes	Retained
SBS		0.2	140.1	0.1	0.2	100.0	No	..

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable.

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

Table B.13 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Cultural activities*	na	..	na	na
	Artbank	na	..	na	na
ACA	*Annual Licence Carrier Charge*	Direct/Indirect	Activity based costing	Deprival	Yes
	Spectrum Maintenance Component	Direct/Indirect	Activity based costing	Deprival	Yes
	Administrative	Direct/Indirect	Activity based costing	Deprival	Yes
AFTRS		na	na	na	na
NLA	*Kinetica*	Direct/Indirect	Other	Deprival	No
	Sale of Goods and Services	Direct/Indirect	Other	Deprival	No
SSA		Direct/Indirect	Other	Replacement	Yes
SBS		Direct/Indirect	Activity based costing	Deprival	No

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.14 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Cultural activities*	FMA	DOFA	..	..	..
	Artbank	FMA	na	na	No ongoing consultation	Yes (1997)
ACA	*Annual Licence Carrier Charge*	Other Act	Govt	na	Govt	No
	Spectrum Maintenance Component	Other Act	Govt	Internal	Govt	Yes (1995)
	Administrative	Other Act	Govt	Internal	Govt	Yes (1995)
AFTRS		Other Act	..	Other	Govt/Industry/ Consumers	Yes (2000)
NLA	*Kinetica*	Other Act	Govt/Industry	na	Industry/Consumers	Under review
	Sale of Goods and Services	Other Act	Govt/Consumers	DOFA	Industry	Under review
SSA		FMA	Govt/Industry/ Consumers	No	Govt/Industry/ Consumers	Yes (2000)
SBS		Other Act	Govt/Industry	DOFA/ Internal	Govt/Industry/ Consumers	Yes (2000)

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.15 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Cultural activities*	..	OPH/NSTC	OPH/NSTC	OPH/NSTC
	Artbank	na	Artbank	Artbank	Artbank
ACA	*Annual Licence Carrier Charge*	DCITA	ACA	ACA	ACA
	Spectrum Maintenance Component	ACA	ACA	ACA	ACA
	Administrative	ACA	ACA	ACA	ACA
AFTRS		AFTRS	AFTRS	AFTRS	AFTRS
NLA	*Kinetica*	NLA	NLA	NLA	NLA
	Sale of Goods and Services	NLA	NLA	NLA	NLA
SSA		SSA	SSA	SSA	SSA
SBS		SBS	SBS	SBS	SBS

na Not available. **..** Not applicable.

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

B.4 Portfolio: Defence

Table B.16 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Goods and services*	Fee	na	na	Adhoc

[a] Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.17 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Goods and services*	12.2	16 439.6	0.1	11 123.1	0.1	No	..

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable.

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

Table B.18 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Goods and services*	Direct/indirect	Averaged	Deprival	Yes

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.19 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Goods and services*	FMA	na	DOFA	No ongoing consultation	No

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.20 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Goods and services*	Defence	Defence	Defence	Defence

na Not available. **..** Not applicable.

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

B.5 Portfolio: Environment and Heritage

Table B.21 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Bird and Bat Banding Scheme*	Fee	Policy	1996	Ad hoc
	Corporate services for AGO	Fee	Policy	1998	Biennially
	Assessments for NRA	Fee	Policy	1995-96	Annually
	Assessments for NICNAS	Fee	Policy	1996-97	Annually
	Wildlife Permits and Enforcement	Fee	Policy	1984	Ad hoc
	AAD -Joint Ventures	Fee	User	1998,1999,1947	Irregularly
	AAD -CRC	Fee	User	1997	Irregularly
	Sea dumping permits	Fee	Policy	1983	Irregularly
	Hazardous Waste Permits	Fee	Policy	1990	Irregularly
	National Halon Bank	Fee	Policy	1993	Irregularly
	Ozone Protection Reserve	Fee	Policy	1995	Irregularly
	Environment and Conservation Council	Fee	User/Demand	1992	Ad hoc
BoM	*Aviation weather services*	Fee	Policy	1952	Annually
	Defence weather services	Fee	Policy	1972	Annually
	Special Services Unit	Fee	Policy	1990	na
	Other specific services	Fee	Policy	1967	Annually
GBRMPA	*Environmental Management and Permit Application Fees*	Fee	User	1990,1993	na
	Communications and Education	Fee	na	1987	Annually

[a] Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.22 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Bird and Bat Banding Scheme*	—	—	100.0	—	9.8	No	..
	Corporate services for AGO	0.5	0.5	100.0	0.5	100.0	No	..
	Assessments for NRA	0.7	0.7	100.0	1.0	70.0	Yes	Refunded
	Assessments for NICNAS	0.5	0.5	100.0	0.5	100.0	Yes	Refunded
	Wildlife Permits and Enforcement	0.2	1.7	11.8	1.7	11.8	Yes	..
	AAD -Joint Ventures	1.2	1.2	100.0	1.2	100.0	Yes	No provision
	AAD -CRC	1.1	1.1	100.0	1.1	100.0	Yes	No provision
	Sea dumping permits	—	0.9	3.6	0.9	3.7	Yes	..
	Hazardous Waste Permits	—	—	100.0	—	41.3	Yes	..
	National Halon Bank	0.5	6.2	8.1	4.7	10.6	Yes	Retained
	Ozone Protection Reserve	0.7	0.7	100.0	0.5	140.0	Yes	Retained
	Environment and Conservation Council	—	—	100.0	—	100.0	No	Retained
BoM	*Aviation weather services*	14.5	14.5	100.0	14.5	100.0	No	Adjustment
	Defence weather services	3.4	3.4	100.0	3.4	100.0	No	Adjustment
	Special Services Unit	9.0	9.0	100.0	9.0	100.0	No	CRF
	Other specific services	5.0	5.0	100.0	5.0	100.0	No	Adjustment
GBRMPA	*Environmental Management and Permit Application Fees*	6.0	26.0	23.1	25.6	23.4	Yes	..
	Communications and Education	1.8	1.8	100.0	3.2	56.3	No	..

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable. — Rounds to zero.

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

Table B.23 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Bird and Bat Banding Scheme*	na	na	na	na
	Corporate services for AGO	Direct	Activity based costing	..	No
	Assessments for NRA	Direct/Indirect	Other	..	No
	Assessments for NICNAS	Direct/Indirect	Other	..	No
	Wildlife Permits and Enforcement	na	..	na	na
	AAD -Joint Ventures	Direct	..	Deprival	Yes
	AAD -CRC	Direct	..	Deprival	Yes
	Sea dumping permits	Direct	Other	..	No
	Hazardous Waste Permits	Direct	..	..	No
	National Halon Bank	Direct	..	..	No
	Ozone Protection Reserve	Direct	..	..	No
	Environment and Conservation Council	Direct	..	..	No
BoM	*Aviation weather services*	Direct/Indirect	Pro rata	Deprival	Yes
	Defence weather services	Direct/Indirect	Pro rata	Deprival	Yes
	Special Services Unit	Total Plus	Pro rata	na	Yes
	Other specific services	Direct/Indirect	Pro rata	Deprival	Yes
GBRMPA	*Environmental Management and Permit Application Fees*	na	..	..	..
	Communications and Education	na	na	Deprival	No

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report).. **na** Not available. **..** Not applicable.

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

Table B.24 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Bird and Bat Banding Scheme*	FMA	Govt/Consumers	Cwealth	Consumers	No
	Corporate services for AGO	FMA	Govt	na	Govt/Consumers	No
	Assessments for NRA	Other Act	Govt	DOFA	Govt	Under review
	Assessments for NICNAS	Other Act	Govt	DOFA	Govt	No
	Wildlife Permits and Enforcement	Other Act	Govt/Industry	na	Govt/Industry	No
	AAD -Joint Ventures	FMA	Govt/Others	DOFA	Others	No
	AAD -CRC	Other Act	Govt/Industry	DOFA	Govt/Industry	No
	Sea dumping permits	Other Act	Govt/Industry	na	Govt/Industry	Yes (2000)
	Hazardous Waste Permits	Other Act	Govt/Industry/ Consumers	DoFA	Govt/Industry	Yes (2000)
	National Halon Bank	FMA	na	na	na	No
	Ozone Protection Reserve	Other Act	Govt/Imdustry	Cweaith	Govt/Industry	Yes (2000)
	Environment and Conservation Council	No Act	Govt	na	Govt	Yes (1998)
BoM	*Aviation weather services*	FMA/Other Act	Govt/Industry	Internal/Cwealth	Govt/Industry	Yes (1998-99)
	Defence weather services	FMA/Other Act	Govt	Internal/DOFA	Govt	Yes (1997-98)
	Special Services Unit	FMA/Other Act	Govt	Internal/DOFA	Govt	Yes (1997)
	Other specific services	FMA/Other Act	Govt	Internal/DOFA	Govt/Industry/ Consumers	Yes (1997)
GBRMPA	*Environmental Management and Permit Application Fees*	Other Act	Govt/Industry/ Consumers	na	Govt/Industry/ Consumers	Yes (1996)
	Communications and Education	Other Act	Govt/Industry/ Consumers	na	Govt	na

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.25 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Bird and Bat Banding Scheme*	Environment Australia	Environment Australia	Environment Australia	Environment Australia
	Corporate services for AGO	DEH	DEH	DEH	DEH
	Assessments for NRA	DEH	DEH/NRA	DEH/NRA	DEH/NRA
	Assessments for NICNAS	DEH	DEH/NICNAS	DEH/NICNAS	DEH/NICNAS
	Wildlife Permits and Enforcement	DEH	DEH	DEH	DEH
	AAD -Joint Ventures	AAD/Treaty nations	AAD	AAD	AAD
	AAD -CRC	CRC	AAD	AAD	AAD
	Sea dumping permits	DEH	DEH	DEH	DEH
	Hazardous Waste Permits	DEH	DEH	DEH	DEH
	National Halon Bank	DEH	DEH	DEH	DEH
	Ozone Protection Reserve	DEH	DEH	DEH	DEH
	Environment and Conservation Council	DEH	DEH	DEH	DEH
BoM	*Aviation weather services*	BoM/ICAO/CASA	BoM	BoM	ASA[a]
	Defence weather services	BoM/DoD	BoM	BoM	BoM
	Special Services Unit	BoM	BoM	BoM	BoM
	Other specific services	BoM	BoM	BoM	BoM
GBRMPA	*Environmental Management and Permit Application Fees*	GBRMPA	GBRMPA	GBRMPA	GBRMPA
	Communications and Education	GBRMPA	GBRMPA	GBRMPA	GBRMPA

a ASA collects the revenue as an agent for BoM. **na** Not available. **..** Not applicable.

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

B.6 Portfolio: Education, Training and Youth Affairs

Table B.26 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*NOOSR migration case assessments*	Fee	Policy	1989	To be reviewed in 2001
	NOOSR sale of publications	Fee	Demand/Users	1982	Ad hoc
	NOOSR Vetassess assessment program	Fee	Policy	1999	Biennially
	NOOSR teaching assessments	Fee	Policy	1999	To be reviewed in 2001
	NOOSR non permanent residents education assessments	Fee	Policy	1997	To be reviewed
	NOOSR education assessments	Fee	Policy	1987	To be reviewed in 2001
	CRICOS & PRISMS	Fee	Demand/Users	1997	Annually
	Jobguide	na	Services	1998	Biannually
	Australian Education International	Fee	Beneficiary/Policy	1993	Annually
	International Services	Fee	Beneficiary/Policy	1993	Ad hoc
	Statistics Unit	Fee	Demand/Users	1991	Annually
Anglo -Australian Telescope Board		Fee	User/Services	1997	Triennially
ANTA		Fee	Policy/User	1996	Annually

[a] Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.27 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*NOOSR migration case assessments*	0.5	0.5	100.0	0.5	100.0	Yes	na
	NOOSR sale of publications	—	—	100.0	—	100.0	No	na
	NOOSR Vetassess assessment program	0.3	0.3	100.0	0.3	100.0	No	na
	NOOSR teaching assessments	0.4	0.4	100.0	0.4	100.0	No	na
	NOOSR non permanent residents education assessments	0.1	0.1	100.0	0.1	100.0	No	na
	NOOSR education assessments	0.1	0.1	100.0	0.1	50.0	No	na
	CRICOS & PRISMS	1.0	1.0	100.0	1.4	71.4	Yes	CRF
	Jobguide	0.1	1.4	7.1	0.3	33.3	Yes	Refund/Retained
	Australian Education International	1.2	5.0	24.0	4.4	27.0	Yes	Retained
	International Services	0.9	0.9	100.0	0.3	300.0	Yes	CRF
	Statistics Unit	—	—	100.0	—	121.4	Yes	Refund
Anglo -Australian Telescope Board		1.3	1.3	100.0	1.2	108.3	No	Retained
ANTA		0.1	25.5	0.4	18.1	0.6	No	na

[a] Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. [b] Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable. — Rounds to zero.

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

Table B.28 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*NOOSR migration case assessments*	Direct	na	na	No
	NOOSR sale of publications	Direct	na	na	No
	NOOSR Vetassess assessment program	Direct/Indirect	na	na	No
	NOOSR teaching assessments	Direct/Indirect	na	na	No
	NOOSR non permanent residents education assessments	Direct/Indirect	na	na	No
	NOOSR education assessments	Direct/Indirect	na	na	No
	CRICOS & PRISMS	Direct/Indirect	na	na	No
	Jobguide	Direct	na	na	No
	Australian Education International	Direct/Indirect	Pro rata (labour)	na	No
	International Services	Direct/Indirect	Activity based costing	Deprival	Yes
	Statistics Unit	Direct/Indirect	Other	na	No
Anglo -Australian Telescope Board		Direct/Indirect	Pro rata (labour)	Deprival	Yes
ANTA		Direct/Indirect	Pro Rata (rent/labour)	na	na

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity.' Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.29 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*NOOSR migration case assessments*	Other Act	Govt	DOFA	No ongoing consultation	na
	NOOSR sale of publications	No Act	Govt	Cwealth	Govt	No
	NOOSR Vetassess assessment program	Other Act	Govt	DOFA	Govt	No
	NOOSR teaching assessments	Other Act	Govt	DOFA	No ongoing consultation	No
	NOOSR non permanent residents education assessments	No Act	Govt	DOFA	No ongoing consultation	na
	NOOSR education assessments	Other Act	Govt	DOFA	No ongoing consultation	na
	CRICOS & PRISMS	Other Act	Govt/Industry	DOFA	No ongoing consultation	Yes (2000)
	Jobguide	None	Govt	na	No ongoing consultation	No
	Australian Education International	FMA	Govt/Industry	DOFA	Govt/Industry	No
	International Services	FMA	Govt	DOFA	Govt	Yes (2000)
	Statistics Unit	FMA	Govt	DOFA/Other	No ongoing consultation	No
Anglo -Australian Telescope Board		No Act	No consultation	Cwealth/ Other	No ongoing consultation	No
ANTA		FMA	Govt	DOFA	Govt	Yes (2000)

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.30 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*NOOSR migration case assessments*	NOOSR/DIMA	NOOSR/DIMA	NOOSR/DIMA	NOOSR
	NOOSR sale of publications	NOOSR	NOOSR	NOOSR/AusInfo	NOOSR/AusInfo
	NOOSR Vetassess assessment program	NOOSR/DIMA	NOOSR/Vetassess	NOOSR	NOOSR
	NOOSR teaching assessments	NOOSR/DIMA	NOOSR	NOOSR	NOOSR
	NOOSR non permanent residents education assessments	NOOSR	NOOSR	NOOSR	NOOSR
	NOOSR education assessments	NOOSR/DIMA	NOOSR/DIMA	NOOSR	NOOSR
	CRICOS & PRISMS	DETYA	DETYA	DETYA	DETYA
	Jobguide	DETYA	DETYA	DETYA	DETYA
	Australian Education International	DETYA	DETYA	DETYA	DETYA
	International Services	DETYA	DETYA	DETYA	DETYA
	Statistics Unit	DETYA	DETYA	DETYA	DETYA
Anglo -Australian Telescope Board		Anglo-Aust. Observatory	Anglo-Aust. Observatory	Anglo-Aust. Observatory	Anglo-Aust. Observatory
ANTA		DOFA	ANTA/ATP	ANTA	ANTA

na Not available. **..** Not applicable.

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

B.7 Portfolio: Employment, Workplace Relations and Small Business

Table B.31 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Job search touch screen units leased to Job Network members*	Fee	Demand	1997	Triennially
	IT implementation and training	Fee	Demand/Services	1998	Ad hoc
	Relocating IT functions	Fee	Policy	1998	na
	Office of workplace services	Fee	User/Services	1994	na
	Personnel operations training	Fee	Demand	1990	Ad hoc
	Public sector team	Fee	Demand/Services	1996	Ad hoc
	Trades Recognition Australia	Fee	na	1989	Ad hoc
Comcare	*OH&S Act administration*	Fee	Policy	1992	Annually
	Licensing under Safety Rehabilitation Compensation Act 1988	Fee	Policy	1992	Annually
	Training activities	Fee	Policy/User	1992	Annually
NICNAS	*New chemical assessment fees*	Fee	Policy	1997	Ad hoc
	Existing chemicals assessment	Levy	Policy	1997	Ad hoc
	Publications and seminars	Fee	Policy	na	Ad hoc

a Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.32 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Job search touch screen units leased to Job Network members*	1.1	1.1	100.0	na	na	Yes	na
	IT implementation and training	15.6	15.6	100.0	15.6	100.0	Yes	na
	Relocating IT functions	15.6	15.6	100.0	15.6	100.0	Yes	na
	Office of workplace services	0.3	0.3	100.0	na	na	No	na
	Personnel operations training	0.2	0.2	100.0	0.4	50.0	Yes	Retained
	Public sector team	0.7	0.7	100.0	0.9	77.8	Yes	na
	Trades Recognition Australia	2.1	2.1	100.0	2.2	95.5	Yes	na
Comcare	*OH&S Act administration*	4.2	4.2	100.0	4.2	100.0	Yes	na
	Licensing under Safety Rehabilitation Compensation Act 1988	1.0	1.0	100.0	1.0	100.0	Yes	na
	Training activities	0.2	0.2	100.0	0.2	100.0	No	na
NICNAS	*New chemical assessment fees*	1.6	1.6	100.0	1.6	100.0	Yes	Retained
	Existing chemicals assessment	2.1	2.2	95.5	2.1	100.0	Yes	Retained
	Publications and seminars	—	—	100.0	—	100.0	na	Adjustment

[a] Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. [b] Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable. — Rounds to zero.

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

Table B.33 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Job search touch screen units leased to Job Network members*	Direct	na	na	No
	IT implementation and training	Direct/Indirect	na	na	No
	Relocating IT functions	na	na	na	na
	Office of workplace services	Direct/Indirect	na	na	No
	Personnel operations training	Direct	na	na	No
	Public sector team	Direct	na	na	No
	Trades Recognition Australia	Direct	na	na	No
Comcare	*OH&S Act administration*	Direct/Indirect	Activity based costing	na	No
	Licensing under Safety Rehabilitation Compensation Act 1988	Direct/Indirect	Activity based costing	na	No
	Training activities	Direct/Indirect	Activity based costing	na	No
NICNAS	*New chemical assessment fees*	Direct/Indirect	Activity based costing	na	No
	Existing chemicals assessment	Direct/Indirect	Activity based costing	na	No
	Publications and seminars	Direct	na	na	No

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.34 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Job search touch screen units leased to Job Network members*	No Act	No consultation	Other	No ongoing consultation	No
	IT implementation and training	Other Act	Govt/Industry	None	Consumers	No
	Relocating IT functions	Other Act	na	na	No ongoing consultation	na
	Office of workplace services	No Act	No consultation	None	No ongoing consultation	No
	Personnel operations training	FMA	Govt	Cwealth	Govt	Yes (2000)
	Public sector team	FMA	Govt	Cwealth	Govt	Yes (2000)
	Trades Recognition Australia	Other Act	Govt	Cwealth	No ongoing consultation	No
Comcare	*OH&S Act administration*	Other	Govt	DOFA	Govt	Yes
	Licensing under Safety Rehabilitation Compensation Act 1988	Other	Govt	DOFA	Govt	Yes (1999-2000)
	Training activities	Other	Govt	DOFA	No ongoing consultation	No
NICNAS	*New chemical assessment fees*	Other Act	Govt/Industry/ Consumers	Independent from Govt	Govt/Industry	Yes (1997)
	Existing chemicals assessment	Other Act	Govt/Industry	Independent from Govt	Govt/Industry	Yes (2000)
	Publications and seminars	No Act	Govt/Industry	Cwealth	Govt/Industry	No

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.35 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Job search touch screen units leased to Job Network members*	DEWRSB	DEWRSB	DEWRSB	DEWRSB
	IT implementation and training	DEWRSB	DEWRSB	DEWRSB	DEWRSB
	Relocating IT functions	na	na	na	na
	Office of workplace services	na	na	na	na
	Personnel operations training	na	na	DEWRSB	DEWRSB
	Public sector team	DEWRSB	DEWRSB	DEWRSB	DEWRSB
	Trades Recognition Australia	DEWRSB	DEWRSB	DEWRSB	DEWRSB
Comcare	*OH&S Act administration*	DEWRSB	SRCC	Comcare	Comcare
	Licensing under Safety Rehabilitation Compensation Act 1988	DEWRSB	SRCC	Comcare	Comcare
	Training activities	DEWRSB	Comcare	Comcare	Comcare
NICNAS	*New chemical assessment fees*	DEWRSB	DEWRSB	NICNAS	NICNAS
	Existing chemicals assessment	DEWRSB	DEWRSB	NICNAS	NICNAS
	Publications and seminars	DEWRSB	NICNAS	NICNAS	NICNAS

na Not available. **..** Not applicable.

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

B.8 Portfolio: Finance and Administration

Table B.36 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Access to Government information*	Fee	Policy	na	na
AEC	*Roll management*	Fee	..	1991	Annually (changed), reviewed (3 yearly)
	Roll products and services	Fee	User	na	Periodic review
	Industrial elections & ballots	Fee	CN	1997	Periodic review
	ATSIC elections	Fee	User	1990	Annually
	State & local govt. elections	Fee	CN	na	Periodic review
	Overseas election assistance	Fee	User	na	Periodic review
ComSuper	*Superannuation administration services*	Fee	Purchaser-provider	1998-99	Annually

a Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services; CN = Competitive neutrality. **na** Not available. **..** Not applicable.

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

Table B.37 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%	na	na
Department	*Access to Government information*	12.0	12.0	100.0	13.2	91.4	na	na
AEC	*Roll management*	0.1	0.3	31.6	5.4	46.1	na	na
	Roll products and services	0.2	0.7	23.8	0.7	23.8	na	Retained
	Industrial elections & ballots	1.1	8.8	12.1	8.8	12.1	na	Retained
	ATSIC elections	5.0	5.0	100.0	5.3	93.8	na	..
	State & local govt. elections	2.1	2.1	100.0	1.9	110.8	na	Retained
	Overseas election assistance	3.5	4.5	77.4	4.3	104.6	na	Retained
Comsuper	*Superannuation administration services*	39.0	39.9	98.9	38.8	101.6	na	Retained

[a] Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. [b] Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable.

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

Table B.38 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Access to Government information*	na	Activity based costing	Market value	na
AEC	*Roll management*	Direct	na	na	No
	Roll products and services	Direct/Indirect	Pro rata (salary)	na	No
	Industrial elections & ballots	Direct/Indirect	Pro rata (salary)	na	Yes
	ATSIC elections	Direct	na	na	No
	State & local govt. elections	Direct/Indirect	Pro rata (salary)	na	Yes
	Overseas election assistance	Direct/Indirect	Pro rata (salary)	na	No
Comsuper	*Superannuation administration services*	..	Activity based costing	Deprival	Yes

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.39 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Access to Government information*	Other Act	Govt	na	na	In progress
AEC	*Roll management*	FMA	Govt	DOFA	Govt	Yes
	Roll products and services	FMA	Govt	DOFA/Internal	Govt	Yes
	Industrial elections & ballots	FMA/Other Act	na	DOFA/Internal	na	In progress
	ATSIC elections	FMA/Other Act	Govt	..	na	Yes
	State & local govt. elections	FMA	na	DOFA/Internal	na	In progress
	Overseas election assistance	FMA	na	DOFA/Internal	na	na
Comsuper	*Superannuation administration services*	FMA	Govt	External	DOFA/Board of trustees	No

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.40 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Access to Government information*	DOFA	DOFA	DOFA	DOFA
AEC	*Roll management*	AEC	AEC	AEC	AEC
	Roll products and services	AEC	AEC	AEC	AEC
	Industrial elections & ballots	AEC	AEC	AEC	AEC
	ATSIC elections	AEC	AEC	AEC	AEC
	State & local govt. elections	AEC	AEC	AEC	AEC
	Overseas election assistance	AEC	AEC	AEC	AEC
ComSuper	*Superannuation administration services*	DOFA	ComSuper	ComSuper	ComSuper

na Not available. **..** Not applicable.

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

B.9 Portfolio: Foreign Affairs and Trade

Table B.41 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Passports*	Fee	Beneficiary/Revenue/Demand	na	Annually
	Consular services	Fee	Demand	1955	10 years
	Market development division	Fee	Policy	1992	Annually
	Australian safeguards and non-proliferation office	Levy	Beneficiary	1993	Annually
	East asia analytical unit	Fee	na	na	Ad hoc
	Finance management branch	Fee	Policy	1998	Six monthly
Austrade	*Client service policy*	Fee	Policy	1998	Irregularly
	Trade promotion activities	Fee	Revenue	1986	Ad hoc
	Programs funded by external organisations	Fee	Services	1986	Ad hoc

[a] Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.42 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Passports*	126.7	126.7	100.0	0.0	na	No	na
	Consular services	1.2	1.2	100.0	0.0	na	No	na
	Market development division	—	—	100.0	—	69.6	No	Retained
	Australian safeguards and non-proliferation office	0.5	na	..	na	..	No	na
	East asia analytical unit	0.1	0.1	100.0	0.8	6.3	No	na
	Finance management branch	14.6	14.6	100.0	0.0	na	No	na
Austrade	*Client service policy*	8.5	103.5	8.2	103.5	8.21	Yes	Retained
	Trade promotion activities	4.5	4.5	100.0	4.5	100.0	Yes	Retained
	Programs funded by external organisations	15.8	15.8	100.0	15.8	100.0	Yes	Retained

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable. — Rounds to zero.

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

Table B.43 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Passports*	na	na	na	na
	Consular services	na	No	na	No
	Market development division	Direct	na	na	na
	Australian safeguards and non-proliferation office	na	Activity based costing	na	na
	East asia analytical unit	Direct	na	na	No
	Finance management branch	Direct/Indirect	na	No	No
Austrade	*Client service policy*	Direct/Indirect	na	na	No
	Trade promotion activities	Direct/Indirect	Activity based costing	na	No
	Programs funded by external organisations	Direct/Indirect	Activity based costing	Deprival	Yes

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.44 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Passports*	Other Act	Govt	na	na	No
	Consular services	Other Act	Govt	na	na	No
	Market development division	FMA	Govt	Cwealth	No ongoing consultation	na
	Australian safeguards and non-proliferation office	Other Act	Govt	na	No ongoing consultation	Yes (1987)
	East asia analytical unit	na	na	na	na	na
	Finance management branch	No Act	Govt	na	na	No
Austrade	*Client service policy*	Other Act	Govt	Cwealth	Govt/Industry/ Consumers	Yes (1998)
	Trade promotion activities	Other Act	Govt	DOFA	Consumers	Yes (1996)
	Programs funded by external organisations	Other Act	Govt	DOFA	Consumers	Yes

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.45 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Passports*	DFAT	Legislation	DFAT/DOFA	DFAT
	Consular services	DFAT	Governer General	DFAT	DFAT
	Market development division	na	MIA/DFAT	MIA/DFAT	MIA/DFAT
	Australian safeguards and non-proliferation office	DFAT	DFAT	DFAT	DFAT
	East asia analytical unit	na	na	na	na
	Finance management branch	DFAT	DFAT	DFAT	DFAT
Austrade	*Client service policy*	Austrade/DFAT	Austrade	Austrade	Austrade
	Trade promotion activities	Austrade/DFAT	Austrade	Austrade	Austrade
	Programs funded by external organisations	Austrade/DOFA	Austrade	Austrade	Austrade

na Not available. **..** Not applicable.

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

B.10 Portfolio: Family and Community Services

Table B.46 **Overview of arrangements**

+Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Australian Institute of Family Studies	*Publications*	Fee	na	1980	Regularly
	Contract research	Fee	na	1980	Regularly
Centrelink	*Business partnership agreements*	Fee	User	1997	Annually

a Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.47 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Australian Institute of Family Studies	*Publications*	0.1	0.1	100.0	0.2	50.0	na	Retained
	Contract research	0.6	0.6	100.0	0.6	100.0	na	Retained
Centrelink	*Business partnership agreements*	na	1 680	na	na	na	na	Retained

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable.

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

Table B.48 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Australian Institute of Family Studies	*Publications*	Direct/Indirect	Pro rata	Historic	No
	Contract research	Direct/Indirect	Pro rata	Historic	Yes
Centrelink	*Business partnership agreements*	Direct/Indirect	Pro rata	Historic	No

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.49 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Australian Institute of Family Studies	*Publications*	Other Act	na	DOFA	Stakeholders	Yes (2001)
	Contract research	Other Act	na	DOFA	Govt/Industry/Consumers	Yes (1999)
Centrelink	*Business partnership agreements*	FMA/Other Act	na	na	Client/DOFA	Yes (2001)

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.50 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Australian Institute of Family Studies	*Publications*	AIFS	AIFS	AIFS	AIFS
	Contract research	AIFS	AFIS	AFIS	AFIS
Centrelink	*Business partnership agreements*	Client	Centrelink/DOFA	na	na

na Not available. **..** Not applicable.

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

B.11 Portfolio: Health and Aged Care

Table B.51 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*TGA*	Fee/Tax	Policy/User	1990	Annually
ANZFA	*Publications*	Royalties/Fee	Users	1991	na
AIHW	*Statistical services*	Fee	Services	1987	na
ARPANSA	*Regulation*	Fee	User	1999	Annually
HIC	*Consultancy services and sale of statistics*	Fee	User	na	na

a Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.52 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*TGA*	41.4	43.8	94.7	49.0	84.5	Both	Retained
ANZFA	*Publications*	0.8	13.6	5.9	13.1	6.1	No	na
AIHW	*Statistical services*	9.2	17.8	51.9	17.7	52.0	No	Refund/Retained
ARPANSA	*Regulation*	1.2	3.8	31.6	3.6	33.5	No	Adjustment
HIC	*Consultancy services and sale of statistics*	8.8	391.5	2.2	416.3	2.1	na	na

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable.

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

Table B.53 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*TGA*	Direct/Indirect	Activity based costing	Deprival	No
ANZFA	*Publications*	Direct/Indirect	% of direct costs	..	No
AIHW	*Statistical services*	Direct/indirect	% of non-salary costs	na	No
ARPANSA	*Regulation*	Direct/Indirect	Pro rata (labour)	..	No
HIC	*Consultancy services and sale of statistics*	Direct/Indirect	% of direct costs	na	No

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.54 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*TGA*	Tax Act/ Other Act	Govt/Industry/ Consumers	na	Industry/Consumers	No
ANZFA	*Publications*	Other Act	Govt/Industry/ Consumers	DOFA/Other	Industry/Consumers	No
AIHW	*Statistical services*	na	Govt	Cwealth	DHAC/FaCS	Yes (1999)
ARPANSA	*Regulation*	Other Act	Govt	DOFA/Other	Minister/Industry	No
HIC	*Consultancy services and sale of statistics*	na	Govt	na	No ongoing consultation	No

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.55 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*TGA*	TGA	TGA	TGA	TGA
ANZFA	*Publications*	ANZFA	ANZFA	ANZFA	ANZFA
AIHW	*Statistical services*	AIHW/DHAC/FaCS	AIHW/DHAC/FaCS	AIHW	AIHW
ARPANSA	*Regulation*	ARPANSA	ARPANSA	ARPANSA	ARPANSA
HIC	*Consultancy services and sale of statistics*	HAC/HIC	HAC/HIC	HIC	HIC

na Not available. **..** Not applicable.

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

B.12 Portfolio: Immigration and Multicultural Affairs

Table B.56 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Miscellaneous*	Fee	User/Revenue/Demand	Mid-80s	Annually
	Translating and Interpreting Services	Fee	User/ Revenue/Demand	1992	Irregularly
	Visa Application Charges	Fee	User/Demand	Mid-80s	Annually
	Citizenship fees	Fee	User	na	Annually
MARA	*Registration*	Fee	Revenue/User	1998	Annually
MRT	*Review of DIMA visa decisions*	Fee	Policy	1999	Irregularly
RRT	*Review of DIMA visa decisions*	Fee	Policy	1999	Irregularly

[a] Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.57 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Miscellaneous*	3.0	8.0	37.5	6.0	50.0	No	Retained
	Translating and Interpreting Services	9.5	24.5	38.8	24.5	38.8	Yes	Retained
	Visa Application Charges	204.1	743.0	27.5	515.4	39.6	No	CRF
	Citizenship fees	8.0	na	na	21.0	38.1	No	CRF
MARA	*Registration*	1.8	1.8	100.0	1.8	100.0	Yes	..
MRT	*Review of DIMA visa decisions*	5.9	na	na	11.7	50.4	No	CRF
RRT	*Review of DIMA visa decisions*	0.7	na	na	17.9	3.9	No	CRF

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable.

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

Table B.58 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Miscellaneous*	Direct/Indirect	Activity based costing	na	na
	Translating and Interpreting Services	Direct/Indirect	Pro rata	Historic	No
	Visa Application Charges	..	..	..	..
	Citizenship fees	..	..	..	..
MARA	*Registration*	Direct/Indirect	Pro rata	Historic	No
MRT	*Review of DIMA visa decisions*	..	..	..	..
RRT	*Review of DIMA visa decisions*	..	..	..	..

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.59 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Miscellaneous*	FMA	Govt	DOFA	DOFA/Industry	Yes
	Translating and Interpreting Services	FMA	Govt	DOFA	Minister	Yes (2000)
	Visa Application Charges	Other Act	Govt	DOFA	Minister/Govt/Industry	Yes (1997)
	Citizenship fees	Other Act	Govt	DOFA	Minister/Govt	Yes (1999)
MARA	*Registration*	Other Act	Govt/Industry/Consumers	DOFA	Industry/Minister	Yes (1997, 1999)
MRT	*Review of DIMA visa decisions*	Other Act	Govt	DOFA	DOFA/Minister	Yes
RRT	*Review of DIMA visa decisions*	Other Act	Govt	DOFA	DOFA/Minister	Yes

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.60 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Miscellaneous*	DIMA	DIMA	DIMA	DIMA
	Translating and Interpreting Services	DIMA/Minister	DIMA	DIMA	DIMA
	Visa Application Charges	DIMA/Govt/Minister	DIMA/Minister/DOFA	DIMA	DIMA
	Citizenship fees	DIMA/Govt/Minister	DIMA/Minister/DOFA	DIMA	DIMA
MARA	*Registration*	DIMA/Govt/Minister	DIMA/Minister	DIMA	MARA
MRT	*Review of DIMA visa decisions*	DIMA/Govt/Minister	Govt	MRT	MRT
RRT	*Review of DIMA visa decisions*	DIMA/Govt/Minister	Govt	RRT	RRT

na Not available. **..** Not applicable.

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

B.13 Portfolio: Industry, Science and Resources

Table B.61 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Refining and Fuels Section*	Fee	Beneficiary	Mid 1980s	Irregularly
	Australian Diver Accreditation	Fee	Policy	1987	Irregularly
	Supplier Access to Major Projects	Fee	Beneficiary	1998-99	na
	Bizlink	Fee	na	Around 1994	No changes
	Emerging Technologies	Fee	Demand	1999	No changes (new programme)
	Innovation Investment Fund	Fee	Demand/User	1997	Irregularly
	Australian Government Analytical Laboratories	Fee	Policy	1987	Annually
	Space Licencing and Safety Office	Fee	Policy	Charges not yet in place	Biennially
	IPS Radio and Space Services	Fee	Administrative decision	1985	Annually
AUSLIG		Fee	na	1950s	Annually
AGSO		Fee	Policy	1988	Regularly
CSIRO		Fee	Encourage links with industry	1949	Regularly
IP Australia		Fee	Policy	1984	Annually
NSC		Fee	Policy	1983	Changes frozen since 1996
ATC	*Trade Events*	Fee	Revenue	Early 1990s	Irregularly
	Advertising	Fee	Revenue/User	Early 1990s	Annually
	Co-operative Marketing Agreements	Fee	Services	Prior to 1996	na
ANSTO		Fee	na	1980s	Annually
ASC		Fee	na	1980s	Annually
BTR		Fee	Policy	1987	Annually
AIMS		Fee	Encourage links with industry	1988	Annually

[a] Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.62 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Refining and Fuels Section*	—	—	100.0	0.1	17.1	..	Retained
	Australian Diver Accreditation	—	—	100.0	0.1	14.3	No	na
	Supplier Access to Major Projects	na	na	na	na	na	na	na
	Bizlink	0.1	5.6	1.3	5.6	1.3	Yes	..
	Emerging Technologies	0.1	0.8	12.5	0.8	12.5	No	Retained
	Innovation Investment Fund	0.1	0.1	100	1.0	8.7	Yes	..
	Australian Government Analytical Laboratories	19.4	30.3	64.1	30.2	64.2	No	na
	Space Licencing and Safety Office[c]	0.0	0.0	..	0.0	..	..	na
	IPS Radio and Space Services	0.1	3.8	2.8	3.7	2.8	Yes	na
AUSLIG		4.7	33.2	14.2	33.2	14.2	No	Adjustment/ Services
AGSO		12.1	75.0	16.2	73.5	16.5	Yes	Retained
CSIRO		250.4	895.2	28.0	775.3	32.3	No	Retained
IP Australia		72.8	74.6	97.6	72.2	100.8	No	Retained
NSC		0.7	1.3	58.2	1.4	53.4	No	..[d]
ATC	*Trade Events*	na	16.4	na	21.5	na	na	Services
	Advertising	na	4.8	na	5.9	na	na	Services
	Co-operative Marketing Agreements	4.0	4.0	100.0	10.9	36.8	No	na

(continued on next page)

Table B.62 (continued)

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
ANSTO		29.9	98.1	30.5	na	na	No	na
ASC		5.8	136.1	4.3	137.1	4.2	No	Retained
BTR		0.6	4.4	12.9	4.3	13.2	No	..[d]
AIMS		4.6	30.3	15.2	27.0	17.0	No	Retained

[a] Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. [b] Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. [c] The Space Licencing and Safety Office is a new agency which is not yet charging for its activities. [d] Revenue raised by this agency has not exceeded costs. **CR** Cost recovery. **na** Not available. **..** Not applicable. — Rounds to zero.

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

Table B.63 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Refining and Fuels Section*	Direct	..	na	No
	Australian Diver Accreditation	Direct	Activity based costing	..	..
	Supplier Access to Major Projects	na	na	na	na
	Bizlink	Direct	..	..	No
	Emerging Technologies	na	..	..	No
	Innovation Investment Fund	na	..	..	No
	Australian Government Analytical Laboratories	Direct/indirect	Pro rata	Deprival	Yes
	Space Licencing and Safety Office	Direct/Indirect	Activity based costing	..	No
	IPS Radio and Space Services	Direct	Pro rata	..	No
AUSLIG		Direct/Indirect	Activity based costing	Deprival	No
AGSO		Direct/Indirect and Total Plus	na	Historic	No
CSIRO		Direct/Indirect	Pro rata (labour)	Deprival	Yes
IP Australia		Direct/Indirect	Activity based costing	Replacement/Deprival	Yes
NSC		Direct/Indirect	Pro rata	Deprival	No
ATC	*Trade Events*	Direct	..	..	No
	Advertising	..	..	..	No
	Co-operative Marketing Agreements	na	..	..	No
ANSTO		Direct/Indirect	Pro rata	Deprival	Yes
ASC		Direct	na	..	No
BTR		Direct	Pro rata (labour)	..	No
AIMS		Direct/Indirect	Pro rata (labour)	Fair value	Yes

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.64 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Refining and Fuels Section*	FMA	Govt/Consumers	None	Consumers	No
	Australian Diver Accreditation	FMA	Govt/Industry	..	Govt/Industry	No
	Supplier Access to Major Projects	No Act	Govt	na	No ongoing consultation	Yes (1999)
	Bizlink	na	Govt	DOFA	No ongoing consultation	No
	Emerging Technologies	Other Act	na	na	No ongoing consultation	No
	Innovation Investment Fund	Other Act	Govt	None	No ongoing consultation	No
	Australian Government Analytical Laboratories	FMA	na	DOFA	Govt/industry	Under review
	Space Licencing and Safety Office	Other Act	Govt/Industry	DOFA/Other	Govt/Industry	..
	IPS Radio and Space Services	FMA	Govt/Consumers	DOFA	No ongoing consultation	na
AUSLIG		FMA	na	Other	Govt/Industry/ Consumers	Under review
AGSO		FMA	Govt	DOFA	Govt/Industry	Under review
CSIRO		Other Act	Govt/Industry/ Consumers	Internal/Cwealth	Govt/Industry/ Consumers	Yes (1997)
IP Australia		FMA	Govt/Industry	DOFA	Govt/Industry	Yes (1999)
NSC		Other Act	Govt	None	Govt/Industry	Yes (1992)
ATC	*Trade Events*	Other Act	No consultation	None	Govt/Industry	No
	Advertising	Other Act	Govt/Industry/ Consumers	..	Industry	No
	Co-operative Marketing Agreements	Other Act	Industry	na	na	..
ANSTO		na	Govt	Internal	Govt	na

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Table B.64 (continued)

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
ASC		No Act	Govt	None	No ongoing consultation	No
BTR		No Act	Govt	Cwealth	Govt/Industry/ Consumers	Under review
AIMS		Other Act	Govt/Industry/ Consumers	Internal/Cwealth	Govt/Industry/ Consumers t	Yes

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.65 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Refining and Fuels Section*	DISR	DISR	DISR	DISR
	Australian Diver Accreditation	DISR	DISR	DISR	DISR
	Supplier Access to Major Projects	DISR	na	DISR	na
	Bizlink	AusIndustry	AusIndustry	AusIndustry	AusIndustry
	Emerging Technologies	DISR	DISR	AusIndustry	DISR
	Innovation Investment Fund	Industry Research and Development Board	Industry Research and Development Board	DISR	DISR
	Australian Government Analytical Laboratories	DISR	DISR	DISR	DISR
	Space Licencing and Safety Office	DISR	DISR	DISR	DISR
	IPS Radio and Space Services	DISR	IPS	IPS	IPS
AUSLIG		AUSLIG	AUSLIG	AUSLIG	AUSLIG
AGSO		AGSO	AGSO	AGSO	AGSO
CSIRO		CSIRO	CSIRO	CSIRO	CSIRO
IP Australia		IP Australia, DISR, DFAT	IP Australia	IP Australia	IP Australia
NSC		NSC	NSC	NSC	NSC
ATC	*Trade Events*	ATC	ATC	ATC	ATC
	Advertising	ATC	ATC	ATC	ATC
	Co-operative Marketing Agreements	na	na	na	na
ANSTO		ANSTO	ANSTO	ANSTO	ANSTO
ASC		ASC	ASC	ASC	ASC
BTR		Ministerial Council	BTR	BTR	BTR
AIMS		AIMS	AIMS	AIMS	AIMS

na Not available. **..** Not applicable.

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

B.14 Portfolio: Prime Minister and Cabinet

Table B.66 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Photographic services; management of advertising accounts; sale of books*	Fee	na	na	na
AIATSIS	*Archives and production*	Fee	na	1964	na
ANAO	*Auditing*	Fees	na	na	Annually
Office of the Commonwealth Ombudsman	*ACT Ombudsman Function*	Fee	na	1996	Annually
	ATO tax reform complaint service	Fee	na	1999-2000	na
Office of the Inspector-General of Intelligence and Security	*Inquiry for Minister for Defence*	Fee	na	na	na
Office of the Official Secretary to the Governor-General	*Replacement awards*	Fee	na	1975	Irregularly
PSMPC	*Training, employment related functions, employment notices*	Fee	na	Late 80s (training), 1994 (employment), prior to 1999 (notices)	Regularly

[a] Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.67 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Photographic services; management of advertising accounts; sale of books*	3.8	3.8	100.0	2.2	171.2	No	Retained
AIATSIS	*Archives and production*	0.3	0.3	100.0	0.4	85.7	No	Retained
ANAO	*Audit fees*	10.6	60.1	17.6	45.4	23.2	No	na
Office of the Commonwealth Ombudsman	*ACT Ombudsman Function*	0.2	0.2	100.0	na	na	No	na
	ATO tax reform complaint service	0.2	0.2	100.0	na	na	No	na
Office of the Inspector-General of Intelligence and Security	*Inquiry for Minister for Defence*	0.1	0.1	100.0	0.1	100.0	No	..
Office of the Official Secretary to the Governor-General	*Replacement awards*	—	—	100.0	na	na	No	na
PSMPC	*Training, employment related functions, employment notices*	8.4	8.4	100.0	22.6	37.2	Yes	Retained

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable. — Rounds to zero.

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

Table B.68 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Photographic services; management of advertising accounts; sale of books*	na	Pro-rata	na	na
AIATSIS	*Archives and production*	Direct	na	na	na
ANAO	*Audit fees*	na	Pro-rata	na	No
Office of the Commonwealth Ombudsman	*ACT Ombudsman Function*	Labour	..	na	No
	ATO tax reform complaint service	Labour	..	na	No
Office of the Inspector-General of Intelligence and Security	*Inquiry for Minister for Defence*	Direct	na	na	na
Office of the Official Secretary to the Governor-General	*Replacement awards*	na	na	na	No
PSMPC	*Training, employment related functions, employment notices*	Direct (training and employment), Direct/indirect (notices)	Pro-rata	..	No

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity'. Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.69 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Photographic services; management of advertising accounts; sale of books*	FMA	Govt	na	na	Yes
AIATSIS	*Archives and production*	Other Act	na	na	Govt	na
ANAO	*Audit fees*	Other Act	Govt	na	No ongoing consultation	Yes
Office of the Commonwealth Ombudsman	*ACT Ombudsman Function*	Other Act	Govt	na	Govt	No
	ATO tax reform complaint service	FMA	Govt	None	Govt	No
Office of the Inspector-General of Intelligence and Security	*Inquiry for Minister for Defence*	No Act	Govt	..	No ongoing consultation	Yes
Office of the Official Secretary to the Governor-General	*Replacement awards*	na	na	na	No ongoing consultation	No
PSMPC	*Training, employment related functions, employment notices*	FMA/Other Act	Govt	DOFA	No ongoing consultation	Yes

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.70 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Photographic services; management of advertising accounts; sale of books*	PM&C	PM&C	PM&C	PM&C
AIATSIS	*Archives and production*	AIATSIS	AIATSIS	AIATSIS	AIATSIS
ANAO	*Audit fees*	PM&C	ANAO	ANAO	ANAO
Office of the Commonwealth Ombudsman	*ACT Ombudsman Function*	na	na	na	na
	ATO tax reform complaint service	na	na	na	na
Office of the Inspector-General of Intelligence and Security	*Inquiry for Minister for Defence*	na	na	na	na
Office of the Official Secretary to the Governor-General	*Replacement awards*	na	na	na	na
PSMPC	*Training, employment related functions, employment notices*	PSMPC	PSMPC	PSMPC	PSMPC

na Not available. **..** Not applicable.

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

B.15 Portfolio: Treasury

Table B.71 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Corporate services for the AOFM*	Fee	User	1999-2000	Annually
	Ministerial support provided to portfolio agencies	Fee	User	1993 Approx.	Annually
	AGA - Actuarial services	Fee	Demand	1990 Approx.	Annually
	AGA - Sale of publications	Fee	na	Early 90s	Five yearly
	Sale of TRYM model	Fee	User	1995-96 Approx.	Adhoc
	Sale of Treasury publications	Fee	na	Pre 1995	Annually
	Corporations and Securities Panel - transcript and experts' costs,	Fee	na	2000	na
ABS		Fee	Demand/Revenue	1988	Annually
ACCC	*Telecommunication regulation*	Fee	Policy	1997	Annually
	TPA fees	Fee	Policy	na	Adhoc
	Contract work, room hire, etc	Fee	na	na	na
AOFM	*Sale of publications*	Fee	na	1999	Annually
APRA	*Prudential regulation of financial institutions*	Levy	Beneficiary	1998[b]	Annually
ASIC	*Regulation of companies and securities markets*	Fee	Beneficiary/Policy	1991[c]	Annually
ATO	*Incidental activities*	Fee	na	na	Annually
	AVO - Valuation activities	Fee	na	na	na
NCC	*National gas code application fees*	Fees	na	1999	No reviews
	Speeches to communications conference	Fees	Beneficiary	1998	Regularly
PC	*Library services*	Fee	na	1995-96	Irregularly
	Sale of publications	Fee	na	1999 Approx.	Annually
	Consultancy work	Fee	na	na	Annually
RBA	*Sale of some publications*	Fee	Demand	1981	Irregularly
Royal Australian Mint	*Minting of coins*	Fee	na	na	na

[a] Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. [b] Financial supervision fees were in existence before this date. [c] Company fees were in existence before this date. **na** Not available. **..** Not applicable.

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

Table B.72 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Corporate services for the AOFM*	0.6	0.6	100.0	0.6	100.0	No	..
	Ministerial support provided to portfolio agencies	0.3	0.3	100.0	0.3	100.0	No	..
	AGA - Actuarial services	0.9	0.9	100.0	0.3	250.7	No	Retained
	AGA - Sale of publications	—	—	100.0	na	na	No	..
	Sale of TRYM model	—	—	100.0	na	na	Yes	..
	Sale of Treasury publications	0.2	0.2	100.0	0.3	50.0	No	..
	Corporations and Securities Panel — transcript and experts' costs,	—	2.3	0.6	1.0	1.3	No	..
ABS		21.5	265.0	8.1	255.5	8.4	Yes	Retained
ACCC	*Telecommunication regulation*	2.8	2.8	100.0	2.8	100.0	No	..
	TPA fees	1.2	1.2	100.0	na	na	No	..
	Contract work, room hire, etc	0.2	0.2	100.0	na	na	No	na
AOFM	*Sale of publications*	na	na	na	na	na	na	..
APRA	*Prudential regulation of financial institutions*	61.2[c]	64.7	94.6	58.8	104.1	No	Adjustment
ASIC	*Regulation of companies and securities markets*	201.0 [d]	201.0	100.0	144.8	138.8	No	CRF
ATO	*Incidental activities*	101.0	108.1	93.4	101.0	100.0	No	Refund
	AVO - Valuation activities	17.7	18.1	97.8	17.1	103.5	No	Retained
NCC	*National gas code application fees*	0.1	0.1	100.0	0.2	27.9	No	..
	Speeches to communications conference	—	—	100.0	—	69.0	No	..

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Table B.72 (continued)

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
PC	*Library services*	—	—	100.0	—	100.0	No	Retained
	Sale of publications	—	—	100.0	—	100.0	No	Retained
	Consultancy work	—	—	100.0	—	100.0	No	Retained
RBA	*Sale of some publications*	0.1	0.1	100.0	0.2	27.0	No	na
Royal Australian Mint	*Minting of coins*	115.0	115.0	100.0	46.9	245.1	No	CRF

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **c** Does not include transfers to ASIC and the ATO. **d** Does not include transfers to third parties. **CR** Cost recovery. **na** Not available. **..** Not applicable. — Rounds to zero.

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

Table B.73 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Corporate services for the AOFM*	Direct	Pro-rata	na	No
	Ministerial support provided to portfolio agencies	Direct	Pro-rata	na	No
	AGA - Actuarial services	Direct/Indirect	na	..	No
	AGA - Sale of publications	na	na	..	No
	Sale of TRYM model	na	na	na	na
	Sale of Treasury publications	Direct (printing)	Pro-rata	..	No
	Corporations and Securities Panel - transcript and experts' costs	Direct (some)	na	..	No
ABS		Direct/Indirect	Pro rata (direct labour costs)	Historic	No
ACCC	*Telecommunication regulation*	Direct/Indirect	na	na	No
	TPA fees	na	..	..	No
	Contract work, room hire, etc	Direct/Indirect	na	na	No
AOFM	*Sale of publications*	na	na	na	na
APRA	*Prudential regulation of financial institutions*	Direct/Indirect	Pro rata	na	No
ASIC	*Regulation of companies and securities markets*	Total plus	na	na	No
ATO	*Incidental activities*	Direct/Indirect	na	..	No
	AVO – Valuation activities	Direct/Indirect	Rule of thumb	Deprival	Yes
NCC	*National gas code application fees*	na	na	..	No
	Speeches to communications conference	Direct	..	na	No

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Table B.73 (continued)

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
PC	*Library services*	Direct	na	..	No
	Sale of publications	Direct (printing, postage)	..	..	No
	Consultancy work	Direct/Indirect	na	..	No
RBA	*Sale of some publications*	Direct	na	na	No
Royal Australian Mint	*Minting of coins*	Direct/Indirect	Pro-rata	Deprival	No

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.74 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Corporate services for the AOFM*	No Act	Govt	..	Govt	Yes
	Ministerial support provided to portfolio agencies	No Act	Govt	..	na	na
	AGA - Actuarial services	FMA	Govt	na	No ongoing consultation	No
	AGA - Sale of publications	FMA	Govt	na	No ongoing consultation	No
	Sale of TRYM model	FMA	Govt	Cwealth	Govt	Yes
	Sale of Treasury publications	FMA	Govt	Cwealth	No ongoing consultation	No
	Corporations and Securities Panel - transcript and experts' costs,	No Act	Industry	na	Industry	No
ABS		FMA/Other Act	Govt	DOFA	Govt/Industry	No
ACCC	*Telecommunication regulation*	Tax Act	Govt	na	na	na
	TPA fees	Other Act	Govt	na	na	na
	Contract work, room hire, etc	FMA	na	na	No ongoing consultation	na
AOFM	*Sale of publications*	FMA	Govt	DOFA/ Cwealth	No ongoing consultation	No
APRA	*Prudential regulation of financial institutions*	Tax Acts	Govt/Industry	Other	Govt/Industry	Yes (2001)
ASIC	*Regulation of companies and securities markets*	Tax Act	Govt	Cwealth/ Other	No ongoing consultation	Yes (2001)
ATO	*Incidental activities*	No Act	Govt	Internal	Govt	na
	AVO - Valuation activities	FMA	Govt	DOFA	No ongoing consultation	Not recently
NCC	*National gas code application fees*	Other Act	Govt/industry	Cwealth	Govt	No
	Speeches to communications conference	na	na	na	na	No

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Table B.73 (continued)

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
PC	*Library services*	FMA	Govt	DOFA	Consumers	Yes (1997)
	Sale of publications	FMA	Consumers	Internal	No ongoing consultation	No
	Consultancy work	FMA	Govt	Internal	No ongoing consultation	No
RBA	*Sale of some publications*	No Act	na	Internal	No ongoing consultation	Yes
Royal Australian Mint	*Minting of coins*	No Act	Govt	na	Govt	Yes

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.75 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Corporate services for the AOFM*	Treasury	Treasury	Treasury	Treasury
	Ministerial support provided to portfolio agencies	Treasury	Treasury	Treasury	Treasury
	AGA - Actuarial services	Treasury	Treasury	Treasury	Treasury
	AGA - Sale of publications	Treasury	Treasury	Treasury	Treasury
	Sale of TRYM model	Treasury/ABS	Treasury/ABS	ABS	ABS
	Sale of Treasury publications	Treasury	Treasury	Treasury	Treasury
	Corporations and Securities Panel - transcript and experts' costs,	The panel	The panel	The panel	The panel
ABS		ABS	ABS	ABS	ABS
ACCC	*Telecommunication regulation*	Treasury	na	na	na
	TPA fees	Treasury	Treasury	ACCC	ACCC
	Contract work, room hire, etc	ACCC	ACCC	ACCC	ACCC
AOFM	*Sale of publications*	AOFM	AOFM/AUSINFO	AUSINFO	AUSINFO
APRA	*Prudential regulation of financial institutions*	APRA/Treasury	APRA/Treasury	APRA/DOFA	APRA/DOFA
ASIC	*Regulation of companies and securities markets*	Treasury	Treasury/Minister	ASIC	ASIC
ATO	*Incidental activities*	ATO	ATO	ATO	ATO
	AVO - Valuation activities	AVO	AVO	AVO	AVO
NCC	*National gas code application fees*	NCC	NCC	NCC	NCC
	Speeches to communications conference	NCC	NCC	NCC	NCC
PC	*Library services*	PC	PC	PC	PC
	Sale of publications	PC	PC	PC	PC
	Consultancy work	PC	PC	PC	PC
RBA	*Sale of some publications*	RBA	RBA	RBA	RBA
Royal Australian Mint	*Minting of coins*	Treasury	Treasury	Royal Australian Mint	Royal Australian Mint

na Not available. **..** Not applicable.

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

B.16 Portfolio: Transport and Regional Services

Table B.76 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
Department	*Noise amelioration program and airport environmental officers*	Fee	Policy	1995-2001	Annually (amelioration), Adhoc (airports)
	ATSB	Fee	na	1999	Adhoc
	Avstats	Fee	User/Demand	1993	na
	BTE	Fee	User/Demand	1996-97	Adhoc
	Coasting trade licence and permit fees	Fee	User	1997	na
	Part X (Trade Practices Act 1974) fees	Fee	na	1989	Irregularly
	Vehicle safety standards	Fees	User	1989	Irregularly
	IASC	Fee	User	na	na
AMSA	*Regulation and safety*	Levies	Policy/User	na	Annually
ASA	*Aeronautical services*	Fee	User	na	Anually (minimum)
CASA	*Aviation safety standards and regulation*	Excise/Fee	Policy/User/Beneficiary	1988	Bi-annually (CPI)
NCA	*Statutory fees, diplomatic leases*	Fee	na	na	na

[a] Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.77 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
Department	*Noise amelioration program and airport environmental officers*	39.9	39.9	100.0	60.9	65.6	Yes	.. (amelioration), refund (airports)
	ATSB	0.2	0.2	100.0	10.2	1.5	na	..
	Avstats	0.1	0.1	100.0	na	na	Yes	na
	BTE	—	—	100.0	—	100.0	Yes	na
	Coasting trade licence and permit fees	0.2	0.2	100.0	na	na	No	na
	Part X (Trade Practices Act 1974) fees	—	—	100.0	—	82.6	No	..
	Vehicle safety standards	7.4	7.4	100.0	6.8	108.3	Both	na
	IASC	na	na	..	na	..	No	..
AMSA	*Regulation and safety*	52.4	54.6	96.0	57.6	90.9	Yes	Retained
ASA	*Aeronautical services*	na	na	na	na	na	No	Retained
CASA	*Aviation safety standards and regulation*	59.9	98.9	60.6	83.7	71.6	Yes	na
NCA	*Statutory fees, diplomatic leases*	1.0	17.0	5.8	15.3	6.5	Yes	CRF

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable. — Rounds to zero.

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

Table B.78 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
Department	*Noise amelioration program and airport environmental officers*	Direct	..	na	No
	ATSB	Direct/Indirect	na	na	na
	Avstats	Direct	na	na	No
	BTE	Direct/Indirect	Pro-rata (direct)	na	No
	Coasting trade licence and permit fees	na	na	na	na
	Part X (Trade Practices Act 1974) fees	Direct/Indirect	Pro-rata (labour)	na	No
	Vehicle safety standards	na	na	na	na
	IASC	Less than direct	Fixed	..	..
AMSA	*Regulation and safety*	Direct/Indirect	Activity based costing	Deprival	Yes
ASA	*Aeronautical services*	Total plus	Pro rata (staff)	Deprival	Yes
CASA	*Aviation safety standards and regulation*	Direct/Indirect	na	Deprival	No
NCA	*Statutory fees, diplomatic leases*	..	..	..	Yes

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity. 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.79 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
Department	*Noise amelioration program and airport environmental officers*	Other Acts	Govt/Industry/ Public	Other	na	Yes
	ATSB	FMA	Govt	DOFA	Govt	No
	Avstats	na	Govt	DOFA	na	No
	BTE	FMA	Govt	DOFA	None	No
	Coasting trade licence and permit fees	Other Act	na	na	na	na
	Part X (Trade Practices Act 1974) fees	Other Act	na	na	None	No
	Vehicle safety standards	Other Act	na	na	na	Irregularly
	IASC	na	Industry	na	Industry and state govt.	No
AMSA	*Regulation and safety*	Tax Act/Other Act	Industry	Independent to Govt	Industry	Yes (1997)
ASA	*Aeronautical services*	Other Act	na	Internal	Industry/Consumers	Yes (2000)
CASA	*Aviation safety standards and regulation*	Tax Act/Other Act	Govt/Industry/ Consumers	Independent to Govt	Govt/Industry	Yes
NCA	*Statutory fees, diplomatic leases*	Other Act	Govt	Internal	No	Yes (1999)

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.80 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
Department	*Noise amelioration program and airport environmental officers*	DTRS	Treasury (amelioration), DTRS (airports)	DTRS	Airservices (amelioration), DTRS (airports)
	ATSB	DOFA	DTRS/ATSB	DTRS/ATSB	DTRS/ATSB
	Avstats	DTRS	DTRS	DTRS	DTRS
	BTE	BTE	BTE	BTE	BTE
	Coasting trade licence and permit fees	DTRS	DTRS	DTRS	DTRS
	Part X (Trade Practices Act 1974) fees	DTRS	DTRS	DTRS	DTRS
	Vehicle safety standards	DTRS	DTRS	DTRS	DTRS
	IASC	DTRS	IASC	IASC	IASC
AMSA	*Regulation and safety*	AMSA	AMSA	AMSA	ACS
ASA	*Aeronautical services*	ASA	ASA	ASA	ASA
CASA	*Aviation safety standards and regulation*	DTRS	DTRS	DOFA/CASA	CASA/ATO/ACS
NCA	*Statutory fees, diplomatic leases*	NCA	NCA	NCA	NCA

na Not available. **..** Not applicable.

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

B.17 Portfolio: Veterans Affairs

Table B.81 **Overview of arrangements**

Agency	*Activity/sub-agency*	*Type of charge*	*Stated rationale for cost recovery*[a]	*When introduced*	*How often charges are changed/reviewed*
AWM	*Image sales and education programs*	Fee	Services	..	5 yearly

a Demand = Demand management; Revenue = Raising revenue; Policy = Government policy; User = User pays; Beneficiary = Beneficiary pays; Services = Expand services. **na** Not available. **..** Not applicable.

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

Table B.82 **Revenue 1999-2000**

Agency	*Activity/sub-agency*	*Revenue raised though cost recovery*	*Total revenue*	*CR revenue / total revenue*	*Total expenses*	*CR revenue / total expenses*	*Whether revenue is earmarked*[a]	*What happens to revenue if it is greater than costs*[b]
		$m	$m	%	$m	%		
AWM	*Image sales and education programs*	0.4	98.0	0.4	na	na	No	Retained

a Earmarking is the assignment of revenue received from a specific tax or taxes to the financing of a particular government activity. **b** Refund = CR revenue is refunded; Adjustment = Fees are adjusted; Services = Services were expanded; Retained = CR revenue retained by agency; CRF = Paid into Consolidated Revenue Fund. **CR** Cost recovery. **na** Not available. **..** Not applicable.

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

Table B.83 **Costs recovered**

Agency	*Activity/sub-agency*	*What costs charges aim to recover*[a]	*How indirect costs are allocated*[b]	*Basis for asset valuation*	*Whether charges include a user cost of capital*
AWM	*Image sales and education programs*	Direct	Formula	..	Yes

a 'Direct' costs are costs that can directly and unequivocally be attributed to an activity. 'Indirect' costs are costs that are not directly attributable to an activity.' 'Total plus' includes direct and indirect costs plus any revenue over this amount, such as a proxy rate of return. **b** Indirect costs are generally allocated pro rata to some or all direct costs or by activity based costing. Activity based costing links an organisation's outputs to activities used to produce those outputs which in turn are linked to the organisation's costs (see appendix H, volume 1 of the inquiry report). **na** Not available. **..** Not applicable.

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

Table B.84 **Accountability and transparency**

Agency	*Activity/sub-agency*	*Legal basis*[a]	*Who was consulted when cost recovery introduced*	*What guidelines were used*	*Who is involved in ongoing consultation*	*Whether the arrangements have been formally reviewed*
AWM	*Image sales and education programs*	Other Act	..	..	No ongoing consultation	No

a FMA = *Financial Management and Accountability Act 1997.* The main purpose of this Act is to provide a framework for the proper management of public money and public property. It is not clear whether this Act provides a legal basis for cost recovery*;* Tax Act = Any Tax Act; Other Act = An Act other than the FMA Act or a Tax Act; No Act = No Act supporting the arrangements. **na** Not available. **..** Not applicable.

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

Table B.85 **Responsibility for various functions**

Agency	*Activity/sub-agency*	*Policy*	*Price setting*	*Administration*	*Revenue collection*
AWM	*Image sales and education programs*	AWM Council	AWM	AWM	AWM

na Not available. **..** Not applicable.

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

C Case study — information agencies

Information agencies are those agencies with the primary function of collecting, compiling, analysing and disseminating information to the public. They include agencies that provide;

- social/economic data — for example, the Australian Bureau of Statistics (ABS) and the Australian Bureau of Agricultural and Resource Economics (ABARE);
- information about the physical environment — for example, the Bureau of Meteorology, the Australian Surveying and Land Information Group (AUSLIG) and the Australian Geological Survey Organisation (AGSO); and
- 'cultural' and archive information — for example, the National Library of Australia and ScreenSound Australia.

Other agencies, including scientific research agencies such as CSIRO, the Australian Institute of Marine Science, the Australian Nuclear Science and Technology Organisation and the Bureau of Rural Sciences, also collect, compile, analyse and disseminate information to the public, but not as their primary function. Some regulatory agencies, such as the Australian Securities and Investments Commission and the Therapeutic Goods Administration, acquire information (sometimes compulsorily) as part of their regulatory function, which they make available to the public. These agencies face many similar issues to those of mainstream information agencies.

C.1 Extent and nature of cost recovery

As outlined in chapter 2, information has characteristics that provide a rationale for some level of government provision. These characteristics include:

- Government's requirement for information to meet its own needs;
- the 'public good' characteristics of information;
- the positive spillover effects of information; and
- the strong economies of scale in the provision of information.

These characteristics are more prevalent in some information products than in others. Products in which these characteristics are more prevalent can be classified

as basic products, and are funded by general taxation revenue. Products in which these characteristics are less prevalent, can be classified as additional products, and are usually funded through some degree of cost recovery. Additional products can be classified further into three groups:

- dissemination, where data that have already been collected and compiled are conveyed to users. Typically, some free dissemination has already been undertaken and further dissemination charged at the marginal cost of providing the product to an additional user;
- incremental products, where some additional collection, compilation or analysis may be undertaken to meet the needs of particular users. Incremental (or avoidable) costs are generally charged for these products; and
- commercial products, which may be sometimes nearly indistinguishable from incremental products except that they are contestable such that competitive neutrality principles apply.

Agencies' cost recovery arrangements

The cost recovery arrangements of several selected information agencies are discussed in the following sections.

Bureau of Meteorology

The bureau's classification of its products is shown in figure C.1. The collection of raw meteorological data and some compilation of the data are taxpayer funded. The bureau's dissemination activities are divided between basic and special products depending on their economic classification as private, mixed or public (see chapter 2). Different economic classifications correspond to different charging regimes.

The basic products comprise:

- a basic product *set* consisting of reports of current weather conditions and forecasts (including warnings), which is provided free through the mass media and the Internet; and
- a basic product *service* that builds on the basic product set, but for which users are charged a fee for access. The cost of access includes (1) any additional costs to the bureau of making the information available to suit the convenience of the individual user and (2) the costs of accessing the products by either telephone or fax.

The special products comprise:

- specialised products for a special sector or user group which have a significant public interest component (such as aviation and defence). The charges that the users pay for these products are based on incremental costs incurred in producing them; and
- commercial products, such as special investigations or tailored forecasts for individual customers, which are undertaken in open competition with the private sector by the bureau's Special Services Unit (sub. 35, p. 9).

International agreements under the World Meteorological Organisation also influence the categorisation of products. These agreements require the bureau to provide certain essential data and products to other national meteorological services on a free and unrestricted basis. These data and products are thus widely available and form part of the bureau's basic product. Any additional data and products given to these overseas agencies are provided on a cost recoverable or commercial basis, and form part of the bureau's special products. The overall economic framework for the provision of meteorological products has been outlined in a number of papers (Freebairn and Zillman 2000a, 2000b).

Figure C.1 **Schematic representation of the Bureau of Meteorology's products**

<table>
<tr><th>Product category</th><th>International exchange</th><th>Economic classification</th><th>Charging regime</th></tr>
<tr><td rowspan="2">Special products</td><td rowspan="2">Additional data and products</td><td>Private goods</td><td>Commercial</td></tr>
<tr><td>Mixed goods</td><td>Cost recoverable</td></tr>
<tr><td rowspan="2">Basic products</td><td rowspan="2">Essential data and products</td><td rowspan="2">Public goods</td><td>Access charges</td></tr>
<tr><td>Free through media</td></tr>
<tr><td colspan="4">Basic infrastructure, data and products (basic system – public goods)</td></tr>
</table>

Source: BoM (sub. 35, p. 10).

According to the bureau the cost of its basic product set was $51 million and the cost of its products provided at the cost of access was $0.7 million in 1999–2000. The cost of its products provided to the aviation industry was $13 million and that of its products provided for defence was $3 million. The bureau's commercial operations raised $9 million (sub. 35, p.3).

Allocating products to categories is not straightforward. The horizontal alignments of boundaries (broken lines) in figure C.1 are only approximate and vary across cases and time. A review of the bureau (Slatyer 1997) recommended the introduction of the basic product set of free information as a restricted subset of the more broadly defined 'basic services' (sub. 35, att. E). The bureau stated that in

choosing which products should be part of the basic product set and which should be available at the cost of access:

> … we have developed a five-page set of guidelines for trying to draw the boundary … recognising that the boundary is going to change with time, with technology, with political pressure. (trans., p. 254)

The difficulty of deciding the extent to which agencies should be involved in purely commercial work is highlighted by the different approaches of overseas agencies providing meteorological products. According to the bureau, in the United States, the National Meteorological Service undertakes no commercial work. It provides only products necessary for public safety and the private sector undertakes any specialised products provided to particular users (trans., p. 260). In New Zealand, the Meteorological Services of New Zealand Limited is a state owned provider of meteorological services. It has a commercial agreement with the Minister of Transport to provide a set of core products of meteorological data acquisition, forecasts and warning that are, in effect, taxpayer funded. It also provides market products to the private sector, including the media and the aviation industry (both domestic and international) (Meteorological Services of New Zealand Limited, sub. 109, p. 1).

Australian Bureau of Statistics

The ABS typically classifies its products as either community service obligations[1] or 'user pays' products. It includes most of its collection and compilation activities and part of its dissemination activities as community service obligations, which are taxpayer funded. According to ABS, the Commonwealth Government has not set specific guidelines for its community service obligations. However, the ABS stated that 'consistent with its functions, the ABS recognises that statistics must be accessible and used by the community, business and government' (sub. 36, p. 6). To achieve this outcome, the ABS disseminates part of its collection — through the mass media, libraries, telephone inquiries and the Internet — at no charge to the user. The ABS stated that the community service obligation attempts to provide 'a good cross-section of summary data from … [its] collections' (trans., p. 1103). The ABS is also required, as part of its community service obligations, to provide certain information to various international organisations such as the United Nations and the OECD.

[1] The term 'community service obligations' is widely applied to non-commercial activities that government business enterprises are required to undertake as part of Government's social or equity policies. Governments usually subsidise government business enterprises for undertaking such obligations.

'User pays' products fall into three broad categories:

- products that have significant private benefits but an element of community service obligation, which are partly cost recovered;
- products that are not perceived to have any community service obligation, which are fully cost recovered; and
- products deemed to be commercial, which are fully cost recovered with an allowance for 'risk' (The ABS has only one commercial product — CDATA) (sub. 36, p. 6).

The ABS also has licensing arrangements with secondary distributors who seek to commercialise ABS data. These arrangements (summarised in table C.1) generally involve a royalty payment for the use of the data, depending on the amount and use of the data. In some cases, such as for MariTrade, the ABS charges a flat fee in addition to a royalty (sub. DR111, p. 1).

Table C.1 **Licensing conditions for commercial use of ABS data**

Use of data	*Conditions*
On-selling of ABS data	Royalties calculated at 70 per cent of ABS data cost or 25 per cent of client revenue depending on how the data are being used.
Provision of a product or service using or incorporating ABS data	Royalties calculated at 10 per cent or 25 per cent of the client's revenue depending on the amount of ABS data incorporated in the final output.[a]
Reference tool for consultancy business	Usually 5 per cent of client revenue depending on how the data are being used.[a]
Income-generating statistical analysis and research	Usually 5 per cent of client revenue depending on how the data are being used.[a]
Publications	Case basis.[a]
Websites	Case basis.

[a] Royalties apply only if the output includes 10 per cent or more of ABS intellectual property.

Source: ABS (2001).

The ABS also charges for providing some other products, such as statistical consultancy, outposting of ABS staff, training courses and seminars. Such products are generally for government agencies and are charged on a 'cost recovery' basis in accordance with (now outdated) Department of Finance and Administration guidelines (sub. 36, att. 1).

A summary of the ABS's pricing policy is provided in table C.2

Table C.2 **Summary of ABS pricing policy for products**

ABS product	*Broad pricing policy*
Publications	The ABS has a standard range of publications designed to meet the needs of a broad range of users. According to the ABS, its budget appropriation funds the cost of producing copies of publications that are part of its community service obligations. Copies of its publications obtained for private use are priced to recover collectively their cost of production, distribution and marketing beyond the cost of production of the copies distributed to meet public good obligations. The cost of the collection, compilation and analysis of the data is not recovered.
Other standard products	The ABS has other standard products that are designed to meet similar needs as met by the standard publications but that are generally not paper based. They include CDATA and the Integrated Regional Data Base. According to the ABS, prices are based on cost recovery for a product or group of similar products. In a few instances, an allowance for commercial 'risk' is included in the price.
Information consultancy	The ABS provides information consultancies, which are one-off compilations of information on request. According to the ABS, these are priced for full cost recovery. There are three components to the cost recovered: • the labour cost, which is the hourly charge calculated for the total time taken to undertake the consultancy. The aim is to recover the costs of the labour involved, including overheads. Overheads include average superannuation, workers compensation, leave and similar salary on-costs, and an allowance for accommodation, training, computing, marketing and sales, and similar corporate and business overheads; • the infrastructure cost, which aims to recover the various system and database costs of providing non-core or unpublished statistical information to clients; and • the direct costs, which are any costs incurred in undertaking a consultancy that are directly attributable to the consultancy, such as courier charges, lamination etc.
Statistical consultancy	The ABS provides statistical consultancies to advise on collecting and analysing information. These are priced for full cost recovery, with the costs to be recovered consisting of labour and direct costs (as defined above).
User funded surveys, statistical units, outposted officers and international consultancies	The ABS provides other products that are priced at marginal cost, with the costs to be recovered consisting of two components: • the nominal salary costs plus average superannuation, workers compensation, leave and similar salary on costs and an allowance for accommodation, training, computing and similar overheads. Overheads for corporate and business support are not included; and • direct costs, which are any costs incurred in undertaking the work that are directly attributable, such as travel, form printing, collection and processing costs etc.

Source: ABS (sub. 36, p. 7).

National Library of Australia

The library's approach to cost recovery is 'for core services to be provided free of charge and for more advanced or value added services, and services to other libraries to be charged at rates ranging from marginal costs through to profit in certain circumstances' (trans., p. 475). Core services are defined broadly as 'access to the collection' (trans., p. 476).

Examples of the library's products and their associated cost recovery arrangements are shown in table C.3.

Table C.3 **Products provided by the National Library of Australia**

Product	*Description*
Kinetica	Kinetica is an online service provided to over 1000 Australian libraries to support those libraries in areas such as cooperative cataloguing and document delivery. The Kinetica service is offered by subscription to organisations with the choice of paying for actual use or on an agreed site licence basis. Kinetica is operated as a full cost recovery service.
Publications	The library produces and markets trade publications based on its collections. These publications are priced to recover their direct costs of production but not the costs of authorship or editing. The library's primary reason for publishing is to make its collections more accessible to the public.
Interlibrary loan/document delivery	Charges for the loan of items or supply of documents between libraries are set within the Australian library community at a standard rate of $13. This charge does not represent the actual costs of supply, but is considered a reasonable cost in terms of encouraging libraries to share resources in the interests of Australian library users generally. Libraries, including the National Library of Australia, may then charge additional fees for guaranteed fast-track delivery of items.

Source: National Library (sub. 5, p. 2).

ScreenSound Australia

ScreenSound Australia's mission is 'to increase the use, enjoyment and safety of Australia's audiovisual heritage, and through this enrich the lives of all Australians' (sub. 30, p. 1). ScreenSound Australia sees its main business as being an archive (trans., p. 343) and taxpayer funding covers the cost of developing, storing and preserving the collection of audiovisual material. Access to the collection, through screenings, presentations, exhibitions and video and audio products produced by ScreenSound, is partly cost recovered. Other products that are not central to its mission, such as its technical facilities and the use of its headquarters as a venue for professional, academic and social functions, are fully cost recovered (sub. 30, p. 4). ScreenSound considers this approach to be a practical way of generating additional

funds to improve public access to the collection (trans., p. 344). Competitive neutrality principles are applied where these products compete with those of private firms. However, many of its products are specialised, so ScreenSound Australia generally does not compete with private firms.

Australian Surveying and Land Information Group

AUSLIG, a business unit within the Department of Industry, Science and Resources, is Australia's national mapping agency. It charges for packaged and customised products, but not for general and reference information. Packaged products include maps and map data, while customised products include satellite imagery. General and reference information products include product catalogues and geodetic controls (sub. 44, p. 4).

Australian Geological Survey Organisation

AGSO, an agency within the Department of Industry, Science and Resources that provides geoscientific information on Australia's natural resources and the environment, distinguishes between partly and fully funded work. A large part of AGSO's product is determined by government policy and taxpayer funded. AGSO also undertakes cofunded or cooperative work with external bodies that will 'enhance or extend AGSO's core program and contribute to or enhance the national geoscience knowledge base'. The results from this work are made available to the public, and the costs are shared in proportion to the balance of the private and public benefit (sub. 55, p.10).

AGSO also undertakes commissioned or fully funded work for both the private and public sectors. It undertakes this work when it 'complements AGSO's strategic program and/or there is a benefit to AGSO through enhanced knowledge or technology transfer'. When the outputs of this commissioned work are for purely private benefits, all costs are recovered, including overheads and a proxy rate of return (sub. 55, p. 11).

Australian Bureau of Agricultural and Resource Economics

ABARE, an agency in the Department of Agriculture, Fisheries and Forestry — Australia, provides economic information for rural, minerals and energy industries. It undertakes 'research that is either of national importance or of importance to a broad spectrum of participants in one or more industries in the commodity sector' (sub. 56, p. 4). The bulk of ABARE's external funding comes from the Department of Industry, Science and Resources and industry research and development

corporations. It undertakes 'research that is essentially of a private good nature, but only when it is complementary with its broader public policy role' (sub. 56, p. 4).

Bureau of Rural Sciences

The bureau, an agency within the Department of Agriculture, Fisheries and Forestry — Australia, provides scientific assessments, analyses and advice in support of the department's objectives. It undertakes cost recovered work that aligns with the department's outputs and priorities. The bureau's clients include rural research and development corporations and other Commonwealth agencies (sub. 69, p. 7).

Rationales for existing arrangements

Generally, information agencies have clear rationales and objectives for cost recovery. These include:

- providing additional financial resources to increase the provision of the agency's products;
- reducing the cost to taxpayers for the provision of the agency's products;
- better managing the demand for the agency's products;
- improving the internal efficiency of agencies; and
- recognising the 'private benefit' element of some publicly-provided products.

Some agencies have also cited reasons for not introducing full cost recovery, including:

- recognising the 'public good' characteristics of information products;
- improving access to information; and
- promoting downstream exploration and development of publicly owned natural resources.

Most information agencies have policy documents, manuals or guidelines on charging, pricing and costing. Table C.4 summarises agencies' policies and guidelines on cost recovery.

Table C.4 **Agencies' policies and guidelines on cost recovery**

Agency	*Policy/guidelines*
Australian Bureau of Statistics	*Dissemination and Pricing Policy*
Australian Geological Survey Organisation[a]	*Commercial Practices Manual*
Bureau of Meteorology	*Charging Manual*
Commonwealth Scientific and Industrial Research Organisation	*Costing and Pricing Policy*
National Library of Australia	*Guidelines on Charging*

[a] AGSO's current cost recovery is based on *Guidelines for Costing Government Activities*, issued by the former Department of Finance in 1991.

Sources: ABS (sub. 36, p. 13); AGSO (sub. 55, p. 7); BoM (sub. 35, p. 10); CSIRO (sub. 88, p. 9); National Library (sub. 5, p. 6); DoF (1991).

Cost recovery mechanisms

Information agencies generally use a fee-for-service approach to recover costs, rather than taxes or levies. These fees include charges for goods and services, subscriptions, licence fees and royalties. The method for setting charges varies for different goods and services, from recovery of marginal costs[2] to full market pricing.

Some agencies offer bulk discounts. The ABS, for example, has reached an agreement with the Australian Vice Chancellors' Committee to provide most universities with access to data at a reduced rate. According to the ABS, this reduced rate reflects the cost saving to the ABS of dealing with one organisation, the Australian Vice Chancellors' Committee, rather than each university individually (trans., p. 1116).

A number of agencies, particularly the ABS, use royalties as part of their cost recovery arrangements. AUSLIG has made use of copyright, licences and royalties in its cost recovery arrangements, although they are 'the exception rather than the rule' and it receives only a relatively small proportion of its revenue from royalties. AUSLIG noted that this form of payment is attractive to users who wish to spread the commercial risk, but for many users the high administrative costs of royalties make an upfront fee more attractive (trans., p. 435).

ScreenSound Australia has had a similar experience with royalties:

> One of the problems … [with these] … arrangements is that there can be an awful lot of administration for trivial sums of money. (trans., p. 344)

2 The cost of producing an additional unit of output (see appendix H).

Information agencies typically charge the user of their products directly. One exception is the Bureau of Meteorology's provision of meteorological products to the aviation industry. In this case, another Commonwealth agency, Airservices Australia, acts as an agent for the bureau; while the bureau determines the charges to be imposed on the industry, Airservices Australia collects the revenue on the bureau's behalf (BoM questionnaire [part II] response).

Consultation

Information agencies use a range of methods to consult with their users to determine whether their methods of cost recovery and the level of their charges are appropriate. The Australian Statistical Advisory Council advises the ABS on:

- the improvement, extension and coordination of statistical services provided for public purposes in Australia;
- annual and longer term priorities and programs of work that should be adopted in relation to providing those statistical services; and
- any other matters relating to those statistical services generally (part III of the *Australian Bureau of Statistics Act 1975*).

The National Library of Australia has a Kinetica Advisory Committee made up of elected and appointed industry representatives. The terms of reference of this committee are to provide:

> … advice on strategic and policy issues affecting the delivery of the Kinetica service, the broad direction of service development, and changes occurring in the library community which are likely to affect services … (National Library of Australia 2000)

ScreenSound Australia, AUSLIG, AGSO and ABARE reported that they undertook market research and client surveys to gauge their clients' satisfaction with their products and charging policies (questionnaire responses).

The Bureau of Meteorology reported ongoing consultation with the aviation industry over its aviation weather services. A variety of committees, working groups, and focus groups involving the bureau, the Civil Aviation Safety Authority, Airservices Australia, the major Australian airlines, the Australian Air Transport Association, airport operators and others are involved in this consultation (BoM 2000, p. 91). However, not all users find these arrangements adequate. Ansett stated that:

> … there is a decided lack of information provided at industry consultation days as to the method and level of charges. (sub. 68, p. 11)

The bureau also reported that a Joint Australian Defence Force/Bureau of Meteorology Defence Weather Services Working Group monitors and reviews the ongoing operations of the defence weather services, including the development of appropriate service level agreements and performance measures (BoM 2000, p. 91).

Revenue collected through cost recovery

The information agencies that responded to the Commission's questionnaire collected nearly $98 million from cost recovery in 1999-2000 (table C.5). The Bureau of Meteorology and the ABS collected around 60 per cent of this revenue. The cost recovered revenue includes transactions with other Commonwealth agencies, which can be quite substantial; for example, 40 per cent of ABARE's cost recovery revenue comes from the Department of Industry, Science and Resources (sub. 56, p. 13).

AGSO reported that it is required to obtain at least 30 per cent of its revenue from external sources. However, it raised only 16 per cent of its total expenses from external sources in 1999-2000 and stated that the 30 per cent external revenue target 'is no longer rigorously applied' (trans., p. 487).

Table C.5 **Cost recovery revenue, 1999-2000**

Agency	*Total revenue from cost recovery*[a]	*Total expenses*	*Cost recovery revenue/total expenses*
	$m	$m	%
Australian Bureau of Agriculture and Resource Economics	11.2	22.0	50.9
Australian Bureau of Statistics	21.5	255.5	8.4
Australian Geological Survey Organisation[b]	12.1	73.5	16.5
Australian Hydrographic Service	2.2	228.6	1.0
Australian Surveying and Land Information Group	4.7	33.2	14.2
Bureau of Meteorology	35.3	202.9	17.4
Bureau of Rural Sciences	0.07	0.2	30.2
Bureau of Tourism Research	0.6	4.3	13.9
National Library of Australia	8.6	51.0	16.9
Productivity Commission	0.05	21.4	0.2
ScreenSound Australia[c]	1.8	47.5	3.8
Total	**98.1**	**940.1**	**10.4**

[a] These figures may include revenue from transactions with other Commonwealth agencies. [b] AGSO reported that it is required to achieve a 30 per cent external funding target. [c] 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 responses to part I of the questionnaire and agencies' annual reports.

Legal basis for cost recovery

Some information agencies have a clear legislative basis for their cost recovery arrangements, but for others the legal foundation is less straightforward. In the view of the Australian Government Solicitor, agencies that impose a charge for the performance of their statutory duties need to be 'authorised expressly by legislation or by necessary implication from the legislation' (see appendix I). For two of the information agencies that are statutory authorities — the ABS and the Bureau of Meteorology — the legal authority to charge for their products is explicit in their legislation. In the case of the ABS, the *Census and Statistics Act 1905* was amended in 1988 to ensure the ABS had the legal authority to charge for its products (sub. 36, p. 5). For the Bureau of Meteorology the relevant Act is the *Meteorology Act 1955*. Another statutory authority, the National Library of Australia, does not have explicit power under its legislation to charge for its products. However it noted that the *National Library Act 1960* did not preclude it from charging a fee for its products (questionnaire response). Further, it has legal advice that:

> … in view of the discretionary elements of [section 6 and 7 of the *National Library Act 1960*], and the lack of any legal compulsion [for users] to obtain [their] services, [it] can charge a reasonable amount for services if it is decided, having regard to priorities and financial resources, that it is not feasible or convenient to do otherwise. (sub. DR125, p. 1)

The legal basis for the cost recovery arrangements of those agencies that are within a department are not clearly defined. In response to a question in the Commission's questionnaire on the legal basis for establishing their cost recovery arrangements:

- ABARE and ScreenSound Australia cited agreements under the *Financial Management and Accountability Act 1997*. However, the main purpose of this Act is to provide a framework for the proper management of public money and public property and it is not clear whether this Act provides a legal basis for cost recovery (see chapter 3); and
- AUSLIG cited Ministerial endorsement of the Commonwealth Public Interest Spatial Data Transfer Policy developed by the Commonwealth Spatial Data Committee (CSDC 1995) as the legal basis for its cost recovery activities. However, AGSO stated that there is no legal basis for its cost recovery activity, even though the Commonwealth Public Interest Spatial Data Transfer Policy also covers AGSO.

C.2 Effects of cost recovery on agencies

The introduction of cost recovery is likely to have both positive and negative effects on agencies. Greater use of appropriate market mechanisms can lead to an

improvement in the internal efficiency of agencies and an improved focus on the needs of their users. However, cost recovery can lead to agencies placing less emphasis on their broader public policy role.

Incentive effects for agencies

Cost recovery can change the incentives faced by agencies, in ways that can be both beneficial and detrimental.

Retention of cost recovery revenue

Where information agencies are able to retain the revenue they raise through cost recovery, they may have a greater incentive to pursue cost recovery. Most of the information agencies that responded to the Commission's questionnaire reported that they are able to access the revenue raised through cost recovery, typically through net appropriation agreements under s.31 of the *Financial Management Act 1997* (see chapter 3). ABARE noted that its budget appropriations, under its s.31 agreement, were reduced by the amount of its expected cost recovery revenue (sub. 56, p. 11). The ABS reported that its s.31 agreement formalised existing arrangements where its base appropriation was reduced, and that all of its cost recovery revenue was returned as 'annotated' appropriations (sub. 36, p. 9). AGSO reported that when it was set a 30 per cent external revenue target, it was to retain 'all revenue up to the target and revenue in excess of the target was to be shared on an 85/15 basis between AGSO and the Consolidated Revenue Fund' (sub. 55, p. 6). However, as noted above, AGSO did not reach this external revenue target in 1999-2000. The Bureau of Meteorology reported that only around 2 per cent of its cost recovery revenue paid into the Consolidated Revenue Fund was not earmarked for return to the bureau.

External revenue targets

AGSO and CSIRO are required to generate 30 per cent of their revenue from external sources. A risk of setting external revenue targets is that agencies may lose focus on achieving an appropriate balance between their central public policy activities and their commercial activities. Agencies may undertake too much commercial activity at the expense of their public policy activities or they may charge too much for particular products. AGSO 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. … 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)

CSIRO expressed similar concerns (sub. 88, p. 6).

Although external revenue targets are applied to the whole agency, generally the burden of achieving the target falls on those units within the agency that are able to generate external revenue. The level of cost recovery within these units will greatly exceed the overall target set for the agency to cross-subsidise other units that are not able to cost recover. As CSIRO stated:

> When you have a 30 per cent target and you translate that through to a research unit and then you look at those units that are able to actually work in a consulting environment … that 30 per cent converts into a 70 or 80 per cent target and we would expect to be fluctuating between 70 and at times even 90 per cent external revenue in terms of the way we operate. (trans., p. 907)

According to AGSO, the burden of meeting its external revenue target falls heavily on its geophysical data, which it sells at a high price because it 'can be used by a mining company to assist in area selection for a mine and … the return [to these companies] is very high' (trans., p. 492).

Given these concerns with external revenue targets, it is not surprising that agencies have also reported that the targets are not strictly enforced. AGSO stated that:

> … the validity of [this] approach has … been devalued over time. It's no longer rigorously applied, but there's a wonderful ambiguity left as to exactly where you should be positioned. (trans., p. 488)

Similarly, CSIRO stated that:

> An important principle in CSIRO's triennium funding agreement with the Government is that the Government will 'view external earnings targets flexibly to allow quality and relevance of the research output and general community benefit to be considered'. (sub. 88, p. 4)

Interaction with objectives of activities being cost recovered

One objective of most information agencies is to provide access to their information. Cost recovery can enhance this objective by providing agencies with additional resources that enable them to provide a greater range of products. ScreenSound Australia stated that:

> The strategic management of the Archive's programs and resources, including cost recovery issues, has resulted in an improvement in both of the two principle indicators of success … supplementation of appropriation and increase in access. … Our increase

> in revenue through cost recovery … has allowed us to provide a very substantial increase in access to services. (sub. 30, p. 5)

Cost recovery can also conflict with this objective if charging for products restricts access. The Bureau of Meteorology highlighted this conflict in relation to meteorological information. The global nature of meteorological phenomena means there are large benefits from the free and unrestricted exchange of information among national agencies. The World Meteorological Organisation provides an international framework for the collection and free exchange of information between its members. According to the bureau:

> … the introduction of any realistically conceivable market framework for international trade of basic meteorological data would result in a rise in cost to Australia of maintaining its current level (quality and quantity) of meteorological service provision by a factor of two to ten or more. (sub. 35, p. 17)

Restricting access to information through cost recovery is likely to have an adverse effect on the wider benefits to the community of the use of this information. CSIRO expressed its concerns that other policy objectives of the Government are being compromised because users are unable to afford the required data. CSIRO stated that:

> … the Government changed from making data freely available … to charging … these datasets are now guarded very carefully, are used strategically for people to try and gain advantage and more importantly, aren't accessible. (trans., p. 901)

Private users of government information expressed similar views. Dr Mark Paterson, a private researcher, was concerned about the effect of cost recovery arrangements introduced by the ABS in the late 1980s for the Australian Survey of Motor Vehicle Use and the Motor Vehicle Census. These arrangements increased the cost of acquiring these data, and he claimed some research with a broader public benefit was not undertaken as a result (sub. 43, p. 4).

There is likely to be a trade-off between the additional resources available from cost recovery and the restrictions on access to information that may result. The additional resources may improve public welfare by funding additional collection and analysis of information, but the restricted dissemination of this information may diminish welfare. As a member of the Australian Statistic Advisory Council noted:

> It is not obvious to me that if the ABS lost the revenue from its sales associated with its core activities, then the world would be worse off. Let us assume that it would have to reduce the amount of data that it collected but the data that it did collect would be more widely disseminated. It is possible that the public benefit from wider dissemination of albeit less data collected may outweigh the loss from less data being collected. (ABS, sub. DR134, p. 8)

Innovation and technology

The increasing use of digital technology and the Internet is having a substantial effect on the dissemination of information. This is influencing how information is delivered, how widely it can be disseminated, the costs and charges of dissemination and the associated cost recovery arrangements.

Digital technology is increasing the amount of information that can be handled electronically and the Internet is allowing this information to be disseminated at a lower cost to a larger number of users. This has led to a substantial increase in the use of the Internet to access products from information agencies. The ABS reported that the use of its website has increased greatly over the past five years — up from an average of about 14 000 hits per month in 1996 to 2 million hits per month in 2001 (sub. 134, p. 3).

However, the establishment and ongoing operation of a website involves costs. The ABS estimated that the additional operating costs of providing all its publications on its website for free would be around $4–5 million per year (sub. 134, p. 4). Similarly, the Department of Agriculture, Fisheries and Forestry — Australia stated that:

> … if all data were to be made available free on the Internet there would be a substantial funding shortfall for information agencies such as [the Bureau of Rural Sciences] and ABARE, which would require additional budget funding to cover. (sub. DR151, p. 5)

In addition, the Internet alone is not always an adequate means of disseminating information. Agencies may need to use additional methods, such hard copies and the media, to provide their products. As the Bureau of Meteorology noted:

> … the Internet is not an adequate dissemination system by itself and hence the Bureau makes significant and essential use of the traditional media (radio, television and newspapers) as an additional method of dissemination of information such as weather forecasts and warnings. (sub. 142, p. 3)

The ongoing need to use other methods of dissemination reduces the potential cost savings from using the Internet.

On the revenue side, the Internet is already affecting traditional cost recovery streams for information agencies. For instance, the ABS outlined factors that are likely to affect its future cost recovery:

- the move from paper based to electronic means of disseminating information is associated with a downward trend in revenue from the sale of publications;
- Internet based self-help developments are affecting information consultancy revenue particularly for the more straightforward consultancy requests;

- the ongoing growth of the information market has led to greater competition in some of the ABS's traditional markets;
- greater use of personal computers and the Internet in Australia has led to a rapid growth in the ability of households and firms to access information on line, often with an expectation that it will be provided free; and
- some other major countries are providing access to a wide range of statistical information for free on the Internet (sub. 26, p. 10).

ScreenSound Australia warned that while the digital age is seen by some as a 'nirvana' which offers an almost unlimited potential to collect, manipulate and disseminate large quantities of information around the world very cheaply, 'at the moment the digital age is a promise but the reality is just an awful lot of expense and an awful lot of work' (trans., p. 348).

Agency efficiency

Cost recovery can improve agency operations by providing market signals and incentives to allocate the agency's resources to meet the needs of users better and to improve its internal management systems. A central issue that faces the managers of information agencies is the allocation of the available resources to meet the needs of their users. Consultation with users is a widely used method. The market signals generated by cost recovery are another. As the ABS noted, one of its objectives for introducing cost recovery was 'to enable demand for ABS products and services to be used as a more reliable indicator of how ABS resources should be prioritised' (sub. 36, p. 5).

Cost recovery can also provide an incentive for agencies to improve their internal management because they need to identify costs better and meet the needs of their users. The systems and processes required for cost recovery can bring wider benefits to the agency. As ABARE reported, 'cost recovery arrangements have caused [it] to adopt formal project management systems much earlier than it would otherwise have done' (sub. 56, p. 20).

However, cost recovery arrangements have their own costs. Agencies may have to divert resources into establishing and maintaining cost recovery arrangements, rather than focus on their core business. As the Environmental Resources and Information Consortium stated:

> … undoubtedly, there are many public scientists now … spending a lot of their research time trying to capture money. (trans., p. 1217)

Operation of agencies

In many cases the introduction of cost recovery has had an effect on the operations of information agencies. The ABS listed some of the challenges it faced with the introduction of cost recovery:

- a need to shift the culture of the ABS from one where output was provided free to one where clients were charged for all but simple enquiries;
- the development of policy and procedures to support charging, and ongoing adaptation of these policies and procedures to meet the requirements of new and different products;
- technical infrastructure had to be developed and maintained to support invoicing and management information requirements;
- the identification of the costs to be recovered and provision of systems and processes to monitor them; and
- actually achieving cost recovery. The ABS struggled to recover its costs in the early years but has moved closer to demonstrated cost recovery with costs being recovered in 1997-98 (the peak Census dissemination year) and in 1999-2000. (sub. 36, p. 5)

Calculating and allocating costs to be recovered

The charges imposed by information agencies depend on which costs are included and how they are calculated. In principle, most agencies would be expected to recover the incremental or avoidable costs associated with additional products (see chapter 2). In some instances, however, agencies have attempted to introduce market based pricing. This may be appropriate where competitive neutrality considerations apply. For example, CSIRO stated 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). However, for most agencies, commercial products are only a small component of their overall operations.

Some agencies have attempted to apply market based pricing more widely, but experienced significant difficulties. The ABS reported that it had difficulties in introducing user charges based on market prices, and its pricing policy now reflects costs (box C.1).

Box C.1 **User charges at the ABS**

The ABS reported that when user charges were introduced in 1988, it proposed introducing market based pricing for all its products except those provided free as part of its community service obligations.

Initially, pricing was based on market prices and set without reference to actual costs, because the ABS did not have mechanisms to determine the relevant costs. The ABS discovered that the interpretation of 'market price' was variable and difficult to assess, given that it is a monopoly provider in many cases. As a result, market prices were often based on the ABS's perception of the clients' willingness to pay. ABS's dissemination performance was largely measured in terms of gross revenue from the various products, and there was limited review of prices. Its main response was to eliminate publications with a small subscriber base and to disseminate the results in more cost-effective ways.

A major internal review of the ABS pricing policy was undertaken in 1994 to allow the ABS to articulate objectives for its pricing policy clearly and to adopt appropriate guidelines and management information. Following this review, pricing policy moved from market pricing to reflecting costs incurred, and procedures for regular review were established.

Source: ABS (sub. 36, p. 4).

Some private users of the products provided by information agencies raised concerns about setting charges based on market prices. J. T. Larkin and Associates stated that 'any price above marginal cost is a tax, even if that price is below average cost' (sub. 45, p. 3).

Agencies also face practical difficulties in cost based pricing. Cost based prices are usually based on recovering the incremental or avoidable costs, as well as other costs such as the cost of capital. All of the information agencies reported that they recover both direct and indirect costs, with most agencies allocating indirect costs on a *pro rata* basis to direct costs. AUSLIG reported that it uses an Activity Based Costing approach to allocates its indirect costs (see appendix B). Box C.2 outlines some of these difficulties faced by the Bureau of Meteorology in costing its product.

Box C.2 **Costing issues for the Bureau of Meteorology**

The bureau reported that within its overall costing and charging policy, it has encountered significant practical issues in costing individual products. These issues have arisen primarily from the inherent subjectivity involved in locating the boundary between 'purely public good services' and 'purely private good services'. This task has been complicated by the need for consistency, or at least compatibility, with the approaches used by other national meteorological services.

In determining the cost of a product, the bureau has identified that overheads require close attention especially when the product is incremental to a basic product. The recent transition from program budgeting to output budgeting resulted in the bureau significantly reducing overhead costs included in the cost recovery charges, particularly in charges for aviation weather services.

Source: BoM (sub. 35, p.14).

Indirect costs may include a share of capital. Capital costs will partly depend on the value of the assets used to produce a product, and different valuation methods will give different results (see appendix H). The Bureau of Meteorology and ScreenSound Australia reported that they use a replacement cost method to value their assets, while the ABS and AGSO use a historical cost method. The National Library and AUSLIG use deprival costing (see appendix B).

C.3 Economic effects of cost recovery

Cost recovery has an effect on the direct users of the products provided by information agencies and on the broader economy. It places some or all of the cost of information products on users, rather than the general taxpayer. This can promote efficiency in the production and consumption of information products. However, charges can have a detrimental effect where prices are set above the cost of providing the product to an additional user or where agencies compete on an unequal basis with private firms.

Effects on industry

Cost recovery may affect industry through applying charges for information products that firms use as inputs. If these charges are set above the cost of providing the product to an additional user, then some firms may be discouraged from using data for which they would have paid the marginal cost. Cumpston Sarjeant, a private actuarial firm, noted that 'high data costs … restrict some potentially very valuable analyses' (trans., p. 941). The Environmental Research and Information

Consortium stated that 'ABS data … is so expensive that we just have stopped using it now for economic and social work' (trans., p. 1222). These firms have provided some examples of the effect of the high costs of data (box C.3). However, it is not clear that these costs are greater than the associated marginal or incremental costs.

Box C.3 **Effects of high data costs on industry**

A number of participants provided examples of how the high cost of obtaining data affected them. Cumpston Sarjeant said it had considered examining patterns of regional mortality against patterns of regional industry. However, the cost of obtaining the data to do this work discouraged the company from proceeding with the project. It believed this would be a problem for researchers considering a range of topics, including regional issues, disease, poverty and land degradation (trans. p. 942).

The Environmental Research and Information Consortium said it was unable to obtain datasets for the whole of Australia at reasonable costs At best it could get 'small parcels, at large cost' that tended to focus on small areas, rather than at the regional or national level. It stated that it believed that if these data were made available to private firms at a reasonable cost, then there would be 'an enormous rush of new, innovative products and services that we could use right across Australia, that would benefit local government, community groups, state government agencies and national policy developments' (trans., p. 1218).

The Environment Research and Information Consortium also pointed to the effect of the policy of the Geological Survey of Victoria and the Northern Territory Geological Survey of providing geophysical data at little or no cost. In Victoria, these data are being used to attract investment into viticulture. In the Northern Territory, they are being used to attract investment into neem oil (a natural pesticide), sandalwood and mahogany, which is being used to support Aboriginal communities. The consortium noted that 'if (the) data had not been provided at no cost … this investment would probably never have eventuated' (trans., p. 1219).

The effect on industry may be aggravated by agencies having to meet external revenue targets. Given that the burden of meeting these targets is likely to fall on a narrow range of products that are able to generate greater amounts of revenue, agencies may find it necessary to charge prices for these products that are higher than the cost of providing them to an additional user. This will have an adverse effect on those users who otherwise would have purchased these products. Box C.4 outlines the effect of AGSO's pursuit of its 30 per cent external revenue target.

Box C.4 **Effect of AGSO's external revenue target**

According to AGSO, the burden of meeting its external revenue target falls heavily on its geophysical data. Charging high prices for this information makes it unlikely it will be used for other beneficial uses (trans., p. 492).

The Environmental Research and Information Consortium expressed a similar concern when it stated that:

> The cost of geophysical [data] from AGSO is far too high for a [small to medium enterprise] to access for R&D, service innovation or service delivery purposes. While current prices for geophysical data were probably set at a level commensurate with the paying capacity of large mining companies, these data are now used … by [small to medium enterprise] for a wide range of resource assessment purposes (for example, soil mapping, hydrology assessment, etc.) and where the client's budget is very low, for example, Landcare groups. (sub. 7, p. 3)

The high price of this information has implications for other objectives of Government. It is likely to reduce the amount of exploration of Australia's mineral and petroleum resources. As AGSO noted:

> … the Government is an equity holder in these resources with responsibility for the custodianship and management of these resources in the interests of the community. The Government, therefore, has a genuine, on-going interest in maximising investment in these resources. The benefits are returned to the community through the discovery and development of new resources. (sub. 55, p. 12)

Differences in Commonwealth and State government charges for geophysical data may distort investment (including foreign) decisions. According to the Northern Territory Geological Survey and the Geological Survey of Victoria, the high price of AGSO's geophysical data is having an adverse effect on cooperation between these agencies. Since 1998 both agencies have charged minimal fees for their geophysical data to encourage exploration. The Northern Territory Geological Survey stated that:

> The differential pricing policy is a deterrent to NTGS embarking on joint projects with AGSO that involve large acquisition costs, as we have found it is difficult to agree on how the products of joint projects will be distributed. (sub. 32, p. 2)

Sources: AGSO (sub. 55, p. 12); ERIC (sub. 7, p. 3); GSV (sub. 99); NTGS (sub. 32, p. 2).

The inclusion of royalties in the charges for information products is particularly likely to affect the use of information. The cost to an agency of providing information to an additional user is unlikely to be related to the revenue or profit of the firms using the information. Royalty-based charges that exceed the cost of providing the product to an additional user will lead to a misallocation of resources.

MariTrade, a consultancy firm, explained how ABS charging arrangements, which included royalties on MariTrade's revenue, had an adverse effect on its business. According to MariTrade, ABS introduced a scale of charges that increased the flat fee for the data MariTrade required from less than $3000 per year to more than $15 000 per year and included a royalty of 25 per cent of MariTrade's revenue. This

increased the cost of the data to $35 000 per year (sub. DR111, p. 1). As MariTrade stated:

> … we believe that this pricing structure is inappropriate to a value adding private sector provider, as it is having the unintended consequence of destroying a market and valuable service we have built up over many years. (trans., p. 1021)

Cost recovery by information agencies may also have adverse effects where agencies compete on unequal terms with private firms. Where agencies are attempting to meet externally imposed cost recovery targets, they face incentives to use access to taxpayer funded resources to undercut private firms.

The Environmental Research and Information Consortium was concerned about agencies having more favorable access to information than commercial users:

> 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)

While this behavior may be contrary to competitive neutrality policies, private firms may be reluctant to pursue an official complaint for fear of retribution. The Environmental Research and Information Consortium stated that:

> I've been reluctant to [complain officially] because I've been subject to considerable retribution by these Government agencies already and to pursue that further I would only be subject to more retribution by them. (trans., p. 1221)

Similarly, MariTrade is reluctant to pursue an official complaint against ABS's charges because of concerns with upsetting its relationship with a 'monopoly supplier' (trans., p. 1029).

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).

Effects on individual consumers

Some information agencies deal directly with individual consumers, as in the case of 'weather by fax', and ABS publications and data requests. Some inquiry participants raised concerns about the effects on consumers of the cost recovery arrangements of some information agencies. For example, Mr R. F. Hadlow, a private researcher, raised concerns about the cost recovery arrangements for photocopying services. Several agencies stated that controlling the demand for their services is a rationale for cost recovery and the National Library specifically listed

controlling the demand for photocopying services (sub. 5, p. 1). Hadlow claimed that:

> DIY/card operated photocopying, at tax payer funded Commonwealth facilities, is charged at 200 per cent above both actual cost and the fee charged by prominent commercial providers. (sub. 34, p. 3)

Further, in relation to photocopying by the staff of an agency, he claimed:

> The charge of 50c per copy indicates an hourly labour charge equivalent to the cost of hiring a skilled tradesman (including overheads) and is well above a reasonable cost for labour for basic photocopying. (sub. 34, p. 5)

He also stated:

> If the cost of copying material is made so expensive that it will not be used, one must question the value of maintaining it at public expense? (sub. 34, p. 3)

Inter-agency transactions

Information agencies often provide products to other Commonwealth agencies. In many cases the information agency will charge these agencies on the same basis as other users but, in some cases, special arrangements have been established. Special arrangements between agencies are often required where an information agency has a statutory obligation to provide certain products to other agencies. For example, under the *Meteorology Act 1955*, the Bureau of Meteorology has the responsibility of providing meteorological products for civil aviation and the Australian Defence Forces. For civil aviation, these products are provided under a Memorandum of Understanding with the Civil Aviation Safety Authority and Airservices Australia. This memorandum sets out, among other things, the responsibilities of the various parties, administrative arrangements, performance standards, general principles for charging for these services and the mechanisms for consultation and review of these arrangements and charges. For the Australian Defence Force, no single document governs these arrangements, but a working group has been established to develop an overarching memorandum of understanding (sub. 35, att. G, p. 5-1).

Special arrangements may also arise when information agencies do not fully recover the costs of providing a product to other Commonwealth agencies. For example, the ABS provides outposted officers to Commonwealth agencies. Generally, the ABS fully cost recovers for the services of these officers, but lower charges may be negotiated where the agency can help the ABS achieve its legislative function (ABS, Canberra, pers. comm., 22 March 2001). Similarly, according to the Bureau of Rural Sciences, many research and development corporations that commission work from the bureau have guidelines that limit their contribution to the costs of the research they have commissioned. These guidelines prevent the bureau from

recovering some costs of providing research. In these cases, the bureau 'looks for a very high level of alignment' between the objectives of the Department of Agriculture, Fisheries and Forestry — Australia (which provides the bureau's appropriation funding) and the objectives of the work these agencies wish to commission (trans., p. 677). These arrangements may result in cost shifting between agencies.

In some cases, agencies receive most external revenue from the public sector, resulting in little net impact on the budget. For example, since 1993-94, ABARE's appropriations have been progressively reduced and its revenue from other sources has increased; by 1999-2000, such revenue was around 50 per cent of its budget. However, about 40 per cent of this revenue is a transfer of appropriations from the Department of Industry, Science and Resources via a service level agreement to fund research for the resources sector (sub. 56, pp. 11–13). The bulk of the remainder of this revenue is from other Government departments and rural research and development corporations. The rural research and development corporations are typically funded by an industry research levy and matching funds from the Commonwealth's general revenue. Thus, half of ABARE's revenue from the rural research and development corporations and all of the direct funding from Government departments are derived from general taxation revenue. As ABARE noted:

> While the focus of research has been changed by more direct links between researchers and industry and policy advisers, the ultimate sources of funds have not changed greatly. (sub. 56, p. 23)

This decentralised approach to funding information agencies is used in Sweden to provide a range of official statistics. Under the Swedish model, a number of government agencies are responsible for providing statistics on health and medical care, social welfare, energy and agriculture. These agencies decide what statistics should be produced, how they should be collected and compiled, and who should have access to them. They also decide who will collect and compile these statistics. Agencies can choose to undertake these tasks themselves or contract them to other government agencies or the private sector (OECD 1998, pp. 73–77). This approach introduces a degree of contestability into the provision of official statistics, but may suffer from a lack of central coordination of statistical output.

C.4 Summary

Information has characteristics that mean some degree of public provision is required. However, it is also appropriate for some information products to be provided on a cost recovery basis. A central issue for information agencies is to

determine which products should be taxpayer funded and which products should be funded by some degree of cost recovery.

Most information agencies have clear rationales and objectives for recovering or not recovering various costs, and have developed guidelines or policies for implementing their cost recovery arrangements. However, in some cases, the legal basis of the arrangements is not clear.

Cost recovery can have an effect on the operations and objectives of information agencies. Additional funds mean the agencies may be able to provide more products, and appropriate charging arrangements can improve the internal efficiencies of agencies and make them more focused on users' needs. However, charging may restrict access to information products and, when combined with external revenue targets, cause agencies to pursue commercial goals at the expense of their public policy roles.

The increasing use of digital technology and the Internet is allowing a greater amount of information to be disseminated to a greater number of users at low marginal cost. However, there may be significant costs involved in the establishment and ongoing operation of a website, and the Internet by itself is not always an adequate means of dissemination. This reduces the potential cost savings from using the Internet.

Other cost recovery issues for information agencies include the possible adverse effects on their users and the broader community if charges are set above the cost of providing the product to an additional user and where agencies compete on unequal terms with private firms.

D Case study — health and safety regulatory agencies

Many Commonwealth regulatory agencies have functions aimed at protecting the health and safety of consumers, the environment and the wider community. These agencies regulate selected activities and products that are perceived to have particular health and safety concerns — for example, chemicals, pharmaceutical products, therapeutic devices, food, imported goods, genetic research and air transport. Participation in these industries is contingent on meeting certain regulatory requirements. Therefore, the regulatory activities and associated charges are discretionary only at the point of entry into a market.

The health and safety role shared by these agencies, and the compulsory nature of their regulatory activities, raise particular issues for cost recovery. Because most of these agencies' regulatory activities tend to affect the health and safety of wide sections of the community (as well as discrete groups of consumers), it may be difficult to identify everyone who benefits from the regulations, and/or impractical to charge them for those benefits. To the extent that charges are compulsory for regulated industries, it may be unclear how these costs affect decision making within regulated firms, or competition between them.

The approaches taken by various Commonwealth health and safety regulatory agencies to these, and other, cost recovery issues are discussed in the following sections. Agencies and divisions of departments included in this case study are listed in box D.1 and then collectively referred to as 'health and safety regulatory agencies'. This case study draws on the cost recovery arrangements of these agencies as illustrations, but does not review each arrangement in detail.

Box D.1 **Health and safety regulatory agencies in Australia**

Therapeutic Goods Administration: The TGA is a division within the Department of Health and Aged Care. It administers a national system of regulatory controls on the quality, safety, efficacy and timely availability of therapeutic goods used in or exported from Australia.

Australia New Zealand Food Authority: ANZFA is a statutory authority within the Department of Health and Aged Care. It develops food standards and other food regulatory measures for Australia and New Zealand.

Australian Radiation Protection and Nuclear Safety Agency: ARPANSA is a statutory authority within the Department of Health and Aged Care. It licenses Commonwealth agencies that deal with radioactive materials or apparatus, or any aspect of a nuclear facility.

Office of the Gene Technology Regulator: The OGTR is an independent statutory office within the Department of Health and Aged Care. Its responsibilities include protecting the health and safety of people and the environment by identifying and managing risks posed by gene technology.

National Industrial Chemicals Notification and Assessment Scheme: NICNAS is a statutory office administered by the National Occupational Health and Safety Commission (within the Department of Employment, Workplace Relations and Small Business). NICNAS assesses the health and environmental risks of all new industrial and selected existing chemicals that are manufactured locally or imported.

National Registration Authority for Agricultural and Veterinary Chemicals: The NRA is a statutory authority within the Department of Agriculture, Fisheries and Forestry — Australia. It is responsible for administering the National Registration Scheme which provides for the assessment and registration of agricultural and veterinary chemical products before sale in Australia.

Australian Quarantine Inspection Service: AQIS is an agency within the Department of Agriculture, Fisheries and Forestry Australia. It administers Australia's quarantine, agriculture and food export laws.

Space Licensing and Safety Office: SLASO is a division within the Department of Industry, Science and Resources. It regulates space activities undertaken within Australia or by Australian nationals overseas.

Australian Maritime Safety Authority: AMSA is an authority within the Department of Transport and Regional Services. It provides regulation and oversight of Australian shipping, maritime navigation facilities and search and rescue services.

Civil Aviation Safety Authority: CASA is an authority within the Department of Transport and Regional Services responsible for setting aviation safety standards, registering aircraft, licensing and enforcing compliance with safety regulations.

Airservices Australia: ASA is a statutory body within the Department of Transport and Regional Services. It is responsible for air traffic control and navigation facilities, as well as airport firefighting services.

D.1 Extent and nature of cost recovery

Regulatory agencies with health and safety responsibilities may share similar issues and concerns with cost recovery, but the nature, extent and objectives of their cost recovery arrangements vary considerably. While some agencies recover a small proportion of their costs, or only the costs of discrete activities, others recover almost all (or in some cases more than) the costs of running the agency.

Revenue collected through cost recovery

The Commonwealth health and safety regulatory agencies listed in box D.1 raised $899 million in revenue through cost recovery arrangements in 1999-2000. ASA recovered the greatest amount of revenue ($585 million) and, along with the NRA, also recovered the highest proportion of agency expenses (109 per cent). However, the chemical and pharmaceutical regulators (NICNAS and the TGA) also generated high proportions of their expenses from cost recovery arrangements (99 per cent and 85 per cent respectively). Cost recovery revenue of these agencies is shown in table D.1.

Agency cost recovery revenues may be less than or greater than costs for a variety of reasons, including activity fluctuations which may be offset between years (as with the TGA), and cost recovery targets which include a rate of return on capital (as with ASA).

Agencies and activities that cost recover

The majority of agencies responsible for health and safety regulation have been established as independent statutory authorities. However, several agencies within the group have different legislative structures. The TGA and AQIS are agencies within departments, and NICNAS is a statutory scheme within a statutory authority (the National Occupational Health and Safety Commission).

There are also some key differences in how cost recovery policy is applied. The agencies recover different proportions of costs and have contrasting charging mechanisms and costing structures. Some agencies, typically those regulating chemicals and therapeutic goods, aim to meet cost recovery targets that are applied to the whole agency. The NRA, NICNAS and the TGA aim to recover 100 per cent of agency costs. On the other hand, agencies such as AQIS, CASA and AMSA have individual cost recovery targets for particular activities.

Table D.1 **Cost recovery revenue of health and safety regulators, 1999-2000**

Agency[a]	*Total cost recovery revenue*	*Total revenue from other sources*	*Total agency expenses*	*Cost recovery target*	*Cost recovery revenue / total expenses*
	$m	$m	$m	%	%
TGA	41.4	2.3[b]	49.0	100	84.5[c]
ANZFA	0.8[d]	12.9	13.1		6.1
AQIS	136.7	42.2	178.2		76.7
NICNAS	3.7	0.1[e]	3.7	100[e]	99.3
NRA	17.6	1.0	16.2	100[f]	108.6
CASA	59.8	39.1	83.7		71.4
ARPANSA	1.2	14.0	16.1		7.5
AMSA	52.4	28.5	77.9		67.3
ASA	585.4[g]	11.0[h]	539.2	100[i]	108.6
Total	**899.0**	**151.1**	**974.3**		**92.3**

[a] TGA — Therapeutic Goods Administration, ANZFA — Australia New Zealand Food Authority, AQIS — Australian Quarantine Inspection Service, NICNAS — National Industrial Chemicals Notification and Assessment Scheme, NRA — National Registration Authority for Agricultural and Veterinary Chemicals, CASA — Civil Aviation Safety Authority, ARPANSA — Australian Radiation Protection and Nuclear Safety Agency, AMSA — Australian Maritime Safety Authority, ASA — Airservices Australia. [b] Revenue from 'other sources' does not include an appropriation from the Government. [c] Cost recovery charges were deliberately set below costs to offset surpluses earned between 1995-96 and 1997-98. [d] ANZFA cost recovery revenue in 1999-2000 came from royalties and sale of publications. It did not recover any revenue from regulatory activities. [e] NICNAS received $113 000 appropriation from Government to cover 50 per cent of its compliance monitoring costs (despite a 100 per cent cost recovery target). [f] The NRA has a stated 100 per cent cost recovery target, but it receives an appropriation from Government of $108 000 for minor use chemicals (equal to 1 per cent of revenue in 1999-2000) (NRA, sub. 39, p. 4). [g] ASA classifies this revenue as commercial service charges rather than cost recovery. [h] ASA receives an appropriation of $11 million to subsidise the cost of towers at regional and general aviation airports. This subsidy is funded by industry from a levy on avtur fuel. [i] ASA bases its charges on the cost of providing its services, maintaining its assets and earning a reasonable profit.

Source: PC estimates based on responses to part I of the questionnaire.

Most of the health and safety agencies recovering costs on an activity basis have distinguished activities that are provided as 'community service obligations' (that are funded from general taxation revenue) from those that have easily identifiable or direct beneficiaries (that are cost recovered).[1] AMSA, for example, fully recovers the costs of regulatory services provided to industry directly but funds its search and rescue functions (which it identifies as a community service obligation) through general taxation revenue.

[1] The term 'community service obligation' is commonly applied to non-commercial activities that government business enterprises are required to undertake for social or equity policy reasons. Government usually directly subsidises these enterprises for undertaking community service obligations.

ANZFA has adopted a different approach. A new model to recover the costs of ANZFA's regulatory activities was introduced in July 2000, although the arrangements have not yet generated any revenue. This model enables ANZFA to impose cost recovery where an 'exclusive capturable commercial benefit' can be identified from the approval of an application, or where applicants request that extra resources be used to 'fast track' their application. This approach may reflect the nature of regulation undertaken by ANZFA:

> Unlike the activities of the Therapeutic Goods Administration or the National Registration Authority, in most cases, the processing of an application by ANZFA 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. (sub. 67, p. 3)

Under this test, ANZFA would recover the costs of an application where the applicant has a legally enforceable property right in a product. Section 66 (9) of the *Australia New Zealand Food Authority Act 1991* states:

> … an exclusive, capturable commercial benefit applies where:
>
> (a) the applicant can be identified as a person or body that may derive a financial gain from the adoption of the draft standard or draft variation of the standard that would be prepared in relation to the application; and
>
> (b) any other unrelated persons or bodies, including unrelated commercial entities, would require the agreement of the applicant in order to benefit financially from the approval of the application.

By contrast, the TGA recovers the costs of all activities regardless of whether the applicant has a property right. Some participants have criticised this approach, arguing that the costs of assessing complementary healthcare products (which are not patentable) should be treated differently from the costs of assessing pharmaceutical products (most of which are patentable) (CHC, sub. 17, p. 4). Similar issues have arisen recently about potential new uses of products that are out of patent (such as generic pharmaceuticals).

There is no uniform treatment of costs relating to policy, research, compliance and monitoring functions. These functions include the preparation of ministerial briefings, litigation activities and research. The TGA and the NRA are required to recover the costs of policy development and regulatory activities from industry. NICNAS, in contrast, receives an appropriation for 50 per cent of its compliance costs, and policy functions relating to industrial chemicals are undertaken by the National Occupational Health and Safety Commission and funded through general taxation revenue.

Historical context

Cost recovery has been an established practice in some health and safety regulatory agencies for several decades. CASA noted that 'cost recovery has been a feature of the provision of aviation regulatory services since 1956' but became policy in 1988 (sub. 75, p. 2). Cost recovery arrangements were introduced in AQIS in 1979. Other agencies, such as the NRA and NICNAS imposed cost recovery arrangements upon their establishment (beginning in 1995 and 1990 respectively).

Although agencies introduced cost recovery arrangements at different times, there has been a general trend across all agencies to increase over time the proportion of costs recovered. The TGA began operations in 1991 with a 50 per cent cost recovery target (although this target was not reached until 1996). This target was later revised to require industry to fully fund those functions specifically related to industry. To implement this revised target, the TGA, in consultation with industry, classified each activity as either industry related or 'in the public interest' and allocated the costs of each activity accordingly. All executive activities were attributed to public interest functions (funded through general taxation revenue) and almost all pharmaceutical evaluation activities were industry related (83 per cent cost recovered). All corporate overheads were to be funded equally from the industry and general taxation. In the 1996-97 budget the Government increased the TGA's agency-wide cost recovery target to 75 per cent, to be phased in over three years. In 1997-98 the Government determined that 100 per cent of the agency's costs would be recovered from industry from 1998-99.

The cost recovery charges of AQIS have also been progressively increased. AQIS introduced cost recovery in 1979, with a requirement to recover 50 per cent of its export inspection activities. Between 1979 and 1988 AQIS expanded the range of activities subject to cost recovery until all inspection activities of agricultural commodities were partly cost recovered. The rate of cost recovery for inspection activities was subsequently increased to 60 per cent of costs in 1988 and to 100 per cent in 1991.

Nature of cost recovery arrangements

Health and safety agencies use a variety of mechanisms to recover the costs of their activities. Most agencies impose fees for regulatory activities provided to industry. These fees are categorised under a number of headings including assessment, administration, registration and application fees, and regulatory service fees. Most health and safety agencies also charge fees for the sale of publications and for other non-regulatory activities such as contracted research and the provision of seminars, conferences and training courses.

The majority of agencies also recover costs through levies or taxes (including customs and excise duties). Levies may be charged on a per product basis (such as the NRA levy on Australian gross sales of products) or on a company basis (such as the NICNAS company registration levy). The cost recovery arrangements imposed by the NRA are outlined in box D.2 as an illustration of the mechanisms used by health and safety agencies.

Box D.2 NRA cost recovery arrangements — three main mechanisms

Application fees are imposed under the Agricultural and Veterinary Chemicals Code. These fees are set out in the regulations to the code and vary according to the type of application and the assessment required. Depending on the type of application, fees fall into one of the following four categories: new products; variations to existing registered products; permits; and modular assessments.

Annual registration renewal fees are imposed under the Agricultural and Veterinary Chemicals Code. Companies are required to pay an annual registration renewal fee for each product on the register. The fees are determined according to the product's disposals in the previous calendar year, where disposals equal the value of the product's gross sales in Australia. The fee paid per product is as follows:

Disposals	*Fee*
Over $25 000	$1000
Between $10 000 and $25 000	$600
Less than $10 000 (registered in three or more States/Territories)	$300
Less than $10 000 (registered in one or two States/Territories)	$200
Nil disposals	$200

Levies on disposals of registered products are imposed under three Acts: the *Agricultural and Veterinary Chemical Products Levy Imposition (General) Act 1994*; the *Agricultural and Veterinary Chemical Products Levy Imposition (Excise) Act 1994;* and the *Agricultural and Veterinary Chemical Products Levy Imposition (Customs) Act 1994*. The levy monies are collected under the *Agricultural and Veterinary Chemical Products (Collection of Levies) Act 1994* and the levy rates are prescribed under regulations to this Act. The fees listed above do not raise sufficient revenue to recover all of the NRA's costs, so levies are used to 'top up' the revenue from application fees and fund compliance activities. The levies are payable on a product's gross sales, exclusive of sales tax. The current levy rates are as follows:

Disposals	*Levy rate*
Less than $100 000	Nil
$100 000 or more	0.65 per cent (capped at $25 000)

Source: NRA (sub. 39, pp. 3–4).

Legislative arrangements

Legislation underpins the cost recovery arrangements of most health and safety agencies. The nature of these legislative arrangements generally varies in accordance with the agency's legislative standing. The enabling legislation of most agencies established as statutory authorities (such as AMSA and the NRA), provides for charging fees-for-service. These provisions are often qualified with a clause that states that such charges are not to amount to taxation (see chapter 3). AMSA's ability to charge is further qualified:

> The amount or rate of a charge must 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 must not be such as to amount to taxation. (s.47(12), *AMSA Act 1991*)

Although the broad authority to charge fees is granted under the enabling legislation, regulations attached to the enabling Act generally provide for the specific nature and amount of fees charged.

Cost recovery regimes of non-statutory authorities also have their foundations in legislation, but the enabling provisions are generally more specific regarding the types of charge that may be imposed. NICNAS, for example, sets charges under the *Industrial Chemicals (Notification and Assessment) Act 1989*. This Act lists the services for which fees may be prescribed under regulations (s.110).

Cost recovery levies (which are technically taxes) must have authorisation in a specific tax Act (see chapter 3). The TGA annual charge, for example, is authorised under the *Therapeutic Goods (Charges) Act 1989*. Similarly, each of the AMSA levies is authorised under a separate Act. Regulations made under the levy Acts usually set out the levy rates, and associated Acts deal with the collection of the levies.

Rationales for existing arrangements

Cost recovery has become an established aspect of health and safety regulation in Australia. Agencies generally did not provide the Commission with detailed reasons for the introduction of their cost recovery arrangements, and in many instances, cost recovery appears to have been imposed without a formal rationale.

The NRA explained its move to full cost recovery in 1995-96 as being 'in line with government policy targets' (sub. 39, p. 2) and NICNAS explained that its move from 50 per cent to 100 per cent cost recovery in 1996-97 was 'to align … with other chemical regulatory agencies, such as the NRA' (sub. 33, p. 1).

The Commission's questionnaire for this inquiry asked agencies to explain the reasons for their existing cost recovery arrangements. Generally, responses varied and provided little detail. Some agencies provided brief responses, such as 'user pays' and 'government decision' while others provided no explanation. AQIS noted that:

> … decisions to introduce cost recovery arrangements in AQIS related to various Government's policies to, where possible, recover costs of providing services to industry where services could be regarded as a normal business expense. (questionnaire response)

ANZFA provided a more detailed rationale for its recent introduction of cost recovery, stating that the arrangements were 'to allow better management of both ANZFA's scarce resources and its workload' (questionnaire response).

Although responses to the questionnaire were generally brief, the rationales for many existing arrangements have been outlined in external reviews of cost recovery arrangements. A review of AMSA levies in 1997 noted that full cost recovery of AMSA's safety and regulatory activities was introduced to conform with:

> … proper public sector pricing principles to recover avoidable costs. The principle states that, as shipping is an economic activity which requires regulation in the community interest, the cost of such regulation should be borne by those generating the need for regulation. In simple terms, if the shipping industry or shipping activity did not take place, the community would not incur the costs of regulation — as it does, those who generate the need should pay the cost and not have it borne by the general community. (Taylor 1997)

Some rationales for cost recovery arrangements have changed over time in response to policy changes. The Australian Pharmaceutical Manufacturers Association suggested that the 100 per cent cost recovery target of the TGA is inconsistent with the TGA's earlier rationale in support of partial cost recovery — in 1991, the then Minister, supported partial cost recovery for the TGA, noting that some activities of the TGA were performed in the public interest and should be funded from general taxation revenue (House of Representatives 1991, p. 464).

In a submission to this inquiry, the TGA argued that full cost recovery is warranted on the grounds that industry gains a significant commercial benefit from product endorsement and 'that all regulatory effort by the TGA is undertaken solely because the industry exists' (sub. 89, p. 10). TGA currently recovers from industry the cost of policy advice, monitoring, compliance and administration costs.

Some agencies stated that they recovered costs because their users were other agencies that in turn recovered costs. The Department of Environment and Heritage, for example, conducts risk assessment reports and provides policy advice to both

NICNAS and the NRA. These assessments deal with the potential effects of chemicals on the non-human environment. The department fully cost recovers this service and stated:

> Consistent with government policy on cost recovery for chemical registration functions, the NRA is fully cost recovered. Environment Australia's provision of the services of environmental risk assessment to the NRA is in turn fully cost recovered. (questionnaire response)

D.2 Impact of cost recovery on agencies

Health and safety agencies have not applied a uniform approach to cost recovery. Agencies apply various charging mechanisms to recover the costs of their activities, and arrangements for the administration and governance of agencies also differ. These approaches have varying effects on agency efficiency.

Incentive effects for agencies

Cost recovery has the potential to create positive or negative incentives for agencies. Positive effects may arise from improved efficiency (although this may be difficult to measure), improved accountability and transparency, as well as improved demand responsiveness. Negative incentive effects may include industry capture, cost padding, gold plating, regulatory creep and cost shifting.

Efficiency effects

Some health and safety agencies said that cost recovery has promoted agency efficiency, transparency and accountability. NICNAS, for example, highlighted increases in outputs, better access to products, and improvements in the quality and useability of its assessments, while costs had remained at 1997 levels (sub. 33, p. 3).

Organisations such as the Industry Working Group on Quarantine stated that cost recovery has improved AQIS's efficiency:

> There is also, I believe, an expectation from the cargo owners and indeed the service providers that, if you have a cost recovery mechanism or system, it should lead to an improvement in efficiency in the service — if you're paying for it — and in our case it has led to efficiency improvements. (trans., p. 1246)

The NRA stated that full cost recovery had increased industry expectations, which had led it to complete 98 per cent of submissions within the allocated timeframe. It also claimed to have been assisted in this achievement by improved industry efficiency — applicants lodged higher quality submissions, in the knowledge that

they will bear additional costs if they need to resubmit their application (sub. 39, p. 1).

Transparency and accountability

The Industry Working Group on Quarantine stated that cost recovery had led to improvements in AQIS's transparency and accountability:

> Industry questions the regulatory authority a lot more than perhaps the regulatory authority would through an internal audit, because we see the commercial side of things and we may suggest that there are better ways of dealing for instance, with the cost recovery mechanisms. (trans., p. 1247)

While cost recovery may encourage users to seek value for money in agency activities, it may also work against accountability to the public. Organisations such as the Complementary Healthcare Council of Australia stated that 100 per cent cost recovery arrangements remove statutory agencies (such as the TGA) from the Government scrutiny applied to agencies funded by appropriations, thus reducing their transparency and accountability (sub. 17, p. 11).

Other industry participants suggested that current arrangements are insufficient to address transparency and accountability concerns and that more direct approaches are required. These could include board representation, industry consultation and the formation of industry consultative committees, with access to appropriate data for measuring performance.

Demand responsiveness

By pricing outputs, cost recovery can help agencies be more responsive to demand. However, the mandatory nature of the regulatory activities undertaken by these agencies gives them considerable power in setting rates and makes it difficult to use demand management techniques. ANZFA's cost recovery arrangements recognise that companies may be willing to pay for the extra resources needed to fast track applications. Although this policy is in place, it is yet to be applied. However, it is important that such arrangements employ additional resources rather than divert resources away from existing agency activities.

Industry capture

Full cost recovery, combined with stakeholder influence, can also lead to perceptions of industry capture, as recognised by the Complementary Healthcare Council of Australia (sub. 17, p. 22). This is particularly the case when industry

believes it has a right to influence regulatory agencies' activities because it pays for them:

> 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. This may be through a Board or stakeholder group that has responsibility to advise on the ongoing process. (PACIA, sub. 24, p. 7)

The NRA stated that it attempts to minimise the risk of agency capture by ensuring transparency and openness within the agency:

> The NRA's management and consultative arrangements also allay fears of industry capture by being very open and transparent. All assessment reports are made available to the public and decisions are disseminated via the NRA Gazette and other communication vehicles. Strong public input is encouraged. (sub. 39, p. 6)

Cost padding

Some industry participants raised concerns about agencies' costs and their impact on charges. For example, Blackmores viewed the annual charges for listing products on the Australian Register of Therapeutic Goods (ARTG) (between $350 and $950 per product) as excessive:

> Changes to the ARTG are made on a fee per application service. It should be reasonable to expect these application fees should also cover the maintenance of the database as well. A computer database of this nature could be contracted out to the private sector at a greatly reduced cost. (sub. 25, p. 1)

Whiteley Industries raised concerns about the costs associated with evaluating anti-bacterial handwash:

> …the simplest testing which is in fact not applicable any more to the TGA is a simple test that costs about $500, but that is not good enough now, we have to use other tests. The cheapest of those costs around about $5000. (trans., p. 1005)

The Australian Chemical Specialties Manufacturers Association raised concerns about calculation of evaluation costs by NICNAS. For example, NICNAS charges a Low Volume Chemical permit fee of $2600 to import less than 100 kg per annum of a new ingredient:

> This process should take less than half a day and is certainly less complex than the TGA Listing Application, for which the TGA fee is $400. NICNAS should be required to justify their $2600 fee for this evaluation. (sub. DR164, p. 12)

The Australian Self-Medication Industry, as well as the Complementary Healthcare Council of Australia, questioned the appropriateness of TGA rental costs. The Department of Finance and Administration imposed a net annual rent of

$5.3 million — an increase of $3.3 million — just prior to the sale of the premises (ASMI, sub. DR123, p. 1; CHC, sub. DR155, p. 3).

Regulatory creep

The Australian Paint Manufacturers Federation stated that cost recovery for government bodies is analogous to a monopoly 'whose decisions do not have to stand the test of competitive scrutiny'. As a result, cost recovery can lead to regulatory creep as 'it is seen by the bureaucrats as a way of extending the organisations operations' (sub. 74, p. 4).

The Australian Chemical Specialties Manufacturers Association raised concerns over the regulatory expansion of the TGA with respect to low risk products such as anti-bacterial handwash and disinfectants:

> …the TGA introduced a new test without any published supporting peer review paper … At that time, there was no Australian laboratory which could run this new protocol and no Australian manufacturers had ever tested their product to this standard. (sub. DR164, p. 9)

The Australian Chemical Specialties Manufacturers Association also raised concerns that agencies, such as NICNAS may develop more stringent regulatory requirements than those overseas, and impose greater costs on Australian firms:

> Product safety data which is accepted by our major trading partners is not accepted in Australia. This means that firms here are forced to provide duplicative and/or unique safety data for Australian regulators, increasing costs and the regulatory burden. (sub. DR164, p. 10)

Cost shifting

When agencies cost recover for some activities and not others, there may be incentives to shift outputs from those that do not recover costs to those that do (see chapter 8). Shifting resources away from those activities with public benefits towards those with private benefits may be inconsistent with program objectives. These concerns were identified in the *Nairn Report, 1996 — Australian Quarantine: A Shared Responsibility*:

> 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 1996 *in* Red Meat Advisory Council, sub. 47, p. 23)

Agency innovation and technology

New technologies may promote both agency and industry efficiency which may also be reflected in lower charges. Information technologies, particularly the Internet, are changing the relationship between regulators and those they regulate. Increasingly, those who must comply with the regulations are able to provide information to the regulator via the Internet.

The TGA stated that the introduction of the electronic lodgement facility has dramatically reduced processing times from 80 to 10 days in the majority of cases for low risk products (sub. 89, p. 21).

Some agencies are actively encouraging the shift to electronic communication. AQIS, for example, encourages industry to use electronic certificates for export by under-charging for electronically issued documents and over-charging for manually issued certificates. The Australian National Audit Office report into AQIS cost recovery systems noted that this practice was agreed with industry (ANAO 2000a, p. 89).

Operation of cost recovery

The implementation of cost recovery requires the calculation and apportioning of costs. Agencies differ in how they allocate costs across activities.

Calculating and apportioning costs

Regardless of the extent of cost recovery undertaken by individual health and safety agencies, most start by estimating their total cost base and allocating both direct and indirect costs to outputs. All health and safety agencies apportion costs by applying some form of Fully Distributed Cost approach (see appendix H). NICNAS, the NRA, the TGA and AMSA use Activity Based Costing to apportion costs (see appendix B). ANZFA, ARPANSA and AQIS all use Fully Distributed Costing to allocate indirect costs as a proportional share of direct costs. AQIS's approach is summarised in box D.3.

Box D.3 **AQIS's approach to apportioning costs**

AQIS apportions costs using a Fully Distributed Cost approach. Where possible, it apportions indirect costs to the different user groups directly (on a program basis), so as to minimise cross-subsidies between users.

AQIS differentiates between those indirect costs that can be specifically attributed to a subset of users (technical and operational costs) and those, such as overheads, that are applied across the whole agency.

- *Technical and operational costs* are exemplified by the costs of detector dogs which are specific to the airports, import clearance, Northern Australian quarantine strategy and the international mail programs. These are allocated on the basis of the number of dog teams used.

The remaining indirect costs are apportioned through a variety of mechanisms, predominantly as a proportion of full-time equivalent staff or as a proportion of direct expenditure:

- *Corporate expenses* are charges of the organisation as a whole, such as insurance and internal audit charges. These are apportioned on the basis of full-time equivalent staff.
- *Overheads* include support services in finance, human resources, information technology and regional support. These are allocated on the basis of drivers such as full-time equivalent staff across relevant programs, direct expenditure, invoices processed, accounts raised and floor space, and represent 11 per cent of AQIS's 2000-01 budget.

Sources: Questionnaire response; ANAO (2000a, pp. 48, 115); AFFA (trans., pp. 664–5).

Cross-subsidies

Cross-subsidies occur when some 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 (ANAO 2000a, p. 84). Many cost recovery arrangements incorporate either incidental or deliberate cross-subsidies, and submissions to this inquiry revealed that rationales for cross-subsidies differ among health and safety agencies. Rationales include the difficulties of separating the costs of the activities/programs, identifying users of the activity or product, perceived equity concerns about charges and responding to industry preferences for the calculation and implementation of charges.

Most health and safety agencies are able to separate their activities within programs and do not use revenue from one program to cross-subsidise another. One exception is the TGA, which uses the revenue from annual registration charges (for

registration on the Australian Register Therapeutic Goods database) to cross-subsidise post-market monitoring and compliance functions.

The difficulty of identifying the users of a regulatory activity was not a common rationale for cross-subsidisation, except for transport agencies. AMSA imposes a general levy based on ship tonnage (the Marine Navigation Levy) to fund the provision of navigation aids such as lighthouses, because it would be impractical to monitor the individual use of these aids. Until 1988, ASA operated a network pricing framework that implicitly included elements of cross-subsidy. (ASA now applies location-specific pricing based on the costs of individual towers).

Various health and safety agencies listed perceived equity reasons for cross-subsidies. CASA subsidises the shortfall from regulatory fees through fuel excise and customs taxes. Similarly, ASA subsidises the costs of operating landing towers at regional airports through a special appropriation funded by fuel excise. These cross-subsidies tend to benefit smaller regional operators at the expense of larger airlines.

In relation to this arrangement, Ansett argued that equity considerations 'should be funded through a community service obligation, not via industry cross-subsidies' (trans., p. 692).

Finally, the adoption of cross-subsidies by some agencies was partly a response to industry consultation. AQIS stated that its policy is to prevent cross-subsidisation between user groups (or programs) by setting charges to achieve full cost recovery (AFFA, sub. DR151, p. 17). However, it has adopted a cross-subsidisation model within its meat inspection program:

> … industry felt the registration charges where too high and they wanted there to be some cross-subsidisation from the fee-for-service arrangement into the non-variable cost structure. That was agreed with industry. It adulterated the purity of our model but it was what industry preferred, and they agreed, and we agreed with them and it has been a very useful mechanism for ensuring that we have agreement with industry. (AFFA, trans., p. 668)

Managing cost recovery revenue

Because of the difficulty of accurately estimating the level of demand for their activities and associated costs, agencies may over-recover (or under-recover) costs in any particular period.

SLASO, for example, has set its charges by calculating the expected full operating costs of the agency over the relevant period (two years) divided by the expected total number of applicants (DISR, sub. 62, p. 16). It has received advice that it was

not imperative for the licence/permit fees to exactly equal the costs, because 'if the fees were calculated in good faith' then they would not amount to taxation. However, the advice noted that if revenue exceeds costs in one period, then fees should be adjusted in the next period to achieve balance (DISR, sub. 62, p. 16).

Where over-recovery of costs may occur, most health and safety agencies indicated that they retain the revenue, but differed in how they manage the surplus. The NRA and ARPANSA stated that excess revenue leads to an adjustment of their respective charges. The TGA noted that excess revenue may be used to limit future price increases or may be retained in case of future revenue shortfalls. (The TGA over-recovered in 1995, 1996 and 1997, but recovered only 85 per cent of its costs in 1999-2000.) NICNAS stated that any revenue in excess of full costs is allocated to priority projects as identified by its Industry Government Consultative Committee (questionnaire responses, appendix B).

AQIS stated that over-recovered funds are allocated into one of three liability accounts following industry consultation (box D.4). However, despite these arrangements, the Australian National Audit Office (2000a, p. 20) found that AQIS had retained $5 million of over-recovered funds and not yet returned them to industry in the form of discounts and rebates to charges.

Box D.4 **Treatment of over-recovered AQIS funds**

Over-recovered AQIS funds are placed into one of the three following liability accounts.

The Income Equalisation Reserve is used to enable AQIS and industry to overcome unforseen downturns in the recovery of expenditure over a period of years. Reserve accounts are established with the agreement of industry, through the program consultative committees.

The Revenue Rebate is used to reduce temporarily the level of charges applied for services performed by the program, as agreed with industry. The method and timeframe for returning these funds is a matter for the relevant consultative committee.

The Industry Initiative Account is used in consultation with industry for projects of benefit to industry, such as research and development, marketing and promotional activities.

Sources: AFFA (sub. DR151, p. 12); AQIS (questionnaire response); ANAO (2000a).

The ability of agencies to retain revenue in excess of their full costs may create incentives for agencies to increase charges (as discussed earlier). Over-recovery of fees-for-service could lead to fees being construed as taxes. AQIS 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. 68). Strong governance arrangements to

promote transparency and accountability would reduce the incentives for over-recovery and any associated risk of legal challenge to fees.

Contestability

A level of contestability can be introduced to an agency's activities through the outsourcing and market testing of activities. For example, the outsourcing of various components of the assessment process for foods, chemicals and pharmaceuticals could lead to greater contestability and promote increased agency efficiency. International arrangements, such as mutual recognition, may also introduce contestability to agency activities. Mutual recognition would increase the pressure on Australian regulators to be efficient by making them compete with comparable international bodies.

International harmonisation of regulation is a necessary first step towards mutual recognition and can also reduce the compliance cost to industry and agency administration and processing costs.

Some inquiry participants complained about a lack of harmonisation and mutual recognition in health and safety regulation. The Australian Chemical Specialties Manufacturers Association noted that:

> … the lack of international harmonisation of definitions and classifications makes provision of data and compliance more difficult and costly. (sub. 60, p. 7)

It also 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)

Similarly, the Plastics and Chemicals Industry Association suggested agencies should:

> … outsource the technical review aspects and undertake a more managerial approach to the assessment process. This would likely lead to competitive costs and reduced overheads which are more justifiable to the applicant. 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 Complementary Healthcare Council of Australia supported this view, stating:

> Many TGA activities could be contested by the private sector. For example, the Australian Register of Therapeutic Goods … 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. At the very least contestability would benchmark TGA performance. (sub. 17, p. 2)

Similarly the Medical Industry Association of Australia noted that the TGA could implement more efficient arrangements by introducing competition in conformity assessment for therapeutic devices, which could:

> … remove potential conflict of interest issues wherein the TGA currently establishes regulatory standards then assesses products against them. (sub. 122, p. 4)

Administrative arrangements

The mechanism adopted for recovering costs (for example, fees-for-service versus levies) can affect the complexity, efficiency and cost of administrative arrangements. Fees-for-service, for example, may be more costly to administer than a levy or tax because of the complexity in calculating appropriate charges. There are also issues relating to the collection method of charges and concerns about their predictability.

In the case of AMSA and CASA, some taxation revenue is hypothecated — that is, the revenue raised through particular tax instruments is earmarked for appropriation to the agencies. Revenue generated from the *Fuel Aviation Revenue (Special Appropriations) Act 1998* is earmarked for CASA. Similarly, revenue received from the Regulatory Functions Levy, the Marine Navigation Levy and the Protection of the Sea Levy are all hypothecated to AMSA. A common issue with levies is ensuring that the amount raised matches the amount needed to fund the relevant activity. Qantas, for example, stated that 'the aviation fuel duty has returned $7.6 million more than anticipated in the past two years' (sub. DR152, p. 2).

The appropriate cost recovery mechanism can depend on the type of program being cost recovered. Levies may be appropriate where it is difficult to allocate costs and benefits to individual users, where users cannot be charged directly or where costs need to be recovered over a long period of time (see chapter 7). Examples include the Marine Navigation Levy (imposed by AMSA) and the Aircraft Noise Levy (imposed by the Department of Transport and Regional Services). However, levies have been criticised for a lack of transparency. As noted by Ansett:

> We have enormous concerns about the use of fuel levies as an appropriate cost recovery mechanism … They are certainly administratively easy. They're not transparent. (trans., p. 694)

While most health and safety agencies collect cost recovery charges themselves, the collection of charges relating to the Department of Transport and Regional Services and transport agencies such as CASA and AMSA are outsourced. The Australian

Taxation Office collects the fuel excise on behalf of CASA, while the Australian Customs Service collects AMSA's levies (but does not charge AMSA for this service).

The Australian Customs Service collects AMSA levies in the course of its barrier management inspection duties. The Australian National Audit Office recognised this to be an efficient approach to levy collection, but noted:

> Consistent with the need for transparency in the management of levies, the collection costs should be visible. As well, they should be included in the total costs attributed to the levy, even if this is at the reporting level and not imposed as a fee-for-service. (ANAO 2000c, p. 44)

ASA collects the Aircraft Noise Levy on behalf of the Department of Transport and Regional Services (using the same administrative system that is used in the collection of aircraft landing fees), and charges the department for this service.

The stability of cost recovery administrative arrangements varies. Transport agencies (such as CASA and AMSA) have had stable administrative arrangements dealing with excise/levies, community service obligation funding and fees-for-service over many years. However, agencies such as the TGA and the NRA, which now fully cost recover, have been subject to changes in government policy relating to cost recovery targets. ANZFA recently implemented new cost recovery arrangements, while the cost recovery arrangements of the OGTR and SLASO are still under review.

Governance

In broad terms, governance refers to the processes that direct and control agencies, and hold them to account. Cost recovery can have important impacts on these arrangements. Key elements of governance include: the transparency of the agency and its activities; the implementation of effective risk management and financial management; and the accountability of the agency (or its board) to stakeholders and the public through clear and timely disclosure. This may involve consultation with stakeholders to enhance the predictability of cost recovery arrangements.

Accountability

Those health and safety agencies that are regulated by the *Commonwealth Authorities and Companies Act 1997* (the CAC Act) are required to have a board structure in place (for example CASA, ASA and the NRA). The board is responsible for management to the Minister. The CAC Act sets out standards of conduct for directors, such as a standard for establishing an audit committee to

assist in financial reporting, risk management and internal control. In other agencies, the Chief Executive Officer is accountable to the relevant Minister.

Industry participants such as Avcare suggested that a board structure with industry representation is their preferred system of governance, stating that the presence of a board may be 'one way to achieve transparency, and scrutiny of some of the costs' (Avcare, trans., p. 385). However, as noted earlier, direct stakeholder participation may lead to perceptions of the agency being 'captured'.

The Australian National Audit Office noted that board representatives should be selected on the basis of their expertise relating to the agency and their financial management skills because they have an obligation to manage the agency with public interest objectives in mind (ANAO 1999).

Consultation

All health and safety agencies have some form of process to consult with stakeholders. However, the degree of accountability and transparency of these arrangements varies between and also within agencies. Most statutory bodies and agencies provide for consultative committees, but their establishment and functions are not standardised.

AQIS operates a separate Industry Consultative Committee for each of its 14 commodity/industry groups, except the Animal Quarantine Stations (because there is no easily identifiable industry for this program). The Industry Consultative Committee for the AQIS meat program, for example, includes:

> A wide range of industry representatives, from game meat establishments, through to red meat establishments, through to cold store operators — everyone in the production chain. They all have sort of cross-representation. Participation in that is financed by the individual group, whoever they happen to be representing, and the secretariat services are provided by AQIS. (AFFA, trans., p. 670)

The AQIS Industry Cargo Consultative Committee appears to promote effective consultation. The committee promotes accountability and transparency across many areas including the Industry Working Group on Quarantine, which has representation on the committee, stated that it addresses:

> … the operational side of things, financial management, cost recovery … over-recovered funds [and] income equalisation reserves … I think the success of the committee has led to further success, so that as it's seen to be an effective way of working, you can do more … (trans., pp. 1245, 1249).

The perceived value of other consultative committees may differ between agencies and stakeholders. The TGA stated that the TGA Industry Consultative Committee (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)

This view contrasts with that of the Complementary Healthcare Council of Australia, which suggested this committee was not sufficiently accountable and transparent, particularly regarding issues of financial management:

> The TICC committee 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 Medical Industry Association of Australia also had concerns with the TGA Industry Consultative Committee and stated:

> … [it] fails to deliver a forum in which industry can expect to be given an opportunity to shape TGA business practices. Industry input can be and is ignored and industry is not empowered in the TICC process to prescribe performance standards. (sub. 122, p. 4)

More generally, the Australian National Audit Office noted that the TGA could improve its relationship with stakeholders by publishing more detailed information in annual reports, as well as producing quarterly performance reports (2000b, p. 54).

Predictability

Predictability in agency activities and charges can improve the stability of its funding base. It can also promote business confidence and enable industry to make informed decisions. As identified by Avcare:

> Fees should be set by regulation and not fluctuate each year according to the predicted workload of agencies (that is, number of applications) as happens with the TGA. A fluctuating approach does not provide the necessary cost predictiveness and budget forecast certainty for industry. (sub. 28, p. 9)

Most health and safety agencies have processes in place to encourage predictability in activities and charges. NICNAS operates a company registration system, which requires that all persons or companies importing or manufacturing industrial chemicals valued at more than a total of $500 000 must register annually with NICNAS and pay a registration charge. A recent evaluation by NICNAS found that:

> … the company registration system provides a stable and predictable funding base, and that the administrative costs of the program compare favourably with alternative funding mechanisms such as funding from consolidated revenue. (sub. 33, p. 2)

As mentioned earlier, AQIS is able to reduce instability in its charging arrangements by allocating over-recovered funds into liability accounts:

> AQIS's policy is for programs to endeavour to fully recover their costs in the year they are incurred. However, full cost recovery in one year is weighed against the necessity for price stability and, in practice, it is not possible to achieve full cost recovery every year without frequently amending charges … The [Income Equalisation Reserve] account is designed to reduce the need for constant changes to fee/charging levels. (AFFA, sub. DR151, p. 12)

Predictability in AQIS's charging arrangements has broad industry support. The Industry Working Group on Quarantine stated:

> … we try to have a predictability of costs, and that's very, very important to industry — that industry knows what the up-front costs are and also doesn't have those costs changing every year or every six months. It's very important to us. (trans., p. 1247)

On the other hand, the TGA has come under industry criticism because its specified charges, although predictable, do not adequately reflect actual costs. Although the TGA differentiates between high and low risk evaluations, assessment charges are then based on the number of pages and the type of information contained in each part of a submission. The Australian Pharmaceutical Manufacturers Association stated:

> Thus, whilst there is a specific fee, for example, for the evaluation of between 20 000 and 40 000 pages of clinical data for a prescription medicine of $88 500, the fee is only notionally related to the actual cost of the activity. (sub. 14, p. 5)

It also stated that industry has suggested increasing annual charges rather than increasing fee-for-service charges, because the former approaches would provide more certainty, but expressed concerns about transparency:

> … such an approach would seem to diminish the degree of transparency of cost recovery arrangements and may allow less pressure to be exerted on the TGA to minimise its costs and introduce efficiency gains. (sub. DR129, p. 2)

ANZFA's model for pricing evaluations (yet to be applied) grades applications according to their complexity and charges accordingly (table D.2). This is intended to 'give applicants certainty of the total charges they will face before they agree to work commencing' (ANZFA, sub. 67, p. 5).

Table D.2 **Australia New Zealand Food Authority charging structure**

Category	*Average hours*	*Cost per hour*[a]	*Actual cost*[b]	*Actual hours*
		$	$	
Very simple application	25	112	2800	0-50
Simple application	125	112	14 000	51-200
Average application	300	112	33 600	201-400
Complex application	500	112	56 000	401-600
Highly complex application	750	112	84 000	601-900

[a] Includes all salary and administration costs for a senior officer in 2000-01. [b] Charges cover all costs of varying a standard or having a product or process approved through to final decision making by the Ministerial Council.

Source: ANZFA (sub. 67, p. 5).

Some industry participants expressed concern about a lack of consultation leading to uncertainty in cost recovery arrangements. Ansett, for example, objected to the lack of consultation regarding the level of fuel levies:

> We're not consulted on the level of activity that is used in determining and setting the level of the fuel levy. We have no reconciliation at the end of the year as to the amount paid and the amount collected in the fuel levy. … we have no consultation about these levies. They're announced on budget night and take effect from midnight on budget night. They impact on our business planning. (Ansett, trans., p. 694)

D.3 Economic effects of cost recovery

The cost recovery arrangements of health and safety agencies have implications for the regulated industry, consumers and the broader economy. They may encourage efficient resource allocation across the economy and contribute to achieving the objectives of the regulation (see chapters 2 and 7). Alternatively, cost recovery arrangements may have negative effects on industry, such as contributing to barriers to entry or deterring innovation. Cost recovery arrangements may also affect consumers of regulated products through higher prices (to the extent that industry passes on the costs of regulation) or through reduced choice of products.

Resource allocation effects

The activities of health and safety agencies benefit, to some extent, three main groups:

- the consumers of regulated products (for example, through increased product safety or service standards);
- the general public (for example, through knowing there is a range of safe products); and
- the regulated firms (for example, through government endorsement of their products).

In other circumstances, health and safety agencies act to prevent the producers or consumers of a product from harming third parties ('negative spillovers'). The NRA, for example, regulates to protect the general community and environment from the potential environmental harm associated with agricultural and veterinary chemicals.

The degree to which different groups benefit may differ between agencies and activities. This can be reflected in cost recovery arrangements where agencies have adopted a 'beneficiary pays' approach. (The Commission considers that the beneficiary pays approach has limitations dealing with cost recovery for regulation that addresses negative spillovers). CASA, for example, identified the beneficiaries of its activities as the aviation industry, the travelling public and the general community. This is reflected in its funding arrangements — some taxpayer funding and some from the aviation industry, a part of which CASA assumes to be passed on to the travelling public (sub. 75, p. 4).

In some circumstances, agencies wish to apply a 'beneficiary pays' approach but cannot charge beneficiaries directly. This may be where: the regulatory activity also has 'public good' characteristics; it is difficult to identify the beneficiaries; and the beneficiaries are so numerous that it is not practical or economically efficient to charge them directly (see chapters 2 and 7).

Many health and safety agencies have identified 'public good' characteristics in some of their activities and these activities are funded from general taxation revenue. AMSA's search and rescue operations, for example, are taxpayer funded. While an emotive issue, general taxation funding of search and rescue operations places no incentive on the most likely users of the service to take greater responsibility for their actions. The Department of Transport and Regional Services suggested an 'insurance scheme':

> … an 'insurance' charge levied on the cost of provision of a year's search and rescue service may well prove to be a feasible option. (sub. 48, p. 4)

In other instances, health and safety agencies do not charge beneficiaries directly because of the difficulty (or cost) of identifying and charging them. AMSA, for example, exempts the non-commercial shipping industry from paying two of its

three levies because it would not be cost effective to levy pleasure craft and fishing vessels (Taylor 1997, p. 20). Similarly, ANZFA does not charge for applications to change the food standards code where applicants do not have 'an exclusive capturable commercial benefit'. Changes to the food standards code may benefit other members of the industry and the consumers of food products, making the beneficiaries too numerous and the task of recovering costs impractical. This 'free rider' problem may also discourage innovation in food development if 'first mover' applicants were charged (see chapter 7).

In most circumstances, consumers of regulated products are the main beneficiaries of the activities of health and safety agencies. However, agencies do not usually have direct contact with consumers and do not charge them directly. Many agencies (for example, CASA) impose charges on the regulated industry, assuming that at least a proportion of these charges will be passed on to consumers in the purchase price.

Some health and safety agencies have assumed that industry is also an important beneficiary of regulation. The TGA, for example, recovers 100 per cent of its costs from industry partly on the basis that industry obtains commercial benefit from regulation (TGA, sub. 94).

Distributional effects of cost recovery arrangements

Aside from the level of cost recovery imposed, the charging mechanisms and structures applied by agencies may also have implications for economic efficiency. Two particular issues are cross-subsidies in charging arrangements and the impact of cost recovery on small firms.

Cross-subsidies

In some industries, firms argued that one sector of the industry is subsidising the costs of regulating another sector. To the extent that cross-subsidisation occurs, price signals will be distorted and some industry sectors may consume more or less of the regulatory activity (to the extent that they have a choice) than they would otherwise. For example, both Ansett and Qantas stated that the fuel excise surcharge paid by airlines is used to cover CASA's regulatory costs and cross-subsidise smaller industry participants. The avtur levy is also used to subsidise the cost of landing towers at regional airports (Ansett, sub. 68, p. 3; Qantas, sub. 63, p. 6).

> There's a disproportionate amount of funding comes out of the levy on the fuel which in reality is paid by Qantas and Ansett as well as the main suppliers. There is a general community benefit from aviation safety overall and of course there is the direct industry benefit itself for all of industry, probably through easier administration, but the

> two airlines are paying a disproportionate part … So this is a cross-subsidy on the two major airlines. (Qantas, trans., p. 1287)

In addition, Qantas noted that only fuel purchased in Australia is subject to the excise, so:

> Australian companies … which predominantly or exclusively conduct their business overseas, receive the benefit of the regulatory oversight provided by CASA virtually free of charge by purchasing their fuel overseas and avoiding the levy. (sub. 63, p. 6)

It has also been suggested by some inquiry participants that farmers are subsidising the consumption by non-agricultural users of products regulated as agricultural and veterinary chemicals. Avcare stated:

> … the NRA also picks up a lot of products which are in the small sales category for home owner uses, things like swimming pools, companion animals and a whole raft of things which are not related to farming enterprises. So what we're seeing now is that the higher sales products tend to be the ones that the farmers use and so those costs for the whole scheme are being paid by the farming community, when in fact the bulk of those 7000-odd products are non-farm products. (trans., p. 933)

On the other hand, other organisations such as the Chemicals and Plastics Action Agenda and the Plastics and Chemicals Industry Association stated that pool chemicals such as chlorine were high volume products and the associated revenue collected by the NRA was 'used as a cross-subsidisation of other work for the agency' (PACIA, sub. 24).

> Pool chlorine is a very basic chemical. It is a very high volume chemical and as such it attracted quite substantial revenue back into the National Registration Authority … (Chemicals and Plastics Action Agenda, trans., p. 225).

Other agencies have implemented cost recovery arrangements with explicit instructions that program areas or locations are not to cross-subsidise other areas. Since 1993, AQIS has been required to recover full costs on a program by program basis, rather than across the organisation as a whole. The Australian National Audit Office concluded that AQIS has generally been successful in this regard, but noted some exceptions. For example, there was some cross-subsidisation in the cargo risk management and entry management programs, as well as in the animal quarantine station program. However, the extent of cross-subsidisation '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).

Impact on small firms

A wide range of cost recovery mechanisms is available to health and safety agencies, and inquiry participants indicated that some may result in more

disproportionate impacts on small firms than on others and, in some cases, may act as a barrier to entry (see below).

In many health and safety agencies, the size of firms determines, to some extent, the level of charges paid. The NRA, for example, imposes a cap on levy payments, and both the NRA and NICNAS impose minimum thresholds for levy payments and allow exemptions from charges in certain circumstances. However, unless differences in charges reflect differences in the level or cost of the regulatory activities consumed, the resulting allocation of resources may not be efficient.

Agencies may base charges on firm size for a number of reasons; for example, NICNAS indicated its arrangements are to minimise the regulatory burden on industry (sub. 33, p. 3). Charges based on firm size may also address distributional objectives. The Council of Small Business Organisations of Australia argued against agencies distinguishing between different groups in their cost recovery charges, stating that:

> … any good or service in the marketplace 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. (trans., p. 535)

The requirement to pay substantial charges up front, for example, may be more of a burden on small firms than large firms if economies of scale make it easier to absorb up-front charges. The NRA stated that consultation with industry prompted its decision to impose only partial cost recovery of initial application costs, and to recover the remaining cost through an annual levy on sales:

> On average about 30 per cent of actual costs are recovered from application fees. However, by having a cost recovery model which have the two components, up front fees and sales levy, the cost is spread over the life of the product. In this way fees do not unduly disadvantage smaller companies or mitigate against local research and development efforts and the promotion of minor agricultural industries. (sub. 39, p. 7)

Although industry participants broadly favour this model (which splits charges among product fees, annual fees and levies), Avcare suggested redistributing the proportion of the split:

> … to capture more at the front end … to more reflect the costs that are actually put into assessment and use levy to top up the other activities of the NRA … to minimise the amount of cross-subsidisation that is occurring. (trans., p. 932)

Avcare favours this approach because it is concerned that those firms whose products have both high volume sales and a long product life cross-subsidise products that are not subject to the levy because they have low volume sales. As stated by Avcare:

> Using levies to spread assessment costs over time is favourable. However, the way the NRA model operates … this leads to most of the assessment costs not being recovered from future sales of the product that's been approved. This is because about 70 per cent of the almost 7000 registered agvet products have sales less than $100 000 a year and don't attract a levy. … On the other hand costs are more than recovered from the few products — about 3 per cent — which have sales over $3 million a year and it does not take too many years to pay back the assessment costs from those higher selling products. A commercial life of more than 30 years is not uncommon … once the cost recovery has been paid or the assessment costs have been paid, those higher selling products continue to cross-subsidise those that don't pay their way. (Avcare, trans., p. 927)

Further, the NRA commented on the likely impact on small firms of reducing its number of charging categories:

> To ensure fees are closely aligned with the level of service, an extensive schedule of fees and charges has been determined in consultation with the industry and reviewed on several occasions. While there has been some suggestion that the number of fees/charges should be rationalised, this may not be in the best interest of small companies who service niche, yet important agricultural sectors. (sub. 39, p. 5)

Participants also commented on the alleged disadvantages faced by small firms in not being able to spread charges across a large product range, volume or market. For example, Whiteley Industries noted:

> … the larger companies can … fund their cost recovery across a greater market share with enhanced margins … As a consequence small suppliers simply cannot compete. (sub. 1, p. 2)

Industry incentives

Many health and safety agencies have incorporated positive incentives to industry into their cost recovery arrangements. Through cost recovery charges, some agencies have attempted to deter frivolous or vexatious applications, promote quality in applications and encourage industry to keep agency records up to date. The NRA, for example, which bases annual registration charges on the gross sales of listed products, imposes a $200 charge on products with nil sales as an incentive to firms to remove old products from the list of registered products. However, there is a risk that such charges are set too high, firms may be deterred from submitting worthwhile applications.

Cost recovery arrangements also have the potential to create undesirable incentives for industry. Cost recovery arrangements may encourage firms to act against the objectives of the regulation. As an example, if pharmaceutical companies were charged directly for the cost of recalling their products, then they might be

discouraged from notifying the TGA of any potential problems with a product. (Recall mechanisms are therefore often funded through an industry levy.) Cost recovery arrangements may also lead firms to behave in a manner that may increase the costs of the regulator. Taylor (1997) refers to a submission by the Australian Yachting Federation which suggested that:

> Charging their members direct[ly] could affect behaviour and search and rescue costs could be higher if their members were discouraged from using navigation aids through some charging arrangements. (p. 17)

Competition effects

Firms wishing to sell products in markets regulated by health and safety agencies face potential regulatory barriers on two levels. The first is at the firm level, where firms are often required to register and receive approval to operate. The second is at the individual product level, through individual product assessment, approval and registration. In both cases it is difficult to distinguish the impact of cost recovery charges from the impact of the regulations themselves and general market factors such as small market size and short market-life of products (see chapter 5).

Firms that face cost recovery charges in addition to the costs of complying with the regulations may be deterred from entering the Australian market. However, not all industry participants attributed decisions about market entry to cost recovery charges. Avcare noted:

> The magnitude of the regulatory costs are largely made up of data generation, ongoing sales levies and stewardship. NRA application costs by comparison are small even with full cost recovery. Business decisions to enter a market should not be made on NRA costs alone. (sub. 87, p. 4)

But a number of submissions indicated that regulatory charges had adversely affected decisions to introduce individual products into the Australian market. The Australian Paint Manufacturers Federation argued that cost recovery arrangements:

> … force companies to make decisions as to what products they will or will not produce in Australia based not on market considerations but on which products are likely to incur the lowest level of fees, levies etc. … coatings manufacturers are making decisions as to which coatings to introduce into Australia not on the basis of what the market really needs but on the basis of what the market can afford having regard, in particular, to the exorbitant level of fees and charges imposed … (sub. 74, p. 4)

The Australian Chemical Specialties Manufacturers Association complained about the additional cost of NICNAS approval for chemicals that were already approved overseas:

> The need to obtain NICNAS approval for ingredients that are widely used overseas but cannot be used here without that approval is a major and growing concern for ACSMA members. … member companies can either forgo the introduction of the product in Australia (as has happened with, for example, a fabric soil repellent) or apply to obtain NICNAS approval. (sub. DR164, p. 12)

Awin Services, commenting on the charges imposed by the TGA for therapeutic devices, noted that it would be cheaper for manufacturers to bypass the Australian market and go directly to the United States, or to the European Union, where regulatory charges are significantly lower relative to the size of the market (sub. 20, p. 1). Cochlear also complained about TGA charges:

> … the impact of 100 per cent cost recovery 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] cannot be recovered in the often short market-life of the product. (sub. 10, p. 2)

The TGA responded to this criticism by stating that current arrangements do not restrict consumer choice because the special access scheme allows individual patient access to unregistered devices in special circumstances (trans., p. 789).

The Medical Industry Association of Australia in turn responded to the TGA:

> There is a decreasing availability of certain therapeutic devices in Australia. The absence of these cannot always be addressed by the TGA Special Access Scheme as product support may not be available. (sub. DR122, p. 2)

In addition, the association stated that although the special access scheme provides access to some products, it is illegal under subsection 22(6) of the *Therapeutic Goods Act 1989* for those products to be promoted to Australian consumers (sub. DR153, p. 2; trans., p. 1066).

Technology and innovation effects

By increasing the costs of market entry, cost recovery charges may impede the introduction of new technologies and deter innovation within regulated industries. These concerns have been recognised by organisations such as the National Farmers' Federation which stated:

> New products often require extensive testing before they can be released onto the market. As a result, they can incur high registration costs which may deter businesses from investing in the new products and technologies. (sub. DR162, p. 10)

A number of agencies have recognised the potential for cost recovery to influence technological development and have modified their cost recovery policies to

remove disincentives to innovation. For example, the NRA requires only minor use permits for chemicals used in research in approved facilities and NICNAS attempts to facilitate the introduction of new technology by issuing early access permits to facilitate access to new low hazard chemicals (see chapter 7).

However, industry participants argued that some cost recovery arrangements continue to act as disincentives to innovation. The costs of approving new complementary healthcare and agricultural and veterinary products, combined with the lack of intellectual property rights in many of these products, is arguably affecting the introduction of new products by creating 'free rider' problems or 'first mover' disadvantages (see chapter 7).

The Complementary Healthcare Council of Australia argued that complementary healthcare producers face a first mover disadvantage:

> The cost of evaluating a new [complementary healthcare 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 is no patent protection for [complementary healthcare 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)

Similarly, Avcare stated that the current approval processes for the NRA, ANZFA and the OGTR were inadequate due to the free riding of data generation:

> The major obstacle to the innovation and research leading to the introduction of new and innovative [agricultural and veterinary] products is the lack of data protection which allows free riding. The patents (which have an effective life for only 10–12 years) for most (about 90 per cent) [agricultural and veterinary] products on the market have expired, however the potential for innovative developments such as new uses and better formulations which are not patentable continues throughout the commercial life of the product which is often 50+ years. (sub. DR118, p. 4)

However, Avcare noted that cost recovery charges should not be used to deal with intellectual property issues (sub. DR118, p. 4).

The Chemicals and Plastics Action Agenda stated that assessment costs are a major impediment to the introduction of new technology in small Australian markets. It highlighted the case of low-solvent paints (which are available in the United States and Europe) which have not been introduced into Australia. It argued that these paints would lead to a reduction in solvent emissions by at least two million litres, which could 'lead to an improvement in either/or environmental quality or public health and safety' (sub. 15, p. 4).

The Department of Industry, Science and Resources observed that charges may deter the development of whole industries, by contributing to barriers to entry:

> … the long-term viability of a new and emerging industry may be inhibited by unduly heavy regulation and cost recovery, especially if these burdens are of an up-front kind. (sub. 62, p. 6)

Two recently proposed cost recovery arrangements, if implemented, could have such effects. The Government has proposed to recover 100 per cent of the costs of the newly established OGTR and SLASO. Each of these agencies is authorised by legislation to charge fees, although regulations determining the fee structures and levels have not yet been implemented. Evidence submitted to the Commission indicates that both agencies are unlikely to receive more than a handful of commercial applications in the initial years of operation, but are expected to operate on a 100 per cent cost recovery basis. The effect of imposing 100 per cent cost recovery on these agencies from the outset, on a strict year by year basis, would result in higher costs being borne by the industry innovators. Further, some clients of these agencies are likely to be researchers and public institutions which, some participants suggest, may have difficulty meeting these charges.

KPMG Consulting summarised the impact of the proposed cost recovery arrangements for the OGTR:

> … around 94 per cent of all applications for gene technology dealings are publicly funded organisations undertaking research with little or no budgetary capacity to address cost imposts without detracting from the funds available for gene technology research. Consequently, an inappropriate cost recovery regime could lead to much proposed gene technology R&D work not being undertaken in Australia, or being moved off-shore. Under either scenario, Australia would be a major loser both economically and in its attempts to remain in the global mainstream of gene technology developments. (2000, p. 3)

The Department of Industry, Science and Resources has responded to these concerns by developing 'a concessional fee structure for non-commercial scientific and educational launches' (sub. 62, p. 19). While the regulations outlining the fee structure for the OGTR are yet to be finalised, the Government agreed to delay implementing full cost recovery until after the first two years of operation.

E Case study — Australian Communications Authority

This appendix reviews the cost recovery arrangements of the Australian Communications Authority (ACA).[1] The reason for this case study is that the Department of Finance and Administration has been asked to review ACA activities and report to the Expenditure Review Committee by the 2002-03 budget. The department has deferred the cost recovery part of this review until the Commission completes its inquiry. However, the analysis in this appendix has been limited by the lack of submissions from organisations that are affected by ACA charges.

E.1 Role of the ACA

The ACA is responsible for regulating the communications industry in Australia. It has two distinct functions: the regulation of the telecommunications industry and the regulation of the radiocommunications industry. The regulation of the telecommunications industry relates to the transition of the industry from an historical monopoly to a more competitive structure. An important factor behind the regulation of the radiocommunications industry is the need to manage the radiofrequency spectrum. A large number of individuals and firms would like to use the radiofrequency spectrum but because it is a scarce resource, it is 'rationed' by the ACA to ensure its efficient use and minimise the risks of interference. The functions of the ACA are summarised in box E.1.

The ACA imposes a variety of charges for the different activities it performs and has varying degrees of discretion over the levels and structures of those charges, with many being determined through legislation. ACA cost recovery ranges from charges for particular services, to amalgamated charges that cover the provision of a number of services, to charges that bear little or no relation to the costs incurred by the ACA in providing a particular service.

[1] The Commission received a separate reference from the Commonwealth Government on 16 July 2001 to inquire into appropriate arrangements for managing the radiofrequency spectrum. The inquiry will review the *Radiocommunications Act 1992* and related legislation, and the ACA's market based reforms and activities.

Box E.1 **Specific functions of the ACA**

The ACA performs a variety of services, which can be broadly split between its telecommunications and radiocommunications functions.

Telecommunications functions

- Licensing telecommunications carriers and telecommunication cablers
- Encouraging industry self-regulation through codes of practice developed by industry and registering those codes
- Determining and enforcing mandatory industry standards where necessary
- Seeking to ensure industry compliance with technical standards and labelling requirements
- Protecting the integrity of telecommunications networks
- Administering legislative provisions relating to the construction of communications facilities
- Reporting on telecommunications carrier and carriage service provider performance
- Managing the Telecommunications Numbering Plan, which attempts to provide adequate number capacity for current and new services
- Overseeing the fulfilment of the universal service obligation, which attempts to ensure that standard telephone services are available to all Australians
- Overseeing the fulfilment of the national relay service, which attempts to ensure people who are deaf or have a hearing or speech impairment have access to standard telephone services

Radiocommunications functions

- Managing the radiofrequency spectrum (although responsibility for the radiofrequency spectrum used by television and radio has been delegated to the Australian Broadcasting Authority)
- Managing electromagnetic interference

Other functions

- Representing Australia's communications interests internationally
- Developing and enforcing consumer safeguards
- Informing consumers

Sources: ACA (2000, p. 2); ACA (sub. DR 127, p. 6).

E.2 Extent and nature of cost recovery

The ACA raises revenue through three mechanisms:

- cost recovery for regulatory activities (for example, the annual carrier licence charge for telecommunications);
- asset sales and rent taxes (for example, auctions of rights to use spectrum, the spectrum access tax to use spectrum, and annual charges for telephone numbers); and
- levies to fund the equity and access goals of government for the telecommunications industry (for example, the universal service obligation levy).

This appendix focuses on the charges that are used to recover ACA costs (box E.2); the asset sales, rent taxes and levies that the ACA administers do not fall within this inquiry's definition of cost recovery (as discussed in chapter 1). Excluding these items, the ACA raised $54.2 million in 1999-2000 (table E.1), which was 110.7 per cent of ACA agency expenses. The ACA raised some of this total cost recovery revenue on behalf of third parties for related purposes. This includes revenue raised on the behalf of the Australian Competition and Consumer Commission for telecommunications regulation and the International Telecommunication Union as well as for the Department of Communications, Information Technology and the Arts' grants and industry development plans. The ACA aims to recover 100 per cent of its own costs and 100 per cent of the costs of these third parties (questionnaire [part II] response).

The ACA's involvement in the International Telecommunication Union allows Australian participation in the setting of international standards for telecommunications and radiocommunications. In addition, the Union provides an international regulatory framework within which the Australian communications industries operate. For example, it manages the worldwide use of the radiofrequency spectrum and supervises satellite networks.

After allowing for the revenue raised on behalf of third parties, the ACA collected net cost recovery revenue of $44.3 million in 1999-2000 (table E.1). This represented 90.4 per cent of agency expenses (sub. 108, p. 1). The ACA stated that this 'under-recovery' was the result of: the timing of amendments to charges; radio licensing exemptions and concessions; inaccuracies in the pricing of charges; variations in the volume of ACA activities; and the reporting distinction between revenue and cost recovery charges for the spectrum auctions (sub. 108, p. 2; sub. DR127, p. 4).

Box E.2 **ACA cost recovery charges**

This appendix focuses on the three charges described below.

Annual carrier licence charge (ACLC)

This charge recovers the costs of certain services carried out by a number of government agencies for the telecommunications industry. It is administered by the ACA. It is paid by owners of telecommunications network infrastructure according to the proportion of their eligible revenue in the industry. (Eligible revenue is gross telecommunications sales revenue less certain revenue streams.) It recovers costs for: ACA and Australian Competition and Consumer Commission regulation of the telecommunications industry; the Commonwealth's contribution to the budget of the International Telecommunication Union; the administration of industry development plans; and grants made by Department of Communication, Information Technology and the Arts for consumer representation and telecommunications research.

Spectrum maintenance component of the apparatus charges

This charge recovers the indirect costs of ACA's radiofrequency spectrum management. It is calculated as a fixed percentage of the spectrum access tax raised from the sale of the radiofrequency spectrum, given potential difficulties in trying to calculate the benefits to individual operators. The charge is currently set at 39.78 per cent of the spectrum access tax paid by operators. It recovers costs for international coordination, International Telecommunication Union membership, domestic planning, interference investigation and policy development.

Administrative component of the apparatus charges

This charge recovers the direct cost to the ACA of a particular licence transaction for the radiofrequency spectrum. These direct costs are calculated using an Activity Based Costing method and reviewed at least every two years. It recovers costs for: issuing a licence, renewing a licence, processing a licence fee instalment and varying licence conditions.

Source: ACA (questionnaire response and sub. 108).

Table E.1 **Cost recovery by ACA, 1999-2000**

	$m	$m	%
Total cost recovery revenue		54.2	
Of which:			
On behalf of the International Telecommunications Union[a]	5.0		
On behalf of the ACCC[b]	3.7		
For DCITA grants[c]	0.8		
For industry development plans[d]	0.4		
Subtotal	9.9		
Net cost recovery revenue		44.3	
Agency expenses		49.0	
Total cost recovery revenue/agency expenses			110.6
Net cost recovery revenue/agency expenses			90.4
Other revenues			
Asset sales and rent taxes			
Annual numbering charge		61.4	
Spectrum access tax		62.4	
Spectrum licensing charge		1360.0	
Levies			
Universal service obligation[e]		280.9	
National relay service[f]		10.8	

[a] Commonwealth's contribution to the International Telecommunication Union for telecommununications and radiocommunications services for 1999. [b] The amount determined by the Australian Competition and Consumer Commission to be the proportion of its costs attributable to telecommunications regulation for 1998-1999, recovered a financial year in arrears by the ACA. [c] Grants for telecommunications consumer representation and telecommunications research, as determined by the Minister for Communications, Information Technology and the Arts. [d] The amount determined by the Minister for Communications, Information Technology and the Arts to be the proportion of the Commonwealth's costs for 1998-99 that is attributable to the administration of part 2 of schedule 1 of the *Telecommunications Act 1997* (related to industry development plans), recovered a financial year in arrears by the ACA. [e] The net universal service cost determined by the Minister for 1999-2000 [f] An Australia-wide telephone access service for individuals with a hearing or speech impairment, which is available using a teletypewriter or a computer with a modem.

Source: ACA (questionnaire response [part II]; pers. comm., 14 March 2001; 2000, p. 88).

The relative contribution of the three charges that generate almost 90 per cent of ACA cost recovery revenue is shown in table E.2.

The ACLC is directed at the telecommunications industry, while the spectrum maintenance and the administrative components of the apparatus charges are directed at the radiocommunications industry and its end users. These charges aim to recover 100 per cent of direct and indirect costs, and include a user cost of capital but not a return on the assets (ACA, questionnaire response). The costs are allocated using Activity Based Costing models and are audited externally.

Table E.2 **Revenue from ACA cost recovery charges, 1999-2000**

Charge	*Revenue*	*Contribution to revenue from cost recovery*
	$m	%
Annual Carrier Licence Charge	18.5	34.1
Spectrum maintenance component	24.5	45.2
Administrative component	5.9	10.9
Miscellaneous [a]	5.3	9.8
Total	**54.2**	**100.0**

[a] Numerous charges that do not raise a significant amount of revenue individually. For example, spectrum auction entry fees, speaking fees and late payments charges.

Source: ACA (pers. comm., 27 June 2001).

Cost recovery legal mechanisms and authority

The ACA was established under the *Australian Communications Authority Act 1997*, which merged the Spectrum Management Agency and the Australian Telecommunications Authority. The ACA gets its powers, including its charging authority, from the *Radiocommunications Act 1992*, the *Telecommunications Act 1997,* the *Australian Communications Authority Act 1997* and a range of related legislation. ACA charges are supported by legislation, regardless of whether they are implemented as a tax or fees-for-service. S 53 of the Australian Communications Authority Act differentiates between the two by requiring that ACA fees-for-service should not amount to taxation.

The large amount of legislation that surrounds ACA charges limits the authority's flexibility in determining the level and structure of some of its cost recovery arrangements. For example, the various elements of the ACLC are set by the Telecommunications Act. While it would be more transparent to disaggregate this charge, the ACA has limited capacity to do so, given that the determinants of the charge are set in legislation.

Rationale for existing arrangements

Cost recovery for regulating the telecommunications industry was explicitly introduced in the earlier *Telecommunications Act 1991* (ACA questionnaire response). The second reading of the 1991 Act stated that the charges provided a method of funding the increased regulation of the telecommunications industry stipulated by the Act.

The Radiocommunications Act (s.3) mentions various objectives, such as the promotion of efficiency and increased responsiveness by the ACA, but does not contain explicit objectives for cost recovery. The ACA's predecessor in regulating the radiocommunications industry, the Spectrum Management Authority, held a public inquiry into the apparatus licence system in 1993 that resulted in the introduction of the current system of cost recovery for the ACA's radiocommunications activities.

The objectives of this system were to reflect the government policy of charging for services provided at a client's request, to create efficiency gains by eliminating frivolous demand and to promote the development of service providers in the private sector (SMA 1993, p. 14). The 1993 inquiry into the apparatus licence system emphasise that there should be a distinction between the charges for ACA direct costs (the administrative component) and ACA ongoing or indirect costs (the spectrum maintenance component). It was hoped that the charges would create greater equity among users (who would pay for the costs they imposed), as well as greater transparency (because the licence fees would be easily understood by interested parties) (SMA 1993, p. v).

However, the spectrum maintenance component 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. The use of the spectrum access tax to determine an operator's spectrum maintenance component charge was intended to reflect an equitable distribution of ongoing Spectrum Management Authority costs, in that the authority's resources tended to be directed at higher demand spectrum and geographic locations (SMA 1995, p. 13). This may be a cost-effective and practical method of charging, given the difficulties in charging for costs that are not easily attributable to individual licensees.

E.3 Impact of cost recovery on agencies

Cost recovery can have a number of effects on the government agency that is recovering its costs. It is particularly likely to have an impact on the agency's incentives for efficiency.

Incentive effects for agencies

As a general rule, if government agencies are not allowed to retain the revenues raised through cost recovery, then they are less likely to seek to maximise the revenue streams and will be disciplined by budget processes rather than by user

behaviour. In the case of the ACA, the revenue raised goes to the Consolidated Revenue Fund and is not earmarked for return to the authority. The ACA receives its funding directly from general taxation revenue. Given that the ACA is the sole Australian supplier of telecommunications and radiocommunications regulation, this arrangement minimises incentives for it to extend the scale and scope of its regulatory activities.

Cost recovery may nevertheless improve the performance of the ACA by indicating the level of demand for certain services that it provides. This can help to bring about an appropriate scale of delivery. To the extent that cost recovery increases the influence that users have over ACA activities, cost recovery may increase the efficiency and improve the tailoring of ACA services towards user requirements. However, there is the danger of 'regulatory capture' with the possibility that the regulator's autonomy may be compromised. The Commission received no evidence on these matters with respect to the ACA.

Cost recovery has the potential to increase the transparency of a government agency's activities, particularly with respect to its costs. This information may help both the government and users to encourage greater efficiency from agencies. Although the formulae that the ACA uses to calculate its charges are publicly available, the link between ACA charges and its costs is not always clear, and the use of amalgamated charging complicates this relationship. ACA charges are therefore not as transparent as they might ideally be. The ACA's suggestion of improving the transparency of the spectrum maintenance component 'by separately identifying total costs for each of its components (for example in [the ACA's] Annual Report and in the Apparatus Licence Fee schedule booklet)' (sub. DR127, p. 5) is consistent with the Commission's recommendation 3.2 that revenue from Commonwealth cost recovery arrangements should be identified separately in each agency's annual report.

Cost recovery has some indirect effects on the incentives for the ACA to increase efficiency. For example, there are plans for electronic payment for the renewal of apparatus licences, the development of systems to lodge application forms electronically, and electronic time recording for internal systems. The stated objective of such developments is to produce a more cost effective and efficient use of resources (ACA 2000, p. 103). The ACA stated that:

> The implementation of a scheme of cost recovery has acted as both a useful discipline on the ACA's radiocommunications licensing activities and a spur to reducing costs through the use of more efficient technologies and better working methods. (sub. 108, p. 5)

The ACA also stated that it does not believe that cost recovery has impeded the development of new services (sub. 108, p. 5). It gave the example of its

accreditation scheme for external operators to undertake frequency assignment work. The ACA applies a reduced cost recovery charge when an accredited external assigner undertakes the frequency assignment, to encourage the take-up of this scheme.

Operation of cost recovery

The proportion of a carrier's eligible sales revenue in the industry is used as a guide to carrier's market share and taken as a proxy for how much the carrier is likely to benefit from or use the telecommunication services associated with the ACLC. There is a lower limit to the ACLC through a fixed component. This appears to favour larger operators because the fixed component of the charge is likely to be more of a burden on smaller firms. However, to the extent that this component reflects the minimum cost of regulating a given firm, this could be an efficient arrangement.

The spectrum maintenance component recovers the indirect costs of ACA spectrum management. Some of these costs are for services that benefit spectrum users — for example, compliance activity such as interference investigation — while others are for services of a broader policy nature, such as those services that meet the policy and advice needs of Parliament and Ministers. The costs of broader policy work may be small, but it is questionable whether industry should fund these policy activities of government (see chapter 7).

Administrative arrangements

As noted above, the ACA has taken steps to introduce more efficient electronic-based systems to reduce costs. It is also proposing to delegate eligible revenue assessment to the Australian Tax Office.

The ACA conducts a major review of its charges every two years. It appears to have initiated changes on these occasions, as well as in between times when 'there are significant changes in costs during a period' (ACA, sub. 108, p. 7). Examples of alterations to charges include: a doubling of equipment testing charges in 1999; an increase in the spectrum maintenance component between 1995 and 2001 (from 29.9 per cent to 39.8 per cent of the spectrum access tax); and an amendment to charges in July 2000 to reflect indirect cost savings and the introduction of the goods and services tax.

Governance and consultation

The ACA's charging process is overseen by external costing consultants, ACA's Cost Recovery Committee and a 'board' (also known as the 'Authority', which consists of a chair, a deputy chair, between one to three members, and various associate members). External costing consultants oversee the calculation of ACA costs and charges. The Cost Recovery Committee is responsible for the cost recovery process and making recommendations to the board. The board is ultimately responsible for final approval and determination of all ACA charges, and it reviews proposed amendments (ACA, sub. 108, p. 8).

The fact that the ACA is a statutory authority encourages independence in its cost recovery activities. Currently, the board comprises twelve members, of whom ten are appointed from outside the ACA. However, ACA legislation and Ministerial direction on certain user charges limit ACA flexibility in its cost recovery activities.

The ACA undertook a public consultation process before introducing its current system of radiocommunications charges. However, no such consultation on telecommunications charges has taken place. The ACA provided two reasons for this lack of consultation:

- telecommunications charges are 'considered the lowest possible to achieve cost recovery' (ACA, sub. 108, p. 7); and
- the fixed component of the ACLC is set as a matter of government policy (ACA, sub. DR 127, p. 7).

E.4 Economic effects of cost recovery

ACA charges that recover the costs of its telecommunications functions are focused on the telecommunications industry, rather than on consumers. However, the ACA stated that the beneficiaries of its activities are 'consumers of the industries, the community and the industry itself' (questionnaire response). To the extent that industry is able to pass on regulatory costs to consumers, the ultimate incidence of the charges may be similar, regardless of where they are initially imposed (see chapter 2). Similar arguments apply to ACA charges for its radiocommunications functions, which are levied on industry. For these reasons, it is important to examine the effects of ACA's cost recovery on both industry and consumers.

Economic effects on industry

As discussed in chapter 5, ACA cost recovery may affect competition by introducing barriers to entry or creating an uneven playing field between firms. The ACLC may have some influence in preventing smaller potential carriers from entering the industry (sub. 108, p. 6). However, the *Telecommunications Act 1997* substantially lowered the minimum ACLC to $10 000.

Further, 'nominated carrier declarations' reduce barriers to entry to owning the telecommunications infrastructure. They allow the owners of telecommunications infrastructure to pass on carrier obligations (under the *Telecommunications Act 1997*) to a nominated carrier. This includes annual costs related to the ACLC, universal service obligation and national relay service levies[2] (sub. 108, p. 6 and sub. 127, p. 6). This is subject to ACA satisfaction that the nominated carrier declaration is not being used for avoidance activities. An example of where a nominated carrier declaration might be used is when a remote Australian community wishes to build its own telecommunications infrastructure to improve services, thereby becoming an owner, but is unwilling to undertake the obligations of being a carrier.

Cost recovery can impose differing burdens on providers of telecommunications services, depending on their characteristics. For instance, the choice of the cost recovery mechanism may have a differential impact on small and large firms, firms located in the cities and those in regional areas of Australia, and on the private and public sectors. There is the potential for cross-subsidisation in the ACA's cost recovery activities due to problems in allocating costs directly when it is not easy to identify how the benefits or costs accrue to particular users. The different treatment of small and large firms in the ACLC, for example, through the presence of a lower limit in the charge, may mean that the amount paid by individual operators does not closely reflect the cost of regulating them. Further, particular Government agencies are charged differently from the private sector. There are radiocommunications licence fee exemptions for diplomatic and consular missions, organisations providing surf life saving or remote area ambulance services, and certain bodies providing emergency services or services that safeguard life. These exemptions may affect the allocation of resources between the private and public sector. However, the scale of this problem is not expected to be large. The ACA does not believe its cost recovery charges create significant distortions: 'The ACA does not believe

[2] The *Telecommunications Act 1997* places various obligations on carriers including compliance with matters of national interest and disaster plans; notification to the ACA of changes in the network's technology; maintenance of facilities; provision of access to other carriers and liabilities for the ACLC; universal service obligation and national relay service.

there are significant access and equity or regional competitiveness issues associated with the radiocommunications cost recovery regime' (sub. 108, p. 9).

The cost recovery formulae of the ACLC, which is based on a company's proportion of eligible revenue in the industry, may introduce an element of uncertainty into ACA charges for telecommunications firms. To anticipate their ACA charges, carriers have to predict their eligible revenue and the eligible revenue of the rest of the industry. The calculation of these variables may also impose compliance costs on the industry. However, these are likely to be insignificant compared with other compliance costs that the firms incur in complying with regulation. Firms may also be encouraged to disguise information about their operations. The proposed plan to use the Australian Taxation Office to assess eligible revenue may address these problems (ACA, sub. 108, p. 4).

Technology and innovation effects

Fees for the modification of apparatus licences may discourage more efficient use of the radiofrequency spectrum. However, these fees are likely to be small compared with the costs of buying and operating new radiocommunications equipment (ACA, sub. 108, p. 5).

Telecommunications equipment needs to comply with ACA determined standards to be connected to telecommunications infrastructure. The costs of demonstrating compliance, including the payment of the associated cost recovery charges, may be a barrier to the manufacturers of niche equipment (ACA, sub. 108, p. 9). However, the Commission received no evidence from industry on this matter.

Economic effects on consumers

Most of the ACA cost recovery charges are on firms, hence consumer impacts are indirect. It is difficult to be precise about the extent that radiocommunications charges are passed on to consumers, given the variety of licences that are available and the differences among the owners of such licences. While the ACA expected that 100 per cent of the ACLC is passed on to consumers (sub. 108, p. 10), it noted the importance of market power and the elasticities of demand and supply in determining the extent to which this occurs (sub. DR127, p. 7).

An alternative approach to funding the ACA would be to use general taxation revenue. Telecommunications consumers are probably large enough to be a good proxy for the general public. However, this would most likely have different efficiency effects from those of the ACA's current method of charging, under which industry and consumers receive some price signals about the costs of administering the regulation by paying in proportion to usage.

F Case study — financial regulatory agencies

The main Commonwealth financial regulators that cost recover are:[1]

- the Australian Prudential Regulation Authority (APRA); and
- the Australian Securities and Investments Commission (ASIC).

The delineation between the responsibilities of APRA and ASIC is functional rather than institutional; both agencies are concerned with the stability and transparency of financial systems. Prudential regulation (liquidity requirements) resides with APRA; disclosure and market conduct regulation resides with ASIC. The two agencies can thus regulate separate aspects of the same company's activities. For instance, while APRA would scrutinise the value of a firm's assets and liabilities, ASIC would ensure they are fully disclosed to the firm's shareholders. Although the constituencies of the two agencies overlap, APRA's is restricted to financial institutions, while ASIC's extends to all companies in Australia.

F.1 Market failures

The 1997 Financial Systems Inquiry Report (the 'Wallis Report') considered that the regulatory activities of both APRA and ASIC are designed to respond to two particular types of market failure: namely, third party risk and information asymmetry. The first market failure stems from the possibility that customers' loss of confidence in a financial institution may affect not only that institution but also its competitors, thus creating a negative spillover. A 'bank run', for instance, can begin with just one insolvent bank and spread to the whole banking sector. While banks may be aware of that risk, they may be unable to insure against it or agree on self-regulation. Further, such a bank run would impose costs on the whole community which the banks are not prepared to internalise. A possible example of third party risk is provided by the recent failure of the HIH insurance company. If, as a result of that failure, the public lost confidence in the insurance sector, then

[1] The other Commonwealth financial regulator, the Reserve Bank of Australia, recovers only the costs of ancillary activities, such as publications, and is not considered in this appendix.

inadequate risk adjustments could occur in economic transactions. This would have detrimental economic effects beyond HIH or its customer chain.

The second market failure stems from customers of financial institutions not usually having sufficient knowledge and expertise to be able to assess properly the risk inherent in transactions of a financial nature. For instance, bank customers have no way of easily knowing whether the bank is liquid (able to meet any cash withdrawals its customers demand) and their deposits are safe. A similar reasoning applies to members of a superannuation fund or customers of an insurance company; they will be discouraged from taking out insurance and superannuation policies if they are not confident that these institutions possess sufficient capital to meet their repayment obligations.

F.2 Extent and nature of cost recovery

This section provides estimates of the revenue raised by APRA and ASIC. It also examines the current cost recovery arrangements of these two agencies, both in terms of their historical context and their objectives.

Revenue collected through cost recovery

Cost recovery by APRA and ASIC is summarised in table F.1. As the comparison of the total revenue cost recovered by the agency to the agency's own expenses makes clear, both agencies recover funds in excess of their operating expenses, significantly so in the case of ASIC (ratio A/C for APRA; ratio A/D for ASIC). However, two caveats are in order. First, part of the financial sector levies collected by APRA are transferred to ASIC and the Australian Taxation Office (ATO) to fund related activities (namely, consumer protection, market integrity, unclaimed monies and lost members functions).[2]

[2] In addition, in 1998-99 and 1999-2000, APRA administered levy revenue — of $17.6 million and $25.6 million respectively — from self-managed ('excluded') superannuation funds which were destined for the ATO. This transitional arrangement has now ended.

Table F.1 **Cost recovery by APRA and ASIC, 1995-96 to 2000-01**

	Unit	*1995-96*	*1996-97*	*1997-98*	*1998-99*	*1999-2000*	*2000-01*
APRA							
Cost recovery revenue[a] (A)	$m				54.4[b]	75.1	66.4
Of which:							
Accruing to APRA (B)	$m				45.4	61.2	51.5
On behalf of ATO[c]	$m				2.3	2.4	2.4
On behalf of ASIC[d]	$m				6.6	11.6	12.6
Total agency expenses[e] (C)	$m				53.4	58.8	50.7
B/C	%				85	104	101
A/C	%				102	128	131
ASIC							
Cost recovery revenue[f] (A)	$m	275.5	297.9	326.1	331.8	361.0	371.0[g]
Excluding transfers to the States and Northern Territory (B)	$m	149.1	167.6	193.5	198.3	226.0	231.9
Excluding all transfers to third parties (C)	$m	na	na	na	na	201.0	na
Total agency expenses[h] (D)	$m	140.4	127.8	133.3	153.3	144.8	139.8[g]
B/D	%	106	131	145	129	156	166
C/D	%	na	na	na	na	139	na
A/D	%	196	233	245	216	249	265

a Includes a small amount of revenue from the sale of goods and services. Does not include levies from small superannuation funds, administered by APRA between 1998 and 2000 on behalf of the Commonwealth Government. **b** Estimate. In its first year of operation, there was no direct link between cost recovery revenue and APRA's appropriation. **c** Levies transferred to the ATO to fund its administration of uncollected superannuation monies. **d** Levies transferred to ASIC to fund its consumer protection functions and the Superannuation Complaints Tribunal. **e** Includes establishment costs of $7.1 million and $6.2 million in 1998-99 and 1999-2000. **f** Does not include levies transferred from APRA. Includes a small amount of fines. **g** Budgeted. **h** Includes a small amount of administered expenses from 1997-98. **na** not available.

Sources: ASIC (questionnaire response); Treasury (2000d, pers. comm., 25 February 2001); APRA (questionnaire response, pers. comms., 23 February 2001, 27 April 2001, 18 June 2001, 2 August 2001; sub. DR113).

Second, a large portion of the fees recovered by ASIC is transferred to the States and the Northern Territory as compensation for relinquishing their company regulation powers to a national scheme in 1991 (box F.1). In addition, some of the fees are used to fund all or part of the operations of numerous other bodies that are part of the national scheme (for example, the Commonwealth Director of Public Prosecutions and the Australian Accounting Standards Board).[3] In 1999-2000, the total amount of fees transferred by ASIC (via the Consolidated Revenue Fund) to third parties was $160 million (ASIC questionnaire response).

[3] This funding is notional, in that no attempt has been made to identify portions of ASIC fees as earmarked to these bodies.

Box F.1 **Commonwealth compensation of the States and the Northern Territory for company regulation**

In January 1991, the States and Territories ceded responsibility for the regulation of companies and securities to the Commonwealth. Under the terms of the Corporations Agreement reached at the time by the various governments, the States and the Northern Territory were to receive financial compensation from the Commonwealth for revenue foregone. The extent of that revenue can be inferred from figures cited by Ramsay (1990, p. 171), which estimated that the annual revenue generated by companies administered under the State based schemes was $200 million, of which only $70 million was spent maintaining the various State Corporate Affairs Commissions.

Section 703 of the Corporations Agreement holds that:

(1) The Commonwealth will distribute among the States [and the Northern Territory] in respect of the year commencing on 1 July 1991, and each succeeding year commencing 1 July, an amount determined in accordance with this clause; and

(2) The amount for any such year ('the current year') is the amount ascertained by adjusting the base amount of $102 000 000 upwards in line with movements in the Consumer Price Index for the financial year 1989-1990 and each succeeding financial year to and including the financial year immediately preceding the current year.

The monies transferred under this agreement since 1991-92 are as follows:

1991-92:	$116.1 million
1992-93:	$118.2 million
1993-94:	$124.3 million
1994-95:	$122.5 million
1995-96:	$126.4 million
1996-97:	$130.3 million
1997-98:	$132.6 million
1998-99:	$133.5 million
1999-2000:	$135.0 million
2000-01:	$139.1 million (budgeted).

While not specified in the agreement, these transfers have been funded from ASIC charges. These compensation payments are expected to continue under the new (forthcoming) Corporations Agreement covering the application of the *Corporations Act 2001* (box F.2).

Sources: Commonwealth of Australia (1997a); Treasury (2001b; pers. comm., 25 February 2001).

When revenues transferred to third parties are netted out of its cost recovery revenue, APRA recovered 101 per cent of agency expenses in 2000-01, coming

close to its target of 100 per cent recovery of agency expenses (ratio B/C). After making the same adjustment for ASIC, cost recovery remained high at 139 per cent of agency expenses in 1999-2000 (ratio C/D). This is partly attributable to an accumulated deficit of $217.6 million incurred by the national scheme between 1991-92 and 1995-96. As a result of that deficit, the amount of revenue recovered by ASIC each year has been set significantly higher than the costs of operating the national scheme (CLERP 2000, pp. 34, 36).

APRA revenue collection

APRA was created by the *Australian Prudential Regulation Authority Act 1998* (APRA Act), following recommendations from the 1997 Wallis Report. This agency took over the prudential supervisory responsibilities of 11 separate agencies. Its reporting and financial arrangements are governed by the *Commonwealth Authorities and Companies Act 1997*. Following recommendations from the Wallis Report, APRA's activities are financed through cost recovery (with adjustments for small amounts of other income). Recovery takes the form of annual levies paid by the regulated financial institutions (banks, life and general insurance companies, superannuation funds, credit unions and building societies), based on a percentage of assets held by the entity, subject to minimum and maximum levy amounts for each industry. Details of these levies for 2000-01 and 2001-02 are given in table F.2.

Table F.2 **APRA levies, 2000-01 and 2001-02**

Industry	*Year*	*Percentage of assets*	*Minimum*	*Maximum*
		%	$	$
Superannuation funds	2000-01	0.020	300	46 000
	2001-02	0.025	400	53 000
Retirement savings account providers	2000-01	0.020	5 000	18 500
	2001-02	No change	No change	No change
Life insurers	2000-01	0.020	500	280 000
	2001-02	No change	No change	364 000
General insurers	2000-01	0.020	5 000	100 000
	2001-02	0.025	No change	240 000
Authorised deposit-taking institutions	2000-01	0.012	500	1 000 000
	2001-02	No change	No change	1 005 000
Foreign bank branches	2000-01	0.006	500	500 000
	2001-02	No change	No change	No change
Non-operating holding companies	2000-01	Flat rate charge of $10 000		
	2001-02	No change		

Sources: APRA (sub. 21, p. 7); Hockey (2001a).

APRA raises levies from institutions under the *Financial Institutions Supervisory Levies Collection Act 1998* and six supervisory levy Acts that apply to the various industries making up the financial sector. For instance, levies are collected from the superannuation industry under the *Superannuation Supervisory Levy Imposition Act 1998*. Levies received are paid into the Consolidated Revenue Fund, but are made available to APRA under a standing appropriation (special appropriation) in s.50 of the Australian Prudential Regulation Authority Act.

In its submission, APRA stated that its activities fall into three categories:

- the formulation and promulgation of prudential policy and practice observed by regulated institutions;
- surveillance and compliance programs and, where relevant, remediation or enforcement measures; and
- advice to Government on the development of regulation and legislation affecting regulated institutions and the financial markets in which they operate (sub. 21, p. 1).

APRA's supervisory role may take the form of an on-site visit to a financial institution to examine asset quality and risk. In the area of enforcement, APRA's activities can range from the appointment of an inspector to Federal Court action (APRA 2000, pp. 14, 16).

The industry-specific levy framework adopted by APRA reflects the Government's intention that industry levies cover the costs of supervising each industry and that there be no cross-subsidies between industries (ANAO 2001).[4]

ASIC revenue collection

ASIC is an independent Commonwealth body now operating under the *Australian Securities and Investments Commission Act 2001*. It began operations in 1991 as the Australian Securities Commission (taking over from the National Companies and Securities Commission). Its name and charter were changed in 1998 following the Wallis Report. ASIC, in its present form, is a statutory authority under the *Commonwealth Authorities and Companies Act 1997*. While ASIC collects large amounts in fees under the *Corporations (Fees) Act 2001* (for example, for the lodgment of annual company returns), these are administered revenue which must go into the Consolidated Revenue Fund. ASIC's main source of funding is a budget appropriation from the Commonwealth Government, which includes transfers from

[4] This is despite the fact that, as APRA levies have the status of a tax, there is no legal impediment to the revenues raised being used to cross-subsidise some industries (ANAO 2001).

APRA to fund its consumer protection functions and the operation of the Superannuation Complaints Tribunal.

Fees accruing to ASIC are charged under ss.5 and 6 of the *Corporations (Fees) Act 2001*. The former section allows for fees (that are taxes) for chargeable matters (for example, the lodgment of a company return); the latter allows for fees that bear no relationship to the cost of providing any service related to the chargeable matter. The amount of each of the fees is set in schedule I to the *Corporations (Fees) Regulations 2001*. As noted earlier, fees collected are significantly in excess of ASIC's regulatory costs.

The legislative framework underpinning ASIC and its fees has only recently been overhauled in response to Constitutional problems identified by the High Court regarding the previous Corporations Law regime. The new regime enables the Commonwealth Parliament to enact the corporations legislation as a federal law, following referral from the States and Territories (box F.2).

Box F.2 ***Corporations Act 2001***

Decisions of the High Court in the cases of *Re: Wakim; ex parte McNally* (1999) 198 CLR 511 and *The Queen v Hughes* (2000) 171 ALR 155 cast doubt on the ability of the Commonwealth to regulate companies and corporations under the *Corporations Act 1989* and the attendant Corporations Law. The former decision implied that the Federal Court did not have the authority to hear matters arising under the State Corporations Acts (forming part of the 1989 national company regulation scheme). The latter decision questioned ASIC's ability to incorporate companies.

These issues arose as a result of the Constitutional foundations of the 1989 national scheme. Under that scheme, the States and the Northern Territory agreed to enact legislation adopting the Corporations Law in force in the Australian Capital Territory (ACT), and to give ASIC (a Commonwealth authority) power to enforce State Corporations Law. However, the High Court decisions mentioned above endangered several important aspects of that scheme.

As a result, the Commonwealth Government introduced the Corporations Bill 2001 (and a number of accompanying bills), which substantially re-enacted the existing Corporations Law of the ACT as a Commonwealth Act applying throughout Australia. The legislative option used for having a single Commonwealth corporations law apply to all States and Territories (excluding external Territories) was to secure a referral of their powers to the Commonwealth under s.51(xxxvii) of the Constitution. All States and Territories have now passed referral legislation to that effect.

As a result of the new bills, ASIC fees — which had the legal status of a State tax under the previous national scheme — are now Commonwealth taxes. As such, they are imposed by a separate tax Act, the *Corporations (Fees) Act 2001*.

Source: Commonwealth of Australia 2001.

Like those of APRA, ASIC's activities range from supervision to enforcement and policy advice. They also include an information element, through the maintenance of a publicly accessible database of company details and participants in financial markets.

Historical context

The present cost recovery arrangements applying to APRA are largely the result of recommendations contained in the Wallis Report. Three recommendations are particularly relevant (box F.3). In addition to meeting these recommendations, APRA's funding arrangements are also designed to be consistent with international standards of prudential regulation. Two statements published by the Basle Committee on Banking Supervision are relevant for cost recovery:

- *Principle 1*: each agency involved in the supervision of banks should possess operational independence and adequate resources; and
- *Principle 1, Essential Criterion 3*: each supervisory agency should be financed in a manner that does not undermine its autonomy or independence and permits it to conduct effective supervision and oversight (ANAO 2001).

Box F.3 **Wallis Report recommendations concerning cost recovery by financial regulators**

Recommendation 104: Regulatory agencies' charges should reflect their costs.

> The regulatory agencies should collect from the financial entities which they regulate enough revenue to fund themselves, but not more. As far as practicable, the regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulations (1997, p. 532).

Recommendation 106: Regulatory agencies should set their charges, subject to approval by the Treasurer.

> Fees and charges imposed to recover costs of the financial regulatory agencies should be determined by the agencies, subject to approval by the Treasurer (1997, p. 534).

Recommendation 107: Regulatory agencies should be off-budget.

> From the perspective of financial regulation, it is preferable that the [Australian Prudential Regulation Commission and Corporations and Financial Services Commission][5] operate off-budget. If they are funded through the Commonwealth Government budget, they should have their funding levels determined by reference to policies for financial system regulation rather than targets for the overall budgetary balance (1997, p. 535).

Source: Wallis (1997).

[5] Now re-named APRA and ASIC respectively.

The implementation of these recommendations and principles has led to the implementation of full cost recovery by APRA since 1999-2000.[6] However, some of APRA's predecessors already cost recovered. For example, the Insurance and Superannuation Commission imposed a levy on superannuation funds under the *Superannuation Supervisory Levy Act 1991* (ASFA, sub. 8, p. 1). In some cases, APRA's creation led to a lower regulatory burden on financial institutions. Prior to 1999-2000 the costs of prudential regulation of banks were recovered indirectly through the Reserve Bank of Australia's non-callable deposit arrangements. The replacement of these arrangements with APRA's supervisory levies led to a reduction in prudential supervision income to the Commonwealth from $250 million to $23 million in 1999-2000 (ANAO 2001).

Cost recovery has existed for much longer for ASIC (and its predecessors) than for the prudential regulators. Indeed, ASIC stated:

> In Australia, cost recovery arrangements have existed since the 19th century. The existing arrangements commenced in 1991 and were modified in 1994. (questionnaire response)

It added that:

> The initial objective of the cost recovery arrangements was to cover all costs associated with the corporate regulator. In 1993, following a review involving the Attorney-General's Department, the Australian Securities Commission and the Department of Finance, the cost recovery arrangements were revised to cover all costs of the national corporate regulation scheme. (questionnaire response)

According to Paper no. 7 of the Corporate Law Economic Reform Program of the Commonwealth Government (CLERP 2000, p. 36), the amount of revenue generated by ASIC must cover:

- its own costs;
- the costs of other bodies forming part of the national scheme (for example, the Australian Accounting Standards Board);
- national scheme related costs of bodies that perform functions arising out of the scheme (for example, the Administrative Appeals Tribunal); and
- compensation payments to the States for revenue foregone as a result of the establishment of the national regulation scheme.

The first three items on this list relate to the operation of the national scheme of company registration and regulation. It may be appropriate, therefore, that companies be charged fees commensurate with these expenses. Regarding the

[6] In its first year of operation, 1998-99, APRA was funded by an appropriation unrelated to its cost recovery revenue.

fourth item — compensation payments to the States and Northern Territory — the Australian Shareholders Association stated that:

> … we can see no possible justification for the continuing payment of 'compensation' to the States and the Northern Territory.
>
> It is clear that when the administration of company law was handled at a State level by State Corporate Affairs Commissions and similar bodies, the amounts collected by the States as fees significantly exceeded the amounts applied in the regulation of companies and the securities industry. In other words these fees constituted a form of State taxation. …
>
> There is no justification for the Commonwealth Government, through the agency of ASIC to continue to levy taxation on companies and other participants in the securities industry on behalf of the States and the Northern Territory. (sub. DR170, pp. 4–5)

Rationale for existing arrangements

The rationale for full cost recovery by APRA is based on the Wallis Report's recommendation that, for reasons of equity and efficiency, the costs of prudential regulation should be borne by those who benefit from it (Wallis 1997, p. 532).

ASIC justified cost recovery as follows:

> Successive governments have taken the view that costs associated with the administration of companies and the regulation of the futures and securities industries should be borne either directly or indirectly by all companies and market participants rather than through public funding by taxpayers. (questionnaire response)

And:

> People involved with companies and participants (and potential participants) in [the futures and securities] industries benefit through their participation in a well regulated capital market. (questionnaire response)

Both agencies' rationales for cost recovery therefore reflect the view that both suppliers and consumers of the products and services being regulated benefit from that regulation. On the other hand, as mentioned earlier, financial regulation in general and prudential regulation in particular is designed to ensure that regulated institutions account for the potential costs that their activities impose on others through negative spillovers (for example, the risk of financial contagion). This suggests that the beneficiaries of regulation may be more widespread than just the suppliers and consumers of financial services.

Discussion of objectives

Both financial institutions and their customers can be expected to feel the direct impact of APRA levies. This impact comprises costs as well as benefits. For the institutions themselves, direct costs in the form of levies may in some cases be partly offset by the benefits of the regulator's 'tick of approval'. The perception that their deposits are guaranteed by the Government, for example, may assist banks in competing with other types of financial institutions such as managed funds. As far as clients of financial institutions are concerned, direct benefits are received when information gaps are addressed and risk is reduced as a result. Clients also incur costs when levies are passed on to them in part or in full.

More important perhaps than the direct impact of APRA levies is their indirect impact. As discussed earlier, prudential regulation is partly designed to address a negative spillover in the form of third party risk. This risk is most pronounced in the case of the banking sector, given the possibility of financial contagion. However, third party risk can also affect other financial institutions for which public trust is important. For instance, a loss of confidence in the insurance industry could result from the collapse of HIH.

By working to ensure the liquidity and solvency of regulated institutions, the prudential regulator may be able to prevent — or at least moderate — the risk that a financial crisis will occur and lead to a widespread loss of consumer confidence. An indirect impact of APRA levies, therefore, is the accrual of third party benefits to financial institutions and their customers or to parties outside the regulated industry. In the case of the banking sector for instance, a banking crisis would be likely to affect general economic activity and employment. By preventing the creation of such negative spillovers, prudential regulation of banks creates third party 'beneficiaries' outside the banking industry.

The question arises about which category of beneficiaries should fund the cost of regulation. Not to charge direct beneficiaries — financial institutions and their customers — would be economically inefficient, because it would deprive them of important price signals guiding their decisions on how much to produce and consume of the regulated activity.

While the regulated institutions also derive third party benefits from the prudential regulation of their competitors, these benefits are in the form of a negative spillover (financial contagion in the case of banks) being avoided. As suggested in chapter 7, these 'beneficiaries' should not be made to pay for the costs of administering the regulation designed to combat the risk of a spillover. The same principle applies to third party beneficiaries outside the industry. While they undoubtedly benefit through the economic stability and predictability associated with a sound financial

sector, they are not the source of the need for regulation and, as argued in chapter 7, charging them would be unfounded for a number of reasons.

ASIC's balance of direct and indirect beneficiaries differs from APRA's. This is mainly because the risk of contagion from one firm failing is negligible in the economy as a whole compared with the financial sector. While ASIC's regulatory activities do have wider benefits in the form of economic stability and transparency, they primarily benefit those with a commercial stake in a regulated company (such as shareholders, creditors, suppliers and financiers) and consumers (in the case of the licensing and monitoring of providers of specialised financial services such as investment advice and auditing). These direct beneficiaries should therefore pay for the cost of the regulation through, for instance, reduced dividends and/or higher prices.

Stakeholders in the regulated companies and consumers of financial services also benefit directly, through being able to access the wealth of financial information ASIC provides through its various registers. However, this service is available to others beyond the agency's immediate constituency. For example, a person who, after obtaining a company's details on ASIC's website, decides not to subscribe to a share offer, benefits from ASIC's regulatory activities without having to bear the administration costs, except to the extent of the search fee. This would have benefits for that person, but also for other entities, such as other firms in which the same person may eventually decide to invest.

Thus, ASIC's information provision activities have broad benefits, which may extend throughout the economy as a result of a well informed and transparent marketplace. In recognition of this benefit, ASIC supplies financial information and documents free to some media organisations and the ABS. This allows for a sound public financial debate, which could be expected to have positive spillovers from a more efficient allocation of resources.

From the above discussion of APRA's and ASIC's regulatory activities, it appears that they generate a combination of direct and third party benefits, as acknowledged by the Association of Superannuation Funds of Australia:

> While the rationale from prudential regulation is clear, it is more difficult to precisely identify who are the beneficiaries of the regulatory regime. There are both public benefits as well as benefits to the entities regulated and their customers/members. (sub. 8, p. 4)

However, the Australian Chamber of Commerce and Industry disputed the existence of direct benefits, stating that:

> Much, if not all, financial services and corporations regulation is a pure public good, and does not create direct benefits for [the] 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. (sub. 70, p. 15)

The NRMA Insurance Group put forward similar arguments:

> … all Australian consumers and businesses benefit from a stable financial system in which all financial services providers are required to meet minimum prudential and consumer protection standards. These standards enhance consumer and business confidence in the financial system and thus improve the efficiency of the overall system and attract additional savings for investment. Due to the existence of these wider economic benefits from regulation in the financial sector there is a strong argument for funding at least part of the cost of prudential supervision and consumer protection from general budgetary revenue rather than from industry levies or charges. (sub. 37, p. 3)

The Investment and Financial Services Association concurred, stressing that over-recovery is even less desirable than full recovery:

> … given the significant public policy purposes that underlie financial sector regulation, a reasonable proportion of the cost should be borne by the whole community, through public funding. Fee and levy revenue should not be expected to meet the whole cost of regulation — and certainly should not exceed the running costs of the relevant regulators. (sub. 9, p. 2)

From these quotes, it would appear that current cost recovery arrangements by APRA and ASIC are at odds with the wishes of industry, because these agencies recover the totality of their operating expenses from regulated firms (and their customers). The views expressed by industry suggest that at least some of these expenses should be taxpayer funded.

However, the Commission has concluded that the price of regulated products should reflect the administrative costs of the regulation (see chapter 7). This ensures producers and consumers of the regulated product face the true resource cost of that product. When, as happens with prudential regulation, the impact of the regulation extends beyond the regulated industry, the cost of the regulation is then built into the supply chain and is borne by producers, downstream purchasers and/or final product consumers.

Finally, one inquiry participant — Dwyer Partners — rejected all cost recovery by ASIC and APRA, not on the grounds of positive externalities arising from a safer financial system, but because *negative* externalities arise from the operations of the regulators. It stated:

> If something is provided as a public service with no care and no responsibility there should be no charge. Far from being entitled to charge anything, APRA and ASIC have been positively mischievous bodies by creating a dangerous illusion of supervision where in fact there has been none. The public would be far better off if warned to keep its eyes wide open in the firm awareness of *caveat emptor* rather than the current

> situation of being heavily taxed for an illusion of safety. APRA and ASIC, in their current form, are creating negative externalities for the investing public by misleading it and overseas investors that Australian financial markets are properly regulated. (sub. DR141, p. 2)

However, in a recent speech, the Minister for Financial Services and Regulation, the Hon. Joe Hockey, clarified APRA's position with respect to company failures:

> The Government's role is not to micro-manage Australian companies. We do not have the capacity or expertise to sit in the boardroom of every Australian company. Accordingly, our prudential regulator APRA does not guarantee the commercial success or the financial future of general insurance companies. APRA's job is to set standards and do its best to ensure that companies comply with those standards. The ultimate responsibility for the prudent operation of all financial institutions rests with the management and board of each institution itself. Others, like the company auditors, also have a significant role to play. (Hockey 2001b, p. 4)

It may also be argued that it is not desirable for any prudential regulator to 'insure' companies against failure. To do so could create incentives to act in a way that is contrary to the objectives of the regulation. Insurance companies, for example, could enter potentially non-performing contracts in the knowledge that the Government will not allow them to fail.

F.3 Impact of cost recovery on agencies

Cost recovery by an agency, in addition to influencing the behaviour of those who pay the charges, can influence the operations of that agency. This section examines the effects of cost recovery on several aspects of APRA's and ASIC's operations, from the incentives they face, to the cost recovery mechanisms they use, to the transparency and accountability with which they carry out cost recovery. These issues are discussed in relation to Commonwealth agencies generally in chapter 5.

Incentive effects for agencies

Cost recovery may, depending on the exact nature of the arrangements, alter the incentives an agency faces. Cost consciousness and efficiency may be encouraged. On the other hand, quasi-automatic cost recovery of all operating costs can lessen the incentives for an agency to be cost effective. Recovery of the costs of only some of an agency's activities may persuade the agency to concentrate on these areas at the expense of others.

The operating expenses of APRA and ASIC are given in table F.3. APRA's costs are estimated based on the activities of its predecessor agencies when appropriate.

Table F.3 **Operating expenses of APRA and ASIC, 1995-96 to 2001-02**

	APRA[a]	*ASIC*
	$m	$m
1995-96	na	140.4
1996-97	na	127.8
1997-98	55.4[b]	133.3
1998-99	58.9[c]	153.3
1999-2000	58.8	144.8
2000-01	50.7	139.8[d]
2001-02	53.0[d]	138.7[e]

a Excludes Government Actuary costs of $1 million from 1997-98 to 1999-2000 (since transferred to Treasury). **b** Estimate of the aggregate of prudential supervision costs incurred by APRA's predecessor agencies: the Insurance and Superannuation Commission, the Reserve Bank's Supervision Department and the various agencies of the State based Financial Institutions Scheme (FIS). **c** Estimate of the aggregate of APRA's costs ($53.4 million — see table F.1) and State authority costs under the FIS (assigned to APRA from 1 July 1999). **d** Budgeted. **e** Forward estimate. **na** Not available.

Sources: ASIC (questionnaire response); APRA (2000; questionnaire response; sub. DR113; pers. comms, 27 April 2001, 18 June 2001, 2 August 2001); Treasury (2001c).

As shown in this table, APRA's operating costs decreased between 1998-99 and 2000-01. According to APRA's evidence to the Parliamentary review of its activities, it achieved this cost reduction at a time when financial institutions grew in complexity and size (Hawker 2000, p. 6). However, the primary reason for cost savings, also according to APRA, 'has been the reduction in administrative costs following the merger of State-based financial institutions into APRA in mid 1999' (sub. DR113, p. 3). APRA's budget for 2000-01 assumes an increase in operating costs of approximately $2.3 million. This is mainly due to an increase in personnel costs (Treasury 2001d).

Part of APRA's cost recovered expenses consist of repayments on two Commonwealth Government loans granted in 1998-99 and 1999-2000 to fund establishment and transition costs.[7] Repayments on these loans, which will be extinguished in 2002, amounted to $5.4 million in 1999-2000.

Changes in APRA's operating costs since its creation have meant changes in levies faced by specific industries. Between 1999-2000 and 2000-01 the maximum levies payable by non-excluded superannuation funds and general insurers increased, while their levy rates declined from 0.04 per cent to 0.02 per cent of assets. Thus, depending on the total assets of an institution, its levy could have gone up or down. NRMA stated that the maximum levy it pays in the general insurance category increased from $75 000 in 1999-2000 to $100 000 in 2000-01 (sub. 37, p. 4). In

[7] These costs have included the building of infrastructure, the set up of head office in Sydney, the establishment of the new APRA organisational teams and the development of new processes and systems to support the new structure (APRA, sub. 21, p. 5).

2001-02 maximum levies payable by these industries increased further (by 140 per cent for general insurers), as did their levy rates (table F.2).

The Association of Superannuation Funds of Australia provided an example of the long term increase in the regulatory charges facing a superannuation fund. From a flat return lodgment fee of $30 in the late 1980s, the maximum amount payable rose to $14 000 in 1991-92 (sub. 8, p. 1). As shown in table F.2, the maximum levy payable by a superannuation fund in 2001-02 will be $53 000. Commenting on the increase in superannuation levies proposed by APRA for 2001-02, the Association of Superannuation Funds of Australia noted that it did not appear reflective of the lower supervisory costs associated with the trend decrease in the number of superannuation funds (sub. DR135, p. 5).

ASIC's operating costs have fluctuated somewhat between 1995-96 and 2000-01. The 15 per cent increase recorded between 1997-98 and 1998-99 is attributable to the transfer of consumer protection functions from the Australian Consumer and Competition Commission to ASIC. Budgeted costs are predicted to remain stable in 2000-01 and 2001-02.

There is no formal relationship between the amount of fees that ASIC recovers and the appropriation it receives from the budget. The monies appropriated to ASIC to fund its expenses decreased between 1999-2000 and 2000-01 (table F.3), whereas the fees it raises were projected to increase that year (table F.1). The increase in the fees collected is partly due to indexation to the Consumer Price Index and partly due to the increase in the number of companies seeking registration.

The lack of direct relationship between ASIC's appropriations and the fees it collects is likely to minimise incentives to engage in 'regulation creep'. However, two inquiry participants noted the possibility of such a development in future. The NRMA observed that proposed changes to ASIC fees and regulations, foreshadowed by the Commonwealth Government in CLERP 7, 'are projected to lead to a significant increase in fee revenue for ASIC and potentially an even greater over-recovery of regulatory costs' (sub. 37, p. 7).[8] For its part, the Association of Superannuation Funds of Australia stated:

> Policy proposals by ASIC … indicate the likelihood that it will require APRA regulated superannuation funds to also obtain a license from ASIC in order to undertake certain core functions of such funds. (sub. 8, p. 7)

This suggests the possibility of regulatory overlap between ASIC and APRA, resulting in unnecessarily high cost recovery charges.

[8] At the time of writing, the bills implementing these changes were awaiting Parliamentary approval.

Cost recovery in the form of voluntary industry contributions can also create the risk of 'agency capture'. According to the Australian Shareholders Association, such contributions already accruing to the Australian Accounting Standards Board (primarily funded from ASIC fees) may lead to more weight being given to the views of the largest contributors (sub. DR170, p. 8).

Information dissemination

To fulfil their functions, both APRA and ASIC collect a wealth of information on the institutions and companies they supervise. This information is contained in databases that are increasingly made available for online searches.

ASIC dissemination

After introducing electronic registration and data lodgment in 1998, ASIC now provides about half of this service online. The dissemination of information by ASIC has also benefited considerably from Internet technology. ASIC reports that 94 per cent of company searches in 1999-2000 occurred online, and that its website ranks among the most visited Commonwealth sites, with 200 000 visits per month by June 2000 (ASIC 2000).

However, it is debatable whether Internet technology is contributing to the full extent possible to a reduction in ASIC's operating costs. While ASIC makes company information available electronically at a slightly lower charge than that for hard copies, the price differential ($2) does not appear to reflect the difference in marginal cost.

It may even be argued that the dissemination of information forms part of ASIC's basic product set. Dissemination of certain financial information may have significant positive spillovers, such as those associated with a transparent and well informed market and, as discussed in chapter 7, such information products should not attract a charge. Some participants shared this view:

> It is hard to see what public benefit is served by compulsory provisions requiring the lodgment [with ASIC] of shareholder and director notices in the public interest which are then withheld from the public unless the public is willing to pay a privatized tax over and above the lodgment fees imposed on the incorporated company lodging such notices. (Dwyer Partners, sub. DR141, pp. 2–3)
>
> At present it's only possible … to search names in the Internet register [of ASIC] without paying a fee, but we would argue that the full database, including for example the address of companies, the names of directors and so forth, should also be accessible without charge on the Internet … the actual, in a sense, raw data from ASIC, I think

consumers should be able to obtain without charge from the internet. (ASA, trans., p. 1034)

However, where information requests received by ASIC involved the further dissemination or the enhancement of a basic product (for example, a more detailed set of company accounts), marginal or incremental cost (respectively) might be charged (see chapter 7).

APRA dissemination

While it supervises a smaller constituency than ASIC, APRA is also the repository of much financial information. As a relatively new institution, APRA has inherited somewhat disparate data systems from its predecessor agencies. As part of its Statistics project, it has harmonised and modernised these systems to facilitate electronic lodgment and consultation of financial information (APRA 2000).

APRA states that this project is designed to 'position APRA to act as the central repository for financial information about regulated entities' (APRA 2000, p. 30). Some of this financial information, collected compulsorily from financial institutions, is shared confidentially with the Reserve Bank of Australia and the ABS. In addition, APRA stated that:

> … institutions and other users of financial sector statistics will be able to access and manipulate aggregate data via APRA's website. A large range of standard reports will be accessible, together with user-friendly analytical tools to allow users to select aggregate data, construct ratios, and/or analyse these figures through time or against different industry cohorts. (APRA 2000, p. 31)

However, one industry participant — Cumpston Sarjeant — questioned the judiciousness of APRA's data dissemination policy, arguing that unnecessary confidentiality goes against the benefits of a well informed market:

> Most of the detailed data supplied by general insurers to APRA are … not available. This has prevented informed analysis by brokers, rating agencies, investment analysts and insurance buyers. Detailed data on individual insurers are available in the USA and the UK. Similar availability in Australia might have helped prevent the HIH collapse, at least reduce its cost to policyholders. Data confidentiality has resulted in misplaced reliance on a single agency. (sub. DR133, p. 1)

This view suggests that APRA's statistics, like company information held by ASIC, could generate positive spillovers. The implications of positive spillovers for cost recovery are discussed in chapters 2 and 7.

Operation of cost recovery

In this section, the respective cost recovery arrangements of APRA and ASIC are presented and discussed.

APRA operation

As illustrated in table F.2, levies accruing to APRA are set annually as a proportion of an institution's assets, with a minimum and a maximum amount to be levied. These levy cutoffs vary by industry, as does the percentage of assets levied. The rationale behind this costing model is that there is a minimum cost involved in regulating any institution. Above that minimum, supervisory costs are assumed to grow with the size of the institution until a point is reached at which size no longer affects these costs.

The costing model in use by APRA implies that an institution's contribution to the funding of the agency will not necessarily match its consumption of the agency's resources. In other words, 'good apples' are made to pay for 'bad apples' within an industry. This is inherent in the fact that the costs to be recovered from each industry are based on APRA's estimate of the costs of supervising that whole industry, not its member institutions.

The adequacy of the model attracted comments from industry during the review of the financial sector levy by Treasury and APRA, before the levies were determined for 2000-01. APRA summarised these comments as follows:

> Industry groups generally argued that the minimum amount payable should equal the cost of supervising these entities [institutions], however there was no consensus in industry views. Entities paying above the minimum tended to assume that minimum amounts (of around $300–$500) were too low and were less than the true minimum cost of supervision, whereas other industry groups argued the minimums were too high.
>
> Some industry groups also suggested that the maximum amount payable should either be raised significantly or even abolished — stating that there is no cap on the size of the risk associated with any entity, therefore, the amount payable should not be capped. Others did not accept this view as it would lead to the situation where the revenue raised from large institutions would be likely to far exceed the costs of supervision involved. (sub. 21, app. 5, p. 3)

An alternative to the industry levy approach would be to introduce a fee-for-service system, whereby individual institutions are made to pay for, say, an audit by APRA. This was a recommendation of the Wallis Report, which stated that 'as far as practicable, the regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulations' (1997, p. 532). Under s.51 of the APRA Act, APRA is able to charge

directly for its services. However, such a system may worsen the situation of a firm in difficulty and/or discourage it from seeking assistance (ASFA sub. 8, p. 9). APRA asked:

> … how much are we to charge a failing institution for its supervision, and is this compatible with our mission to protect deposit holders and premium takers? Who will ask for advice if we charge by the hour for it? (sub. DR113, p. 4)

Charging for specific services may also create incentives for the regulator to step up these activities for revenue raising purposes. While APRA at present raises some revenue from direct charges for services provided (for example, publications), this represents only about 2 per cent of its overall revenue (APRA, sub. 21, p. 2; APRA 2000). However, in 2001-02 APRA will introduce fees for discrete services such as licence applications and will consider the introduction of further fees (Treasury 2001d).

Nevertheless, two issues arise regarding the calculation of costs and their allocation by APRA. First, APRA's internal structure is not industry based. Rather, as shown in box F.4, the main delineation occurs between diversified institutions and specialised institutions. The former covers conglomerate, multi-product groups, often with international links, while the second contains more narrowly defined, single product institutions. While this dichotomy is dictated by functional considerations, it does not overlap well with the levies, which are industry based. For levying purposes, divisional costs are allocated among industries on a time basis, but this process is necessarily approximate (box F.5).

Box F.4 **APRA's divisional structure**

APRA is organised into four main divisions:

- Diversified Institutions Division;
- Specialised Institutions Division;
- Policy, Research and Consulting Division; and
- Corporate (human resources, information technology, legal, public affairs, risk assessment, finance and secretariat).

Source: APRA (sub. 21, p. 1).

Box F.5 **Cost estimation process in APRA**

To determine the levies needed to cover its costs, APRA estimates, on a quarterly basis, the time spent by its staff directly supervising each industry. Unallocated costs are then apportioned *pro rata* of the direct costs. In relation to this estimation process, the Australian National Audit Office found that APRA's use of staff numbers does not account for differences in the actual costs incurred by the agency. Specifically, it noted that time estimates in the Diversified Institutions Division for 2000-01:

- allocated supervisory time to each institution in each industry, which does not recognise any relative differences between the staffing costs for the different industries; and
- were based on an estimate for only one of the four branches. There was no information to indicate that this branch was representative of the activities of the entire division.

Further, it found that APRA has never measured staff time spent performing various activities and the time taken to perform different supervisory tasks. It concluded that it was not possible for APRA to demonstrate the accuracy of its approach. It recommended, therefore, that APRA periodically assure itself of the accuracy of its cost estimation approaches, in the interest of greater transparency and accountability.

Source: ANAO 2001.

APRA recognised this issue:

> … increasingly as we go forward it will be more difficult to allocate costs to the traditional industry groups. (Hawker 2000, p. 13)

For this reason, APRA expressed a wish for the base levy rate to be similar across industry sectors (banks, insurance, superannuation) but to vary according to risk (trans., p. 184). If this were implemented, APRA would be able to levy conglomerates based on their overall level of risk (and therefore on their consumption of supervisory resources) rather than on their institutional make-up. A joint APRA and Treasury review of levies in 2000 considered a move to whole-group and risk based levies. In the face of industry opposition, such a move was rejected for now. It will be examined again as part of the 2003 Government assessment of the changes recommended by the Wallis Report.

The Association of Superannuation Funds of Australia reiterated industry reservations at the prospect of a uniform risk based levy:

> … applying uniform percentage rates and an overall cap of $1 million for a financial services group would lead to a massive redistribution of the levy burden. Such a redistribution would be very hard to justify in terms of the regulatory costs involved for various organisations. (sub. 8, p. 10)

However, one financial conglomerate — the NRMA Insurance Group — indicated that it favoured such a levy:

> … NRMA Insurance Group believes that the levy imposed on each institution should be set more on a risk-based approach under which the levies depend on the degree of supervision or monitoring required. A significant advantage of this approach would be that it would provide an incentive for sound prudential management by financial institutions because those that are well-managed and require less supervision would pay lower levies.
>
> In view of the trend towards institutions becoming conglomerates it would appear to be more appropriate to move towards a single levy structure for the overall entity. We note that APRA is intending to move towards a more common levy framework, as stated in its 1999 Industry Consultation paper, and we support this intention as it will help to improve the efficiency of prudential supervision as well as eliminate inequities that exist in current arrangements. (sub. 37, pp. 4–5)

A second cost issue lies with APRA's apportioning of overhead and non-supervisory costs across industries. As shown in box F.6, 42 per cent of APRA's costs in 1999-2000 were due to activities not immediately directed at industry (development of prudential policies and standards, administrative support and corporate governance).

Box F.6 **APRA's cost structure**

Total costs were shared across activities in 1999-2000 in the following break-down:

- 49 per cent for supervision, rehabilitation and enforcement;
- 14 per cent for the development of prudential policies and standards;
- 9 per cent for liaison with industry; and
- 28 per cent for administrative support and corporate governance.

Source: APRA (sub. 21, p. 8).

At present, such overarching costs are spread across regulated industries according to the time spent in the supervision of institutions belonging to that industry. The Australian National Audit Office found that:

> … entities that manage multiple levies such as APRA and AMSA face considerable cost allocation problems devising transparent and efficient costing systems given the need to allocate significant indirect costs across levies. (2000c, p. 66)

APRA stated that a more detailed activity-based costing system, while possible, would involve extra costs, produce greater uncertainty regarding levies faced by industry from year to year, and not necessarily be more efficient than the current system (APRA, trans., p. 183).

Further, APRA claimed that it is difficult to develop an accurate measure of regulatory effort devoted to individual financial institutions or individual groups of financial institutions. It stated that:

> The bottom line here is that it is virtually impossible to come up with a formula for calculating levy rates for cost recovery of an organisation like APRA that will satisfy everybody every year. (Hawker 2000, p. 11)

A divergence between regulatory costs and cost recovery revenue for regulators that straddle several industries can lead to cross-subsidisation between different industries, contrary to professed Government policy (ANAO 2001). A 2000 audit of APRA levies by the Australian National Audit Office concluded that smaller, self-managed superannuation funds ('excluded superannuation funds') were cross-subsidising larger financial institutions before 1998-99. Cost recovered revenue amounted to 965 per cent of regulatory costs for the excluded superannuation funds, but significantly less than 100 per cent for other types of financial institution. The Australian National Audit Office concluded that:

> … prior to 1998-99 … cost recovery outcomes achieved by APRA and its predecessor the Insurance and Superannuation Commission, bear little relationship to the actual cost of prudential regulation of these funds. (2000c, p. 68)

This apparent anomaly was partly rectified in 1998-99, when the supervision of most self-managed funds was transferred to the ATO, and the levy they faced was reduced from $200 to $45. However, some small APRA funds continue to face the same minimum levy facing larger superannuation funds. According to the Association of Superannuation Funds of Australia, this has resulted in the case of a single superannuation Approved Trustee (which administers several thousand funds) paying more than $1 million in levies. This amount is equivalent to the levies paid by major banks individually and exceeds that paid by superannuation and insurance providers (sub. 8, p. 3; sub. DR135, pp. 6–7). It is also likely to be in excess of the actual supervisory costs of auditing that trustee. It is difficult, however, to assess the significance of this example without specific knowledge of the value and risk of the assets managed by that or similar trustees. The 2000 joint APRA and Treasury review of industry levies recommended that:

> … small APRA superannuation funds [be charged] the same rate as other prudentially regulated superannuation funds recognising the importance of these financial institutions receiving an appropriate level of prudential regulation. (Treasury 2000c, p. 4)

By charging all superannuation funds the same minimum levy of $300, APRA was able to reduce the levy rate for these institutions from 0.04 per cent in 1999-2000 to 0.02 per cent in 2000-01. For 2001-02 the minimum was increased to $400 and the rate has risen to 0.025 (table F.2).

Another possible source of industry cross-subsidisation is created by estimating levy revenue and supervisory costs in advance of the financial year to which they apply. As mentioned earlier, any shortfall or excess in revenue collected by APRA in one year leads to automatic levy adjustments in the following year. However, these adjustments do not necessarily lead to, for instance, a shortfall in one year being recovered in the subsequent year. An analysis of this issue by the Australian National Audit Office concluded:

> … there is some imprecision in APRA's calculation of adjustments for over- or under-collections from earlier years. Although ANAO estimates that there was a shortfall of some $2 million in levy revenue against costs for 1999-2000, the 2000-2001 ADI [Authorised Deposit-taking Institution] levy parameters were prepared on the basis that APRA had over-recovered in 1999-2000 by $1.7 million. This indicates that other industries may be subsidising the cost of supervising ADIs as insufficient levy revenue was budgeted to be collected in 2000-2001 to cover the apparent shortfall in 1999-2000 and budgeted costs for 2000-2001. (2001, p. 16)

Treasury's response, on behalf of APRA, considered that it is not unreasonable to expect a difference between the estimated cost and the actual cost of supervision, but that there is no intention of cross-subsidisation in levy payments across sectors and little, if any, evidence of cross-subsidisation in practice (ANAO 2001, pp. 39–40).

Beyond the question of cost allocation across industries, some inquiry participants questioned whether industry should fund some of APRA's costs at all. In relation to APRA's policy functions, for example, the Association of Superannuation Funds of Australia stated:

> … paying for the policy development is a little bit odd, and paying for international aid activities by a government agency is a little bit odd as well. (trans., p. 137)

It also claimed that the benefits of these functions were not always accessible to them:

> … quite a few of these policy functions have moved into the Treasury portfolio proper within the central Treasury, and even though we may be paying for some of that policy function, when you knock on the door of APRA and want to discuss any of those policy issues you're told to go away and talk to Treasury. (trans., p. 137)

In the recent past, the Association of Superannuation Funds of Australia has also conveyed the dissatisfaction of superannuation funds at being required to repay APRA's establishment costs, 'when these costs are not an intrinsic part of the regulation of superannuation' (cited in Blue 1999). The portion of establishment costs apportioned to non-excluded superannuation funds amounted to $2.7 million in 1998-99, $1.6 million in 1999-2000 and $2.0 million in 2000-01, at a time when

the number of superannuation funds in operation fell sharply (APRA, sub. 8, pp. 3–4; ASFA, sub. DR135, p. 6).

Finally, the Association of Superannuation Funds of Australia expressed misgivings about the levies transferred by APRA to the ATO. It argued that the real cost to the ATO of maintaining the lost superannuation members register was almost certainly far below the amount of funds transferred from APRA for that purpose ($2.3 million per year). Given the increasing use of online access technology, it thought that the tax office was over-recovering the cost of answering queries and matching members and funds. It stated that 'consideration should be given to alternative delivery mechanisms for the information, or contracting out of the administration of the function' (ASFA, sub. DR135, p. 4). Finally, it indicated that the maintenance of the lost members register should be funded from the Consolidated Revenue Fund, given that the Commonwealth Government benefited financially from unclaimed superannuation monies, (ASFA, sub. 8, pp. 7–8).

ASIC operation

Fees charged by ASIC range from $8 to $1800. In contrast to APRA fees, these do not vary according to the industry and asset size of the applicant. However, there are variations based on the nature of the company; proprietary companies, for instance, are charged a lodgment fee lower than that for public companies. In addition, ASIC undertakes some activities free of charge (for example, the supply of corporate information to selected media organisations and the ABS). Cross-subsidisation also takes place, from company returns fees to other ASIC activities (for example, licensing, fundraising and takeovers).

As noted previously, fees charged by ASIC must cover a number of costs beyond the agency's operating costs. The main non-agency item is the compensation to States and the Northern Territory for revenue foregone under the national company regulation scheme. In 1994 fees were set at a level capable of achieving equality between ASIC's total costs (including compensation) and total revenues over time. However, between 1991-92 and 1995-96, the operation of the national scheme incurred an accumulated deficit of $217.6 million (CLERP 2000, p. 34).

Given this deficit, and given the need for compensation and cross-subsidisation, the annual company return fee (usually between $200 and $900) has been set at a level significantly higher than the direct cost of receiving and processing annual returns (CLERP 2000, p. 36). This is meant to allow ASIC to eliminate the deficit by 2000-01 and to equate revenues with costs thereafter.

The level of fees following the elimination of the deficit is under examination by the Government, as part of its CLERP 7 reform proposals. These proposals are aimed at simplifying lodgment and compliance by firms, and revising fees in line with 'user pays' principles (ASIC, questionnaire response). The Australian Chamber of Commerce and Industry stressed the need for ASIC fees to fall on elimination of the deficit:

> … there does not appear to be any convincing revenue argument to continue ASIC fees at the current levels, even on a basis of 100 per cent cost recovery. A surplus is difficult to justify on the basis of cost recovery or public policy principles. (sub. 70, p. 15)

Another inquiry participant expressed concern about the possible effects of high fees. The NRMA likened ASIC charges to a tax on industry, resulting in higher costs to consumers and a reduction in the competitiveness of Australia's financial services sector (sub. 37, p. 1).

Governance and consultation

The levy rate setting process by APRA incorporates a number of transparency and accountability safeguards. The industry is consulted annually on the levy rates to be implemented in the next financial year. These rates are subject to approval by the Treasurer (or delegate). APRA is subject to the Parliamentary review process and to supervision by the Australian National Audit Office. In addition, its levy collection framework was reviewed and confirmed by the Government in 1999. A further review will be conducted in 2003 (APRA, sub. 21, p. 4). APRA levies are not subject to Parliamentary approval or review.

Despite the existence of consultation in the setting of APRA levies, views expressed by financial institutions or their representatives suggested that the level of transparency has been insufficient. For instance, the NRMA stated that:

> APRA should … seek to develop transparent measures of supervisory costs for the industries that it regulates, and report regularly on its performance and cost levels. The reporting should be done on a six-monthly basis, which is the same as APRA requires of the companies that it supervises. (sub. 37, p. 1)

The Association of Superannuation Funds of Australia concurred:

> Not only is the consultation not there but the sort of information that we used to get that we could see where the levy was being spent and how it was being spent seems to have disappeared. Partly this is because of the nature of the organisations who use the levy and the way they are structured in terms of functions rather than our particular industry or industry groups. It's therefore difficult to see what part of a levy is being used for superannuation purposes. (trans., p. 136)

APRA responded:

> There have been opportunities for stakeholders to both receive information from APRA and input to changes in the way levies are administered. … APRA consults with eleven industry associations representing more than 10 000 institutions. (sub. DR113, p. 5)

The Treasurer (or delegate) supervises ASIC's activities and sets its fees. In 1993, fees were reviewed by a committee comprising representatives of the Attorney-General's Department (which then had portfolio responsibility for the Corporations Law), the Australian Securities Commission (ASIC's predecessor) and the Department of Finance (ASIC, questionnaire response). In 1995, the Commonwealth Government decided that there should be a series of supplementary fee increases to accelerate cost recovery (CLERP 2000, p. 34).

The Australian Shareholders Association expressed the view that stakeholders should have greater input into ASIC's fee setting mechanism — for instance, through the appointment of independent, non-executive commissioners, and through greater consultation with representatives of the entities liable for payment of ASIC charges (sub. DR170, p. 15). The Association also called for greater transparency of ASIC's activities, fee setting and cost structure, citing a lack of detailed information in the agency's annual reports (sub. DR170, p. 16).

Concern over a lack of transparency was also expressed regarding the monies transferred from APRA to ASIC. The Association of Superannuation Funds of Australia noted that:

> One difficulty in evaluating whether activities of ASIC should be funded by way of the [APRA] levy arrangements is that very little information is provided by ASIC on the nature of its superannuation related activities outside the operation of the Superannuation Complaints Tribunal. The ASIC 1999-2000 Annual Report provides very little evidence of significant activity in regard to superannuation apart from a compliance review of superannuation member statements. (sub. 8, p. 6)

The Association of Superannuation Funds of Australia also questioned the funding arrangements for the Superannuation Complaints Tribunal, which is oversighted by ASIC, noting that the greater financial contribution required from the superannuation industry in 2000-01 did not appear to have been matched by a commensurate increase in the Tribunal's resources (sub. DR135, p. 3).

Concerns about the transparency of ASIC's superannuation activities echo those recorded by the 2000 joint APRA and Treasury review of APRA fees, which led to the recommendation that 'steps will be taken to ensure that the [funds collected by APRA and] appropriated to ASIC [are] fully explained in ASIC's annual financial statements' (Treasury 2000c, p. 10).

Another governance issue of concern to regulated institutions is predictability. This applies mainly to APRA, since ASIC charges are known from year to year, except for Consumer Price Index related increases.[9]

APRA uses a number of mechanisms to avoid overly wide variations in the levies imposed on the institutions it regulates:

- it can use reserves on balance sheet to help meet unforeseen demands on resources and reduce volatility in levy rates from year to year;
- the annual levy rate applying to an industry is based on a three year average of cost estimates for that industry (past year, current year, following year); and
- adjustments are made for any significant over- collections or under-collections from the current year.[10]

These mechanisms notwithstanding, the Association of Superannuation Funds of Australia was critical of some unexpected increases in levies in 2000-01:

> There's no evidence of [greater accountability] in the annual reports and, if anything, the process of setting the levies for the current financial year was very much truncated. I think it was a phone call at the last minute on the basis of some summary papers circulated for another purpose and then, even later in the process, an announcement that a change was being made to the maximum levy. (trans., p. 142)

APRA indicated that this unforeseen increase had been due to the funding of the Superannuation Complaints Tribunal (oversighted by ASIC) (trans., p. 186).

As acknowledged by APRA, unforeseen changes in the number of industry participants also hinder predictability. Such changes affect the actual amount of levies collected by APRA, relative to the budgeted amount. In 2000-01, for example, unforeseen changes in the number of superannuation funds led to a shortfall in levy revenue of $3.3 million. This resulted in an under-collection of $0.5 million overall for APRA in that year, which will cause all levies to rise in 2001-02 (Treasury 2001d).

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9 However, the Commonwealth Government has foreshadowed, in its CLERP 7 document, changes to ASIC fees and regulations which, according to the NRMA, 'are projected to lead to a significant increase in fee revenue for ASIC and potentially an even greater over-recovery of regulatory costs' (sub. 37, p. 7).

10 All industries, except the superannuation industry, pay their levies in advance on 1 July for the financial year ahead.

F.4 Economic effects of cost recovery

As an impost on firms, industries and consumers, cost recovery by financial regulators may produce a number of economic effects. In this section, effects on industry and consumers are examined.

Economic effects on industry

Cost recovery by financial regulators affects individual firms as well as whole industries. This can be expected to lead to intra-industry effects (at the firm level) as well as inter-industry effects (at the industry or sector level). These resource allocation effects are examined below, followed by a discussion of possible compliance costs imposed by cost recovery.

Resource allocation effects

As discussed in chapter 2, cost recovery can improve economic efficiency when it recovers the administrative costs of regulation. It forces firms (and industries) to recognise the true cost to society of producing a particular output. In the case of financial institutions, cost recovery is partly designed to finance the cost of suppressing a 'third party risk' spillover — namely, financial contagion. By charging institutions a cost commensurate with addressing the potential risk they create, cost recovery promotes the efficient allocation of resources.

Conversely, cost recovery will hinder efficient resource allocation if it imposes identical levies on firms (or industries) with different levels of risk. In its submission to the 1999 *Review of Financial Sector Levies*, the Association of Superannuation Funds of Australia suggested that the actual supervisory costs were far higher for a general insurer than for a corporate superannuation scheme (due to the low risk attached to the latter). Yet, if they both had assets slightly in excess of $1 million, they both would have faced an annual levy of $5000 in 1999-2000 (ASFA, sub. 8, p. 16).

In the present APRA model, levies are based on supervisory costs, which are in turn driven by staff allocation. For instance, in 2000-01, approximately 38 per cent of staff were allocated to the supervision of superannuation funds (APRA, sub. DR113, p. 5). Accordingly, levies collected from those funds were budgeted to cover 36 per cent of APRA's operating costs (Treasury 2001d). This arrangement may be termed a 'cost only' model, whereby cost recovery from an industry reflects the amount of time spent regulating that industry.

Economic efficiency will be impaired if the time spent is related directly, say, to the number of institutions in an industry rather than their risk profile. Given that the maximum levy payable by any institution is approximately $1 million, industry contributions to the operation of APRA do not necessarily reflect the size of the respective industries, as measured by their assets. For instance, the assets of the superannuation industry amounted to only 38 per cent of those of Authorised Deposit-taking Institutions in 1999-2000 (APRA 2000, p. 14). Yet, in that same year, the costs of supervision (and hence the levies) were 5.7 per cent higher for superannuation than for Authorised Deposit-taking Institutions (Treasury 2000c). Thus, there is an imbalance between supervisory costs and asset distribution across industries.

These issues have led to calls for the removal of levy caps (Van Leeuwen 1999) or at least for levies to reflect more closely the benefits of regulation. In its submission to the 1999 Review of Financial Sector Levies, the Association of Superannuation Funds of Australia stated that:

> Prudential issues regarding large banks can involve matters of systemic stability that are not relevant to, say, a superannuation fund or life insurer. The major banks can and should pay levies which reflect the benefits of this provision of systemic stability. (Treasury 2000c, p. 17)

The industry-specific levy model used by APRA may also produce other forms of distortion in resource allocation. First, different levies for banking, insurance and superannuation activities may discourage firms from diversifying and exploiting economies of scope. The NRMA, for instance, mentioned that, as a diversified financial institution, it pays four different APRA levies (sub. 37, p. 3). Such a levy model may create perverse incentives for firms to minimise cost recovery payments by disguising their true vocation or by restructuring their activities. In the latter case, resources may be wasted through: duplication of some functions; or operation on too small a scale.

Second, the existence of a levy could discourage a firm from entering (or diversifying into) an industry. If the levy is an accurate measure of the cost of regulating a firm's operations and it makes it uneconomical for that firm to enter an industry, then resource allocation would be efficient. The same argument applies to a firm being forced out of a market by an appropriately set levy. However, allocative inefficiency would result from an inappropriately set levy that drove an otherwise efficient firm out of business. According to the Association of Superannuation Funds of Australia, however, levies for the superannuation industry are not normally of such magnitude as to have this effect (sub. 8, p. 6).

Cost recovery can also create resource allocation distortions at the intra-industry level. This may be the case in the banking industry. While the assets of the big four

Authorised Deposit-taking Institutions (banks) represented 60 per cent of the Authorised Deposit-taking Institution capital under regulation in 1998-99, they paid only 16 per cent of Authorised Deposit-taking Institution regulatory costs (Hawker 2000, p. 10). This implies that the burden of the levies will bear more heavily on a small credit union than on a large bank, for reasons potentially unrelated to risk or monitoring requirements.

Other intra-industry distortions can be created if different regulators charge comparable institutions different levies. The Association of Superannuation Funds of Australia suggested that the difference in levies faced by self-managed funds and small APRA funds ($45 and $300 respectively) is not necessarily commensurate with differences in supervision (by the ATO and APRA respectively) and has the potential to distort consumer choices (sub. DR135, p. 6).

Overall, the evidence suggests that the effective burden imposed by APRA levies varies depending on the size and specialisation of financial institutions. It also appears that this discrepancy, in some cases, is not based on differences in risk and/or prudential activity and, therefore, has the capacity to distort the efficient allocation of resources in the economy. Nonetheless, judgments about fine-tuning the charging model also need to take into account the transaction costs of complex arrangements.

Inquiry participants also expressed concerns regarding the disparity between the degree of regulatory oversight required by a firm and the ASIC fee it attracted. The Australian Shareholders Association noted that, in 1998-99, proprietary companies represented 98.6 per cent of ASIC's company constituency and contributed fees equivalent to 160 per cent of ASIC's running costs (sub. DR170, p. 1). Yet, proprietary companies are generally small and not subject to the stringent disclosure requirements of, say, companies listed on the Australian Stock Exchange. This means that the regulatory costs generated by proprietary companies are likely to be significantly smaller than those of public companies. The implication, according to the Australian Shareholders Association, is that '[ASIC's] annual return fee of $200 paid by proprietary companies grossly exceeds the cost of regulating that sector of the industry' (sub. DR170, p. 11). This has the potential to introduce economic distortions based on firm size.

Compliance costs for firms

The Commission did not receive direct evidence of high compliance costs resulting from cost recovery by financial regulators. However, it seems likely that the cost of complying with levies and fees rises with the number of such charges. In the case of the NRMA, the payment of four separate levies to APRA is likely to entail higher

compliance costs than would be incurred under a single, risk based, levy model (irrespective of the amount of that levy). However, APRA noted that its:

> … progressive capital program aimed at developing technology to assist with the complex analysis of the financial sector … will have a profound impact on the way in which supervision is carried out including a reduction in user burden associated with the completion of statistical returns. (Treasury 2001d)

Given that statistical returns are required for the calculation of levies, this also implies a reduction in the cost of compliance with cost recovery arrangements. Compliance costs may also be higher, proportionately speaking, for small firms, because they are less likely to have access to sophisticated accounting systems.

Regarding ASIC fees, proposals made by the Treasurer as part of CLERP 7 (CLERP 2000) are aimed primarily at simplifying and alleviating compliance procedures under the Corporations Law. As an example, companies would no longer be required to lodge an annual return with ASIC (although they would still be required to pay an annual fee). These proposals, which are likely to reduce compliance costs, are part of the Financial Services Reform Bill currently before the Senate.

Impact on consumers

As explained in chapter 2, consumers and regulated firms will usually share the burden of cost recovery. The former will bear part of cost recovery through higher prices and reduced choice; the latter will bear part through lower sales and possibly lower profits. This may represent an efficient outcome if both groups also derive benefits from regulation or if the regulation acts to suppress negative spillovers.

The apportioning of regulatory costs rests on the ability of firms to pass on the costs to their customers (and, in the case of ASIC, shareholders). However, economic distortions on the consumption side may arise if this burden is passed on based on criteria other than regulatory costs. A diversified financial conglomerate, for instance, may decide to pass on the totality of its cost recovery burden to consumers in only one of its markets, based on the characteristics of demand in that market (such as a lack of competition and product differentiation), regardless of the regulatory costs of that market. This could result in, say, insurance subscribers being made to carry the cost of prudential regulation, not just of insurance activities but also of banking and superannuation activities. Such burden-shifting could impair efficiency through, for instance, consumers under-insuring or over-investing in superannuation. However, the Commission has not received any evidence of this type of distortion occurring.

G Other jurisdictions

This appendix examines the experiences of other countries and selected Australian States with cost recovery. It looks specifically at Canada, Finland, Iceland, New Zealand, Sweden, the UK and the US. It also looks briefly at those Australian States that have produced guidelines.

G.1 Introduction

Although most countries increased their use of cost recovery during the 1980s and 1990s (McMahon 1995; New Zealand Treasury 1998; Hills 1995), there are large differences in how long individual countries have been implementing general policies on cost recovery. For example, the US Office of Management and Budget developed a policy document specifically on user charges as early as 1959. Most of the countries examined either created or revised their policy documents in the 1990s to reflect an increasing role for cost recovery. A summary of the guidelines used in these countries is provided in box G.1.

This inquiry represents the first comprehensive approach to cost recovery at the Commonwealth Government level for regulatory and information agencies. It may also have implications for other types of agencies and other jurisdictions, including State Governments. Box G.2 contains a summary of the current guidelines available at the State level in Australia. Most State guidelines primarily address competitive neutrality issues and thus have only limited application to cost recovery as practised by many Commonwealth Government agencies.

Box G.1 **Overseas guidelines for cost recovery**

Canada — *Cost Recovery and Charging Policy* (Treasury Board of Canada Secretariat 1997b) provides guidelines to Canadian government agencies on their charges. It contains 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. The Canadian guidelines seem to support relatively low levels of cost recovery, compared to those of other countries, through their endorsement of partial cost recovery in the presence of public benefits.

Finland — *User Charging for Government Services Act* (Vallinheimo and Joustie 1998a) provides guidelines to Finnish government agencies on their charges. There is a lack of other documents in English that explain the broader rationale for this legislation so it is difficult to speculate on the coverage of economic, accounting and costing issues. The legislation promotes the use of cost recovery, but lists many possible exemptions including: health care and other welfare services; administration of justice; environmental protection services; education; and general cultural activities.

New Zealand — *Guidelines for Setting Charges in the Public Sector* (NZ Treasury 1998) provides guidelines to New Zealand government agencies on their charges. It contains some information on the accounting, costing and economic issues surrounding cost recovery. The guidelines examine the economic principles that may make cost recovery inappropriate but provide limited practical advice on how these principles should be applied. The guidelines state that the potential beneficiaries of government activities, and individuals, groups or firms that require regulation ('risk exacerbators') should be subject to cost recovery.

OECD — *User Charging for Government Services* (OECD 1998) contains 'best practice guidelines' for OECD countries. It also contains case studies on the approaches taken in particular countries, describing the user charges of a government agency within each country to illustrate how cost recovery policy is implemented in practice. The guidelines promote user charges only if they are implemented under appropriate circumstances, such as where there is clear legal authority, determination of full costs and consultation with users.

UK — *The Fees and Charges Guide* (UK Treasury 1992) provides guidelines to UK government agencies. It contains detailed accounting and costing information but little information on economic issues. There is a presumption in favour of full cost recovery and no attempt to address circumstances when full cost recovery is inappropriate, other than stating that partial cost recovery is permissible with Ministerial agreement.

US — *Circular No. A-25 Revised* (OMB 1993) provides guidelines to US federal government agencies on their charges. It contains limited information on the accounting, costing and economic issues surrounding cost recovery. It encourages full cost recovery from identified recipients of government activities, irrespective of whether all or some of the benefits are passed onto others.

Box G.2 **Australian State Government guidelines for cost recovery**

Some Australian States have produced guidelines on user charges. The coverage of the guidelines differ among the States. Most have a competitive neutrality emphasis and may exclude regulatory activities, but others have a broader scope. In general, the guidelines contain advice on costing with full cost recovery being promoted as a general principle.

New South Wales — The New South Wales Treasury has produced *Guidelines for Pricing of User Charges* (2001). The emphasis of the guidelines is on competitive neutrality compliance. User charges are classified as the revenue generated from government agencies selling products in competition with the private sector. The definition of user charges specifically excludes taxes, fines and regulatory fees because of the degree of compulsion in these transactions. Full cost recovery is encouraged subject to an adjustment for the costs not incurred by a government agency by operating in the public sector (such as return on capital and taxation measures). The implementation of full cost recovery can be waived if the agency is able to demonstrate that the benefits are less than the costs.

Victoria — The Victorian Department of Treasury and Finance has produced *Guidelines for Setting Fees and Charges Imposed by Departments and Budget Sector Agencies, 2001-02* (2000). It contains guidance on costing, charging and competitive neutrality compliance. The guidelines advocate full cost recovery as a general rule and recommend the application of competitive neutrality principles as far as possible. Full cost recovery may be inappropriate where there are conflicting policy objectives, the activity contains public good characteristics, the product is supplied commercially in an open market or the activity relates to regulation (it identifies regulatory fees as being distinct from other user charges).

South Australia — The South Australian Department of Treasury and Finance has produced *A Guide to the Implementation of Cost Reflective Pricing* (2000*)*. This document focuses upon 'cost reflective' pricing as a means for achieving competitive neutrality. Cost reflective pricing is defined as full cost recovery of an activity plus an adjustment for the net cost of being produced in the public sector as opposed to the private sector. However, cost reflective pricing is seen as a starting point for price setting — consideration should also be given to market conditions. It may not be appropriate to implement cost reflective pricing where the costs exceed the benefits. If this is the case, it is necessary to consider whether the benefits to the public from an activity warrant its supply.

(Continued next page)

Box G.2 (continued)

Tasmania — The Tasmanian Department of Treasury and Finance has produced *Costing Fees and Charges: Guidelines for Use by Agencies* (1998). This document focuses on costing issues but also discusses charging. The general rule is that charges should be based on full cost recovery. Full cost is identified as including direct costs, indirect costs and imputed costs necessary for competitive neutrality compliance. However, less than full cost recovery may be appropriate where there are positive spillovers, legal restrictions, conflicting policy objectives or it is difficult to identify the users of an activity. The guidelines require comprehensive and clear documentation for the implementation of a subsidy, including its amount and benefits.

Western Australia — The Western Australian Treasury has produced *Costing and Pricing Government Outputs* (1998). This report contains guidance on costing, pricing and compliance with competitive neutrality principles. It encourages full cost recovery, stating that in some cases it is the most cost-effective approach to pricing outputs. However, short run marginal cost pricing and long run marginal cost pricing are possible alternatives. A cost–benefit analysis of the application of competitive neutrality principles to charges should be undertaken and submitted to the Minister and the Cabinet Government Management Standing Committee before such principles are implemented. Full cost recovery involves setting a revenue target for the supply of output, but may be inappropriate in the presence of positive spillovers, government direction, legal restrictions or commercial supply in an open market.

Queensland — The Queensland Treasury has produced *Full Cost Pricing Policy* (1996) to implement National Competition Policy in Queensland. Full cost includes fixed costs, variable costs and an appropriate rate of return for capital costs, taxes, debt and competitive neutrality requirements. However, this document emphasises that full cost pricing should only be taken as a 'benchmark' for the price of a product because of the commercial nature of many activities subject to competitive neutrality. Consideration should also be given to return on equity and payment of dividends. Community service obligations or government service obligations can lead to partial cost recovery, subject to agreement between the relevant agency, portfolio department, the portfolio Minister and the Treasurer. The separation of policy and regulatory functions from commercial activities is recommended.

G.2 Rationales

There are two common objectives for cost recovery in the countries studied. The first is the promotion of a more efficient allocation of resources. User charges may act as a test of market demand, eliminating frivolous demand and helping to bring about an appropriate scale of delivery (Treasury Board of Canada Secretariat 1997b, p. 1). They may also empower the consumer, along a 'user pays, user says' principle, and a more client-focused service may result in greater quality and

efficiency (Treasury Board of Canada Secretariat 1997b, p. 1). Cost recovery may bring a greater awareness of a government agency's costs, both internally and externally (Borild 1998, p. 73). Greater cost awareness may aid the selection of the most appropriate supplier (New Zealand Treasury 1998, p. 2). The objective of promoting economic efficiency was also common among the guidelines of the Australian States. For example, the guidelines of New South Wales state that an objective of competitively neutral pricing is to achieve an efficient allocation of resources between public and private businesses (New South Wales Treasury 2001, p. 6).

The second widespread objective is the promotion of increased fairness through the beneficiaries of products paying for their provision instead of the general public. This may also be fiscally desirable because it reduces the need for funding from general taxation revenues (Treasury Board of Canada Secretariat 1997b, p. 1).

A number of countries also cited revenue raising as a possible objective for cost recovery, although their approaches differ. New Zealand's *Guidelines for Setting Charges in the Public Sector* seems to encourage the use of cost recovery for revenue raising purposes. One of its objectives for cost recovery is 'reducing reliance on funding from general taxation' (New Zealand Treasury 1998, p. 2). It also states that, as an alternative source of funding to user charging:

> … the working presumption is that recourse to taxation should be avoided except where its advantages can be clearly demonstrated. (New Zealand Treasury 1998, p. 2)

The US Office of Management and Budget appears to see cost recovery as an alternative to general taxation, stating one of its objectives as 'the self-sustainment of Government agencies' supply of goods and services to specific recipients' (OMB 1993, p. 2). Anderson (1991, p. 14) believes that revenue raising has been an important factor behind the increase in user charges in the US.

A revenue raising objective is not explicitly acknowledged in the UK guidelines, but the use of charges to recover past deficits of government agencies is encouraged, while the return of past surpluses is discouraged. The guide states that it is the 'normal presumption' that fee levels should be set to recover past deficits, but that previous surpluses should not 'normally be taken into account' (UK Treasury 1992, p. 9).

In contrast to the countries above, Canada's *Cost Recovery and Charging Policy* document specifically precludes the use of cost recovery to raise revenue:

> … charging cannot be used simply as a means of generating revenue to meet the funding requirements of the department or agency. (Treasury Board of Canada Secretariat 1997b, p. 1)

G.3 Legal authority

The Constitutions of many countries restrict the use of cost recovery, particularly with regard to constitutional distinctions between taxes and user charges (New Zealand Treasury 1998, p. 18). Many constitutions require that taxes be implemented through specific legislation, and this principle invalidates user charges that have the characteristics of a tax but are not supported by such specific legislation. This is the situation in Australia, Canada, New Zealand, the UK and among other countries. The guidelines of the Australian States do not generally discuss the legal authority for the charges of state government agencies. The constitutions of the Australian States, with the exception of Western Australia, do not distinguish between taxes and charges.

Factors that may be seen as giving user charges the characteristics of a tax include: whether the transaction is voluntary; the strength of the link between the revenue source and use; the size of the user charge; and whether indirect as well as direct costs are recovered (New Zealand Treasury 1998, p. 17). The Swedish Constitution, for example, defines a user charge as being directly related to the services rendered and not exceeding the full cost of those services (Borild 1998, p. 73). These issues are also likely to affect whether government organisations recover costs for individual services or across the agency. The guidelines of Canada, Finland, New Zealand, the UK and the US encourage cost recovery for individual goods and services.

The Finnish parliament overcame the potential limitations of the constitutional distinction between a tax and a fee-for-service by enacting the *User Charging for Government Service Act 1992* (Vallinheimo and Joustie 1998a). This Act provides the Finnish government with a broad ability to implement user charges within the guidelines embodied in the Act (Vallinheimo and Joustie 1998b, p. 35).

In the US, it is unclear how far the Constitution places limits on the application of user charges. In 1989, there was a unanimous ruling by the US Supreme Court that user charges are not taxes in the case of *Skinner v. Mid-America, 87-2098*. Anderson (1991, p. 24) took this to mean that user charges are whatever the government says they are — a user fee is different from a tax because Congress has decided that the two are different. Anderson suggested that this was a pragmatic decision, reflecting the extent of user charges in the US local, state and federal governments.

However, in 1998, the US Supreme Court made a ruling that user charges can be taxes, and therefore unconstitutional, in *United States v. United States Shoe Corp*. It was ruled that a purported user fee was unconstitutional because the link between the revenue source and the use of the revenue was too indirect (Joint Committee on

Taxation 1998, p. 7). There are two possible interpretations of this outcome and it is unclear which is the more applicable:

- this ruling may reflect a turnaround by the US Supreme Court from *Skinner v. Mid-America, 87-2098* on the distinction between taxes and user charges; or
- the Court reached its conclusion based on particular circumstances of this case.

Some governments, such as those of Iceland, Sweden and the UK, are unable to charge for services unless the ability to do so has been specifically granted in legislation for a given agency (UK Treasury 1992, p. 2; Borild 1998, p. 74; Hjalmarsson 1998, p. 52). This results in government agencies having to implement legislation agency by agency because of the lack of general legislation (Hjalmarsson 1998, p. 52). Canada has three types of legal authority for setting fees — specific department legislation, *the Financial Administration Act* and 'Ministerial Authority to Contract' (Treasury Board of Canada 1997b, p. 7). While the *Financial Administration Act* and 'Ministerial Authority to Contract' may side-step this problem, it is likely to still exist under specific departmental legislation. The introduction of cost recovery may be deterred if the agency is required to spend significant resources on developing its policy and enacting the legislation. It may also increase the possibility of inconsistencies in the cost recovery practices of different government agencies — piecemeal legislation may be introduced agency by agency without appropriate reference to some over-arching legislation or policy.

G.4 Governance and accountability

The countries reviewed have different governance and accountability arrangements in place. Consultative processes differ both in terms of the consultation undertaken in developing the guidelines, and consultation required by the guidelines. Canada's *Cost Recovery and Charging Policy* document was developed using consultation with nationally-based industry groups, groups representing Canadian individuals, academia, major user-charging departments and the Office of the Auditor-General (Treasury Board of Canada Secretariat 1999, p. 3). In contrast, the *Finnish User Charging for Government Services Act 1992* was produced with no formal consultation with interested parties.

The Canadian guidelines require government agencies to ensure efficient means of consultation with affected parties before and during cost recovery (Treasury Board of Canada Secretariat 1997b, p. 2). The New Zealand guidelines acknowledge the need for some kind of consultation process through user groups or some form of advisory board but it is not a compulsory requirement (New Zealand Treasury 1998,

p. 26). In contrast, the Finnish *User Charging for Government Services Act 1992*, the UK *The Fees and Charges Guide* and the US *Circular A-25 Revised* do not mention consultation with interested parties in setting user charges.

In Canada, agencies are required to conduct impact assessments of fee setting decisions, both before introduction and on an ongoing basis. There is also provision for raising concerns with the President of the Treasury Board, including concerns over any lack of consultation in the fee setting process (Treasury Board of Canada Secretariat 1997b, p. 5).

In Finland, government agencies are required to publish their pricing decisions in the Official Gazette. This might increase the transparency of such decisions to interested parties, but it appears that interested parties have limited power to raise concerns through a 'watchdog' institution or specified consultation process. The government organisation producing the service is entrusted with ensuring that the cost of production and the quality of service are appropriate (Vallinheimo and Joustie 1998b, p. 36).

In Sweden, all government agencies are required to consult yearly with the Swedish National Audit Office about their user charges. This is intended to ensure that user charges are uniform, relevant and do not exceed the full cost of the service over the service's lifetime (Borild 1998, p. 74).

In the US, the Office of Management and Budget performs a variety of oversight functions over agencies' cost recovery activities. However, its ability to independently gauge whether a given level of cost recovery is appropriate is arguable given the strongly pro-cost recovery role given to the it in *Circular No. A-25 Revised* (OMB 1993).

Accountability mechanisms exist in most Australian 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 an external biennial assessment of government agencies charges by the Budget Committee, another appropriate Committee, or Cabinet. In Queensland, the implementation of each government agency's user charging policy is subject to agreement between its portfolio department and the Queensland Treasury. Agencies are required to report their costing and pricing every three months to the Queensland Treasury and their portfolio department. The New South Wales guidelines do not specifically refer to an accountability mechanism, but agencies have the option of consulting with Treasury analysts for advice and assistance. The guidelines of Victoria, Tasmania and Western Australia require government agencies to review their charging policies internally on an annual basis.

Most Australian State guidelines require government agencies to publish their charging policies. These are required to be published in Victoria as part of an agency's business plan; in Tasmania as specific agency manuals; and in Western Australia in agencies' annual reports.

G.5 Application of cost recovery

The guidelines under consideration raise two questions about the application of cost recovery to government activities: first, should the government be undertaking that activity at all; and second, the cost effectiveness of implementing cost recovery. In relation to the first question, the Canadian guidelines state:

> Cost recovery can only be initiated where the Government has deemed the activity in question to be a legitimate and necessary role for the federal government, and one that cannot be provided adequately by the private or voluntary sector. (Treasury Board of Canada Secretariat 1997b, p. 2)

The UK guidelines state 'the presumption is that services should wherever possible be provided by the private sector rather than the public sector'. It even calls for 'periodic review' of the necessity for the activity to be provided by government (UK Treasury 1992, pp. 6, 25).

The New Zealand guidelines require government agencies to consider whether their products could be 'out-sourced' or 'devolved' to the private sector (New Zealand Treasury 1998, p. 10).

In relation to the second question, most policy documents acknowledge the impracticality of undertaking cost recovery if the associated administration costs outweigh the benefits. The emphasis given to consideration of administration costs varies between countries. In the US, the cost of collecting the fee should not be 'unduly large' and in Canada it should not be 'excessive' in relation to the collected revenue.

Full cost recovery

Full cost recovery is the general principle behind the calculation of user charges for statutory activities among the countries examined, but there is some variation in how this rule is applied. Statutory activities are those that are determined to fall within the realm of government, either through legal definition in statutes (UK Treasury 1992, p.2; Vallinheimo and Joustie 1998b, p. 35), or through inadequate alternative provision in the private or voluntary sector (New Zealand Treasury 1998, p. 2; Treasury Board of Canada Secretariat 1997b, p. 2).

Where charging for inter-governmental services is discussed, the normal rule is that full cost recovery should be applied. In the US, *Circular No. A-97* (OMB 1969, p. 5) states 'such services will be provided only on payment or provision for reimbursement [of] all identifiable direct and indirect cost of performing such services'. In the UK, the guidelines state 'charges should normally be set to recover the full cost of the service' (UK Treasury 1992, p. 19). The same policy exists in Finland.

The application of cost recovery differs between the countries studied in three main ways:

- the extent to which a deviation from full cost recovery is allowed on an unintentional or temporary basis;
- the extent to which a deviation from full cost recovery is allowed on an intentional or indefinite basis; and
- the definition of 'full cost recovery' and in particular, the treatment of the cost of capital.

Temporary deviations from full cost recovery

In relation to a temporary deviation from full cost recovery, in the UK it is 'legitimate… to apply a degree of tolerance' to the full cost recovery principle (UK Treasury 1992, p. 5). In Sweden, costs only have to be fully recovered in the 'long-run'. A government agency may deviate from full cost recovery in a given year to reflect previous surpluses or deficits (Borild 1998, p. 74). In Iceland, previous deficits must be returned by direct repayments or by charges temporarily lower than the costs and vice versa (Hjalmarsson 1998, p. 42). However in the UK, the retrieval of deficits is encouraged far more than the return of surpluses. It is the 'normal presumption' that charges should be set to recover past deficits, but surpluses should not 'normally be taken into account' when setting charges (UK Treasury 1992, p. 9).

Less than full cost recovery

A key distinguishing factor between countries appears to be the extent that less than full or partial cost recovery is permissible on an ongoing basis, particularly with respect to the treatment of public benefits. Australian State guidelines generally endorse less than full cost recovery where there are: conflicting policy objectives, legal restrictions, positive spillovers or where a service is provided predominantly for a core user and additional capacity can be supplied at little or no extra cost. For example, a metropolitan public hospital may provide meals to a private hospital at

marginal cost in order to utilise its additional capacity (Tasmanian Department of Treasury and Finance 1998, p. 8).

Partial cost recovery may occur in the UK subject to agreement among Ministers (UK Treasury 1992, p. 5). However, the circumstances under which ministerial agreement is appropriate are not elaborated on.

Public benefits provide a case for partial cost recovery in New Zealand but 'the loss in public benefits from charging at full cost would have to be significant' (New Zealand Treasury 1998, p. 2). The description of 'public benefits' follows an economic definition of 'public goods'.

Deviation from the rule of full cost recovery occurs in Canada if the activity has public policy objectives that may be affected or if it contains a mix of private and public benefits. The Canadian *Cost Recovery and Charging Policy* acknowledges the continuum of activities between purely private and purely public goods (Treasury Board of Canada Secretariat 1997b, pp. 3, 6). It identifies four characteristics as useful in determining where an activity lies between the two ends of the scale:

- the extent to which individuals can be excluded from a product for which they have not paid;
- the extent to which charging will influence demand for a product;
- the extent to which a mandatory service confers direct benefits with respect to marketability and reduced liability through the mitigation of risks; and
- the relative importance of policy objectives associated with the activity.

In Sweden, full cost recovery does not apply if the objective of the activity would be adversely affected. For example, Swedish citizens' constitutional right of access to information means that individuals are only charged the cost of executing an order for information services, with most information being provided free on the Internet (Borild 1998, p. 74).

The relevant public policy areas that qualify for exemptions in Finland are identified as: health care and other welfare services; administration of justice; education; general cultural activities; and environmental protection services (Vallinheimo and Joustie 1998b, p. 36). While this list covers many of the core functions of government, no rationale is given in the legislation for these particular choices.

In the US, *Circular A-25 Revised* (OMB 1993, p. 4) states that full cost recovery applies to identified recipients of government activities, irrespective of whether all or some of the benefits are passed on to others, including the public in general. This

rule does not apply to all government activities, as some government activities qualify for exemption in other documents. *Circular No. A-130* states that user charges for government information products should be set 'at a level sufficient to recover the cost of dissemination but no higher' (OMB 1996, p. 9).

Cost of capital

Cost recovery charges may include a rate of return on capital for two main reasons. The first is that the government may seek a return on its capital that is equivalent to what it would receive if the capital was put to its next best use. This opportunity cost of capital is often measured by a long-term bond rate. The second reason is to ensure competitive neutrality in the pricing of government products. Thus, a rate of return may be incorporated in charges for 'commercial services', which tend to be provided at the government's discretion rather than required through statutes, as well as being in more direct competition with the private sector (UK Treasury 1992, p. 2). The guidelines of the Australian States frequently define full cost recovery as including direct costs, indirect costs and imputed costs necessary for competitive neutrality compliance (including, the cost of capital and certain taxes and charges from which public sector organisations are exempt).

In the UK, full cost recovery is defined as including a six per cent annual cost of capital. This is defined as the amount of interest the government could earn on its capital if it were put into an alternative use (UK Treasury 1992, p. 8). In the US, full cost recovery includes an annual rate of return on capital equal to the average long-term Treasury bond rate (OMB 1993, p. 5). One of the objectives of cost recovery in Canada is to 'earn a fair return for the Canadian public for access to, or exploitation of, publicly-owned or controlled resources' (Treasury Board of Canada Secretariat 1997b, p. 2). In Finland, there is no requirement for statutory services to earn a return on their capital, as this only applies to commercial services (Vallinheimo and Joustie 1998b, p. 35).

In general, the inclusion of a rate of return is encouraged for government activities that operate in a more commercial environment. In the countries reviewed, it appears general competition legislation had a large influence on policies for charging for commercial services (Hjalmarsson 1998, p 52). In the UK, commercial activities are expected to recover at least full cost, with adjustments being made for the degree of risk and competition surrounding that activity (UK Treasury 1992, p. 26). The more risk and/or competition involved in the activity, the greater the return expected on the capital assets. In the US, the price for commercial services is meant to mimic their potential 'market price'. Possible methods suggested for determining the market price include competitive bidding and benchmarking (OMB 1993, p. 5). The Finnish and Icelandic approach to user charging for commercial

services is that they should be set through competition in the open market with other sellers and show overall profitability with a return on capital similar to that expected by private investors (Vallinheimo and Joustie 1998b, p. 36; Hjalmarsson 1998, p. 52).

Usually the guidelines did not explore whether charging a rate of return is appropriate to cover the costs to society of a particular activity. It would appear that the guidelines relate to user charges, whereas charging to make allowances for social costs is deemed to be more a matter for taxation (New Zealand Treasury 1992, p. 22).

G.6 Trends

Most governments appear to have made little effort to estimate accurately aggregate levels of cost recovery. The data that are available are frequently dated and incomplete. Hence it is difficult to compare the scale of cost recovery across countries and over time.

In Canada, Can$4.3 billion was raised from government 'sales of goods and services' in 2000-2001 (Statistics Canada 2001). This figure over-estimates the extent of cost recovery because it includes asset sales. Seventeen per cent of government revenue was generated by user fees in 1990 (Sproule-Jones 1994, p. 7). This figure is likely to have understated the true extent of user fees because it does not include the revenues of government agencies that operate in a more commercial environment. A government-wide summary shows no apparent increase or reduction in the revenue generated from charges to non-government users between 1994-95 and 1997-98 (Treasury Board of Canada Secretariat 1998). However, there have been trends within categories. It seems that there has been a greater shift towards cost recovery in agencies associated with the environment (Canadian Environmental Assessment Agency, Environment and Fisheries and Oceans), law (Federal Court of Canada, Justice, Supreme Court of Canada and Tax Court of Canada), immigration, foreign affairs, trade, finance, and the Canadian Space Agency. Conversely, there appears to have been a significant reduction in cost recovery for Public Works and Government Services.

There is little recent information on cost recovery in the US. In 1995-1996, US$56.7 billion was raised from 'federal charges' (US Census Bureau, Washington, pers. comm., 20 April 2001). This figure is a very rough approximation of cost recovery because it includes asset sales and excludes revenue received and spent in the same financial year. Furthermore, this is the last year that the US Census Bureau collected finance data for the Federal Government. In the period prior to 1990, there

was a relative increase in the reliance on non-tax revenue sources for federal, state and local government (Anderson 1991, p. 19). At a federal level, non-tax revenue represented 17.6 per cent of total revenue in 1970, 21.8 per cent in 1980 and 24.7 per cent in 1985 (Netzer 1992, p. 498). A similar trend can be found in the user charges imposed by American state and local governments but it appears that much of the increase in user charges at the local level took place in the 1970s rather than the 1980s (Netzer 1992, p. 499).

In Finland, the total amount of user charges in the budget sector rose nearly nine per cent, between 1994 and 1995 with an increase of FIM540 million. This reflected the implementation by government agencies of the *User Charging for Government Services Act 1992*. However, over half of all government services subject to charges under this Act were produced and consumed within government. These inter-governmental charges amounted to nearly FIM2900 million in 1995. Sales to non-government parties amounted to FIM2500 million in 1995 (Vallinheimo and Joustie 1998b, p. 37).

In the UK, approximately £2 billion was raised from 'government charges' in 1998-1999 (UK Treasury, London, pers. comm., 13 February 2001). Charges for public services fell from £7.9 billion in 1978-79 to £7.6 billion in 1993-94 (Hills 1995, p. 32). Earmarked taxes, which are likely to contain some charges that can be viewed as cost recovery items, increased between 1978-79 and 1993-4 from almost £31.1 billion to £47.5 billion.

Overall, it seems that most countries increased the scale of their cost recovery activities over the course of the 1980s and 1990s. However, in some cases, such as Finland, a significant portion of this increase was due to a rise in inter-governmental charging.

G.7 Case studies

The following case studies show how the previously discussed guidelines have been implemented in practice by various government agencies. Overseas cost recovery arrangements for the review of prescription drugs, medical devices and dietary supplements are described, followed by overseas cost recovery for selected information agencies.

Overseas cost recovery arrangements for the review of prescription drugs, medical devices and dietary supplements

Government agencies around the world pursue similar objectives in their review of prescription drugs and medical devices, but have different cost recovery mechanisms. There are also differences in cost recovery mechanisms for the review of dietary supplements, and it appears that the objectives differ among countries, as indicated by the diverse regulatory structures for these products.

United States

The Food and Drug Administration is responsible for the regulation of prescription drugs, medical devices and dietary supplements in the US.

The Food and Drug Administration recovers almost 50 per cent of the total costs of prescription drug review (FDA 2000c). The charges were introduced in 1993, under the *Prescription Drug User Fee Act* 1992, and have grown each year since. The Act was enacted to supplement the Food and Drug Administration's resources for the review of human drug and biological applications and the funds may not be used for other purposes, including activities related to the review process such as the surveillance of post-marketed products. There are four fees charged under the *Prescription Drug User Fee Act 1992*: full application fee; half application fee; annual establishment fee; and annual product fee. The Food and Drug Administration's ability to collect these charges is tied to written performance goals. In 1999-2000 these charges generated US$122 million (FDA, 2000b).

The Food and Drug Administration may also impose user charges for its medical device services. However, its ability to collect these charges is tied to written performance goals which have not been met — so it has not yet been able to collect charges. The estimated revenue from the proposed charges for 2000-2001 was US$5.8 million (FDA 2001a).

The Food and Drug Administration is responsible for only post-market surveillance of dietary supplements. Manufacturers do not need to register with the Food and Drug Administration or receive its approval before producing or selling dietary supplements (FDA 2001b).

Canada

The Therapeutic Products Programme regulates prescription drugs and medical devices in Canada, while the Natural Health Products Directorate regulates dietary supplements.

The Therapeutic Products Programme's cost recovery mechanisms follow the Canadian Government's policy that charges should be set according to the private benefit associated with the activity. There are almost fifty different charges for Therapeutic Products Programme activities related to prescription drug activities. They comprise: 100 per cent cost recovery for adverse reaction monitoring and 'for cause' inspections; 70 per cent cost recovery for application reviews; and 30 per cent cost recovery for other post-marketing costs. In 1999-2000 the Therapeutic Products Programme collected Can$37.3 million through these charges (Health Canada 2000, p. 4).

The Therapeutic Products Programme has various charges in place for its activities relating to medical device regulation which commenced in 1998-1999 (Awin, DR119, p. 2). These include: annual fees for medical devices; annual fees for product licensing renewal; and establishment licence fees. The revenue from these fees in 1999-2000 was Can$2.5 million (Health Canada 2000, p. 4).

The Canadian Government has allocated Can$10 million towards establishing a separate entity, the Natural Health Products Directorate, for the regulation of complementary healthcare and dietary supplements. The Natural Health Products Directorate is reviewing its current cost recovery policy and although it is anticipated that it will recover at least some of its costs, it is unclear how far such charges will apply to the review of dietary supplements.

United Kingdom

The Medicines Control Agency regulates prescription drugs and dietary supplements in the UK, while the Medical Devices Agency regulates medical devices.

The Medicines Control Agency recovers 100 per cent of all prescription drug regulation costs. Costs were partially recovered following the 1971 amendments to the *Medicines Act 1968*. Full cost recovery was initiated in the early 1990s. There are over 50 different charges. In 1999-2000, the Medicines Control Agency collected £28 million and spent £36 million (using carryover revenue).

In practical terms, the Medical Devices Agency does not engage in cost recovery for its activities relating to the regulation of medical devices. Its Business Plan for 2000-2001 cites £18 000 in revenue from 'device testing' but this is only a fraction of its total expenditure of £9.6 million (MDA 2000).

Dietary supplements fall within the category of 'borderline' products at the Medicines Control Agency, so long as they contain familiar substances and do not

contain pharmacological active substances or make medicinal claims. Cost recovery is not imposed for the review of these products.

Cost recovery by overseas information agencies

National statistical agencies divide their products into those for the general public (basic products) and those that are developed for identified groups of users (additional products). Basic products are charged at less than full cost or not at all, depending on the method of delivery. The differences among countries lie in the scope of products that are identified as providing a service to the general public and the methods of charging for the various additional products.

Some products of national statistical agencies can be substituted for the products of overseas agencies, for example, for research purposes. Over-pricing by one agency relative to others may mean that some of its products are not used. This can lead to research and analysis in a given country being carried out using statistical information from another country. This has been a problem in Canada and Australia, with US data being used as the basis for domestic policy recommendations.

United States

Much US statistical information is available relatively easily and free of charge through media such as the Internet. The general policy on user charges for the US federal Government, as described in *Circular No. A-25 Revised*, is modified for its information products through *Circular No. A-130: Management of Federal Information Resources*. Rather than full costs being recovered, it seems to encourage marginal cost recovery, stating that agencies should:

> … set user charges for information dissemination products at a level sufficient to recover the cost of dissemination but no higher. They shall exclude from calculation of the charges costs associated with original collection and processing of information. (OMB 1996, p. 9)

Circular No. A-130 takes the view that information products provide a number of services to US society and economy, such as ensuring the accountability of government, fostering research, and maintaining a healthy economy and a democratic society (OMB 1996, pp. 4–6). The benefits from a free flow of information are argued to outweigh the costs. Marginal cost recovery is seen as supporting this. Further, *Circular No. A-130* recognises that the government is the largest single producer, collector, consumer and disseminator of information in the

US as well as being reliant on public cooperation for its raw data (OMB 1996, pp. 4–5).

The US Census Bureau is the principal US statistical agency. Its activities are categorised into four product lines: decennial censuses, economic statistics, demographic statistics and reimbursable work. The first three activities are taxpayer funded but reimbursable work is cost recovered. Reimbursable work refers to certain products for federal government agencies, the public and foreign entities (Census Bureau 2000, pp. 3–6). In 1999-2000, the US Census Bureau recovered 15.3 per cent of its total costs and 103.2 per cent of the costs of reimbursable work through charges specific to the reimbursable work program (Census Bureau 2000, p. 17).

Canada

Statistics Canada is Canada's principal statistical agency. Its basic work on public policy issues is taxpayer funded. It is deemed to be in the public interest that Canadians are 'informed citizens'. This means that all taxpayer funded surveys on public policy issues and outputs from existing surveys are provided free of charge through the Internet. However, information for personal advantage or organisational goals that is not part of the basic work of Statistics Canada is supplied on a cost recovery basis. In 1999-2000, Statistics Canada recovered 19.1 per cent of its total costs (Statistics Canada 2000, p. 9). The costs recovered include direct and indirect costs.

United Kingdom

The Office for National Statistics is the principal statistical agency in the UK. The agency's basic work is funded by taxation revenue while other work, including alterations to existing data to meet specific client requests, is cost recovered (ONS 1995, p. 1). In 1999-2000, the revenue that the Office for National Statistics recovered through charges met 30.6 per cent of its total costs (ONS 2000, pp. 53-54).

The Office for National Statistics aims to place increasing amounts of its products on the Internet, where they are free to users that do not on-sell these products or make a profit (ONS 2000). The *Guide to Charging for Goods and Services* (ONS 1995) sets out appropriate charging principles for work carried out at client request. There are four main rules: charges recover full costs; no distinction is made between private and public sector customers; rate of return on assets is maximised; and details of how charges are calculated are not revealed (ONS 1995, p. 2).

France

A Prime Ministerial document, *Circulaire du 14 fevrier 1994 relative à la diffusion des données publiques*, sets out the policy for government provision of information and charging arrangements in France. A government agency can provide non-basic or transformed information if it can demonstrate that the provision of such information falls within its mandate, meets a collective need and is not provided by the private sector in a way that meets the public interest. The document acknowledges the argument that if a government agency is fulfilling a public role, it should not charge for its services. However, charging may be appropriate in order to manage demand; to meet competitive neutrality requirements; and to ensure fairness within a 'beneficiary pays' model. Charges are not expected to recover costs that have already been taxpayer funded or to generate profit, except where there are competitive neutrality or intellectual property considerations.

L'Institut national de la statistique et des études économiques (INSEE) is France's principal statistical agency. Its pricing policy for electronic data is set out in *Arrêté du 10 octobre 2000*. INSEE holds intellectual property rights over its products and this forms a component of its charges, along with construction, maintenance and updating costs. The charges distinguish between different types of statistical products and different intended uses of the material. Information on enterprises, public organisations and their institutions has a different set of charges to macroeconomic data. It costs more to use data in an unrestricted or commercial way than it does to use data in a restricted or non-commercial way. The licence fee payable to INSEE for redissemination purposes varies according to the number of users targeted by the redissemination. It is greatest in the case of Internet redissemination. INSEE also provides a selection of its products on the Internet without charge and these can be reproduced without restriction, provided that INSEE is referenced and an effort is made to maintain the quality of the data.

Sweden

Statistics Sweden is the principal statistical agency in Sweden. It has a decentralised structure for determining the content and form of the statistics it produces, based on purchaser-provider agreements with other government agencies. Responsibility for the coordination and quality control of some statistics has been delegated to other government agencies, which can then contract Statistics Sweden to supply statistics to them (see appendix C). This 'commissioned work' accounts for about 70 per cent of Statistics Sweden's turnover (Borild 1998, p. 75).

H Costing approaches

For efficient and effective cost recovery, government agencies need to identify and measure the appropriate costs of their activities and products. When measuring costs, agencies need to account for a number of factors; for example, the effects of accrual accounting, capital cost calculation methods and competitive neutrality principles. Once agencies have identified and measured costs, they can allocate those costs to products. An in-principle decision is also necessary about which approach to cost recovery is to be adopted (for example, recovery of full cost, marginal cost, incremental cost or avoidable cost).

H.1 Some benefits of costing products

If cost recovery charges are based on the wrong costs, or if the costs of agencies are not appropriately allocated among activities and products, then decisions about the production and consumption of government supplied products may be distorted. Environment Australia mentioned some of these issues:

> Knowledge about costs is an essential ingredient in ensuring efficient and cost-effective decision making and assists transparency in valuing resources used to provide goods and services.
>
> Undertaking proper costing analysis is useful for program management and can be used to identify cost drivers and eliminate non-value-added activities, leading to more efficient operations and increasing the transparency of business activities. (sub. 76, p. 3)

Costing products accurately can improve an agency's information base, help it to set cost reflective prices and improve the efficiency with which products are produced and consumed. Environment Australia stated:

> To the extent that prices may be set in order to recover the costs of a particular good or service, accurate costing will enable the correct pricing signal to be sent to users and producers, thus promoting economic efficiency objectives. (sub. 76, p. 2)

Costing outputs can also be useful for promoting transparency. If costing information is available to the public, then there could be greater scrutiny of the efficiency and effectiveness with which government services are delivered. Where cost recovery occurs, there could also be greater scrutiny of that process. Those who

pay the charge will have an interest in placing pressure on agencies to improve efficiency.

The Australian Customs Service mentioned accountability and transparency mechanisms in relation to its costing system:

> Customs maintains … costing of its services to ensure that … the charges imposed are limited to the calculated costs of delivery of the functions. Charges are externally reviewed biannually to ensure that they reflect any changes in the costing structure that are recorded in the costing model. The full activity-based costing model is provided to industry representatives through a number of forums. (trans., p. 449)

The need to identify and track costs is not unique to cost recovery agencies. All Commonwealth departments and agencies are required to specify and set prices for the outputs they deliver to Government (see chapter 3).

'Costing' should be distinguished from 'market pricing'. The cost of a product is the value of the inputs that have been used in its production, while market pricing represents the market value of a product. Although this price is influenced by the cost of production, distribution and supply, it is also influenced by demand (DOFA 2000, p. 8). In most instances, cost recovery is not aimed at seeking to 'price to market'. When costing a product, agencies typically define the product then identify and measure the costs of its production.

H.2 Defining the product to be costed

Before agencies can set charges, they need to define the activity or product, then estimate the associated costs. It is useful for an agency to know the full costs of a particular activity or product, regardless of whether it intends to fully recover those costs. Costing information will assist the agency in, for example, knowing how efficiently it is producing those products. Some commonly used costing terms are defined in box H.1.

To achieve outcomes, governments undertake a range of activities and provide a variety of products. Activities and products need to be defined before they can be costed. When defining the activity or product it is usually desirable to:

- specify the objectives of the activity or product and the targets to be met;
- identify the activity or product and the inputs necessary to produce it;
- identify constraints to producing the activity or product; and
- specify quantity and quality characteristics of the activity or product.

Box H.1 **Cost definitions**

Direct costs are costs that can be directly and unequivocally attributed to an activity or product. They include labour (and labour on-costs) and materials used to deliver products.

Indirect costs are costs that are not directly attributable to an activity or product and are often referred to as overheads. They can include 'corporate services' costs, such as those of the chief executive officer's salary, financial services, human resources, records management and information technology.

Capital costs comprise the user cost of capital and depreciation. The user cost of capital represents the opportunity cost of funds tied up in the capital used to deliver activities or products. It is the rate of return that must be earned to justify retaining the assets in the medium to long term. Depreciation reflects the portions of assets consumed each period.

Fixed costs are costs that do not vary with the amount of activity or product. Rent and capital are usually fixed costs in the short run.

Variable costs vary with the volume of activity or product and typically include direct labour and materials.

Common or joint costs remain unchanged as the production of different products is varied. These costs are incurred if any one of the goods is provided; for example, the cost of a telephone line remains unchanged whether it is used for local or long distance calls.

Source: CCNCO (1998a).

Quantitative characteristics may cover physical standards, product volumes, product frequencies, and material, safety, accuracy and reliability standards. Qualitative characteristics cover descriptive standards and typically state the objectives that the activity or product is intended to achieve. These include set criteria against which performance can be measured.

If activities or products are defined too narrowly, agencies may devote more resources to determining costs than may be gained in subsequent improvements to allocative efficiency. The Department of Science, Industry and Resources commented that registering objects to be launched into space is a low cost function and so minimal that it would not be cost effective to cost it separately (trans., p. 768). On the other hand, activities or products to be costed should not be defined too broadly; for example, activities subject to cost recovery should be costed separately from activities that are not subject to cost recovery, such as policy advice.

H.3 Measuring costs

This section examines what cost components should be included in the measurement of full cost of a product. It also considers the effect of accrual accounting on the measurement of costs, and provides a description of the different capital cost calculation methods. The effects of competitive neutrality are also considered.

The full cost of a unit of product is the value of all resources used or consumed in the provision of that product. These costs may include:

- direct labour costs (for example, wages and salaries) and other labour costs (for example, allowances, long service leave and superannuation);
- direct materials and services (for example, the costs of stores, computer services and services obtained on a contract basis);
- an appropriate share of indirect labour (for example, executive, office services, personnel, library and audit services);
- an appropriate share of indirect materials and services (for example, office machinery, advertising, insurance and freight and cartage). Some materials classified as indirect costs could be direct costs, but attributing them to a particular product may be impractical or too costly (for example, office stationery);
- accommodation charges, which could be both direct and indirect (for example, rent, repairs and maintenance, cleaning and utility charges); and
- capital costs (for example, depreciation, interest on working capital and return on non-current assets)[1] (see below). Some could be direct costs, such as plant and machinery dedicated to the production of particular products; others could be indirect costs, such as assets used by corporate services.

Accrual accounting and output based budgeting

An accrual based budgetary framework, incorporating output based budgeting, was introduced into the Commonwealth public sector with reporting beginning from 1999-2000. Previously, agencies within the Commonwealth public sector used cash based accounting that recognised revenues and expenses when payments were made or received. Accrual accounting recognises revenues and expenses in the accounting

[1] Non-current assets are assets that are not reasonably expected to be converted to cash, sold or consumed within a year of the balance sheet date. They include property, plant and machinery.

period in which they occur, irrespective of when cash is paid or received. The framework requires all agencies to:

- measure resource consumption and revenues on an accrual basis, recognising costs and revenues when they are incurred;
- set prices for products they deliver, and identify outcomes to which the products contribute;
- levy a capital use charge on net departmental assets;
- identify performance indicators to monitor performance against outcomes; and
- report performance.

The new framework requires agencies to improve their costing so they are able to price all products and monitor and report performance. The former Department of Finance (now Department of Finance and Administration) identified the ability to cost activities properly as a major benefit from the introduction of full accrual accounting. It argued that cash accounts are more open to manipulation and are a poor basis for cost comparisons (DoF 1996).

The move from cash to accrual accounting has had implications for two cost components that are important in determining the full costs of products. First, the measurement of capital has changed. Under the cash based system, the operating statement included the capital expenditures made to acquire assets. Under the accrual system, depreciation rather than capital expenditure is included in the operating statement. Second, the move to accrual accounting has changed the way in which employee entitlements are treated; for example, superannuation is now accounted for when it is accrued, rather than when there is an associated cash flow.

Some agencies have recognised the benefits flowing from accrual accounting. The Australian Bureau of Agricultural and Resource Economics commented that:

> The change from cash to accrual accounting means that there is a more realistic account of costs over time and assurance that full account is taken of capital costs. The combination of accrual and market testing/outsourcing changes means that [the bureau's] costings are based on full costs with a competitive market base. (sub. 56, p. 17)

The National Library of Australia stated:

> The recent move to accrual accounting has provided a sound accounting base for calculation and attribution of capital costs where this is required. … Accrual accounting has also prompted the review of indirect cost attribution to ensure that there is a greater degree of accuracy in attributing costs to particular outputs or goods and services within those outputs. Accrual accounting also leads to more accurate reporting of

expenses and revenues as they are incurred, providing improved management information for decision making purposes. (sub. 5, p. 3)

Capital costs

Capital costs consist of the user cost of capital and depreciation. The user cost of capital reflects the opportunity cost of capital used in agencies. Capital can be used elsewhere or it can be used to retire debt. The charge also reflects the cost to the community or taxpayer of government capital raising. To measure the user cost, an agency needs to value the asset and apply a rate of return to that value. Depreciation reflects the portion of the asset value that is notionally consumed each period in the production of products. The inclusion of capital costs and the method used in calculating them will influence the cost of a product. This, in turn, will influence the level of any cost recovery for that product.

Inclusion of capital costs in the cost of product not only accounts for the opportunity cost of capital and depreciation, but it may also improve asset management. In the absence of a capital charge, agencies had an incentive to treat the use of assets as free once they had been acquired. Inclusion of capital costs creates an incentive to dispose of surplus assets and to use an efficient mix of assets.

It can be difficult to value assets and determine a rate of return and several questions arise. What asset valuation method should be used? What is an appropriate rate of return to apply? How should the costs of poorly utilised assets be included? All components of capital costs, asset valuation, rates of return and depreciation need to be assessed together, because they are inter-related.

Asset valuation methods

A number of methods can be used to value non-current assets (box H.2). The method of valuation chosen may lead to significantly different estimates of the value of capital, and different methods can be more suitable under different circumstances. These differences can have significant implications for cost recovery. The methods can be broadly categorised as being cost based, value based or a combination.

Cost based methods

A number of cost based asset valuation methods can be used — for example, historic cost, replacement cost, reproduction cost, depreciated replacement cost and depreciated optimised replacement cost (DORC). Historic cost is simpler and less

costly to use than more complex asset valuation methods and does not require a subjective assessment of the value of the assets. However, historic cost does not account for changes in the value of the asset in response to inflation, improvements in technology and changing market conditions.

Box H.2 **Asset valuation methods**

Historic cost values assets at the original cost to the organisation of acquiring the asset, including relevant financing and set-up costs. The historic valuation can be adjusted for depreciation, where an asset has a limited life, by the subtraction of accumulated depreciation. Accumulated depreciation represents the amount of the assets' service potential that has already been used.

Reproduction cost values assets at the current cost required to reproduce the existing asset, mainly in its present form, using the specifications of the original asset.

Replacement cost values assets at the current cost of replacing the asset with a similar asset that can provide equivalent services and capacity.

Depreciated replacement cost adjusts replacement cost to account for asset consumption by subtracting accumulated depreciation.

Depreciated optimised replacement cost (DORC) values assets at the replacement cost of an 'optimised' asset, less accumulated depreciation. An 'optimised' asset is one that most efficiently produces a specified level of product. The effects of inefficiencies such as excess capacity, duplication, redundancy and poor location are removed from the valuation.

Fair market value uses the price the asset would sell at in a competitive open market, where both the buyer and seller are 'willing but not anxious'. It reflects the value of an asset in its best alternative use.

Net present value uses the present value of the predicted cash flows generated from the use of the asset. It involves estimating the future income generated by an asset, then discounting that income stream at a discount rate that reflects the risks of owning the asset.

Deprival value represents the loss that could be expected by a firm or agency if it was deprived of the service potential or future economic benefits of the asset. If the asset to be lost to the organisation is to be replaced, then the asset should be valued at its market value, replacement cost or reproduction cost, depending on the circumstances. If the asset is not replaced, then it should be valued at its economic value, which is the greater of either the asset's net present value or fair market value. Where the asset is surplus to requirements, it should be valued at its fair market value.

Optimised deprival value is measured by the lesser of DORC and the economic value of the asset, where the economic value is the greater of either the asset's net present value or fair market value.

Sources: SCNPMGTE (1994b); QCA (1999).

When asset values are rising, historic cost will understate both the asset value and the depreciation expenses in each period. For these reasons, historic cost may be more suitable for valuing assets that have a short life.

Replacement and reproduction cost are other cost based methods that have the advantage of valuing the asset at the current cost of replacing or reproducing it. The main disadvantage of these approaches is that the asset is replaced with an asset of equivalent service potential, even though the asset may not be the most efficient asset to use. These inefficiencies could arise from factors such as excess capacity or unsuitable location.

DORC accounts for these inefficiencies. However, it is more expensive and complex to use, and requires more subjective judgment in determining the optimal asset.

Value based methods

The two main value based methods of asset valuation are fair market value and net present value. Fair market value represents the command over cash that the asset comprises at the reporting date. Its main advantage is that the value is based on factual and observable information and is verifiable. Its main disadvantage is that highly specialised assets that may have been costly to acquire, particularly ones that have characteristics that are specific to a particular owner, may not have a high value in the market.

Using net present value overcomes this problem. However, this method has drawbacks because it is difficult to estimate future cash flows and determine an appropriate discount rate. It could be difficult to estimate the future benefits of non-commercial activities such as regulation undertaken by, for example, the Australian Securities and Investments Commission or the Australian Competition and Consumer Commission. There is also a circularity problem, because the selected discount rate will determine the rate of return on assets.

Hybrid methods

The two main hybrid methods of asset valuation are deprival value and optimised deprival value. These methods make use of a combination of value based and cost based valuation methods. Deprival value has the advantage of providing information on the current costs of providing a product and the current value of the assets. It reflects whether the firm or agency has maintained its capacity to continue its present level of production. It avoids inadvertent erosion of operating capacity. The deprival value method has similar advantages and disadvantages to those of the

market value, replacement cost, net present value and fair market value methods, because it is based on a combination of these approaches. Under the Commonwealth Government's resource management framework, agencies are directed to use the deprival model to value assets (DOFA 2001, pp. 1–23).

Optimised deprival value is the lesser of DORC and the economic value of the asset. It differs from deprival value as it makes use of DORC to take account of inefficiency. Optimised deprival value would have the advantages and disadvantages of whichever method (DORC, net present value or fair market value) is used.

Methods of determining the user cost of capital and depreciation

Once a non-current asset has been valued using an appropriate valuation method, the capital cost can be determined via calculation of the capital use charge. The Australian Geological Survey Organisation, CSIRO and the Australian Bureau of Agricultural and Resource Economics are examples of agencies that include a rate of return in their cost recovery charges. They do this as a requirement of competitive neutrality. Agencies that are not fully cost recovered are also required to pay a capital use charge, although they are funded for this charge from appropriations (see below). The user charge should be applied to net assets — that is, assets less liabilities. Agencies also need to calculate depreciation. Capital costs may vary depending on how depreciation is calculated.

User cost of capital

There are a number of ways in which to determine the rate of return used to calculate the capital use charge. One approach is to apply a uniform rate across all agencies. Alternatively, unique rates for each agency can be determined by benchmarking or by calculating the weighted average cost of capital (CCNCO 1998b).

The Commonwealth Government currently applies a uniform rate of return across all agencies. (box H.3). Under these arrangements partly cost recovered agencies could potentially receive both an appropriation for the capital use charge and include a cost of capital in charges to users. This could occur if the capital use charge is funded through both appropriations and cost recovery charges and agencies are able to retain access to the funds raised (see chapter 3). Given that it is sometimes appropriate that cost recovery charges include a cost of capital (for example, when cost recovered activities or products account for a significant proportion of the use of an asset), there may be a risk of 'double dipping' in such circumstances.

Box H.3 **The Commonwealth's user cost of capital arrangements**

A capital use charge is levied on Commonwealth agencies and authorities that are not fully funded through user charges or industry levies. The rate is standard across agencies, calculated as the risk free long term bond rate (which will vary over time) plus a risk premium. In 2000 the capital use charge comprised a 6 per cent risk free rate and a 6 per cent risk margin; that is, the capital use charge was effectively double the long term bond rate.

The charge is estimated at the beginning of each financial year and included in an agency's price of products. The charge is based on net departmental assets at the end of the previous financial year. Administered assets that are not controlled by the agency, but managed by agencies on behalf of the Commonwealth, are excluded. Most agencies that are either wholly or partly funded from general taxation receive appropriations for the capital use charge. Agencies that are fully funded through user charges or industry levies are excluded from these arrangements.

Source: DOFA (2001).

The former Department of Finance (now Department of Finance and Administration) argued that it should include both a risk free component and a risk premium (DoF 1991). The risk free rate represents the cost to government of raising capital and is set at the long term bond rate. The risk premium represents risk that cannot be diversified via the undertaking of a larger portfolio of projects — for example, risk arising from a project's susceptibility to fluctuations in economic activity. This is a cost that private investors bear and for which they require a higher rate of return. These concepts are based on the capital asset pricing model which is usually applied to private investment decisions. The former Department of Finance argued that these concepts can be usefully applied to determine the risk premium for the public sector as a whole (DoF 1991).

It can be argued, because the cost of capital reflects the cost to the Government of raising capital, that the user cost of capital should not vary across different Commonwealth agencies. However, some uses of capital may be more risky than others — for example, if the Government entered into a commercial operation in competition with other providers. It may be appropriate then for the cost of capital to vary according to the level of risk.

In addition, the majority of activities and products that are the subject of this inquiry cannot be easily characterised as being commercial in nature, even though their costs may be recovered. This can make the task of measuring the opportunity cost of capital more difficult.

Benchmarking to similar private companies or industry averages can be used to determine agency specific rates of return. However, a number of agencies that are the subject of this inquiry are statutory monopolies, for which it may be difficult to find suitable benchmarks. There are also problems with benchmarking itself. It can be difficult, for example, to isolate specific factors affecting an individual agency's rate of return from underlying market conditions.

The weighted average cost of capital can also be used to determine an appropriate rate of return. The Steering Committee on National Performance Monitoring of Government Trading Enterprises has outlined the operation of this method (SCNPMGTE 1996). Broadly, weighted average cost of capital accounts for the costs of debt and equity. These costs arise because an agency must pay interest on debt, and those providing equity expect a return on their investment that is commensurate with the risk of the enterprise. The rate of return on equity is determined using the capital asset pricing model. However, the weighted average cost of capital requires more data and knowledge of theory than needed for other methods. The model also presents problems with estimating the return on equity.

Regardless of the method used to determine the user cost of capital, there could be problems in allocating these costs where there are indirect or joint capital costs. That is, where capital costs cannot be directly attributed to the production of a particular product.

Depreciation

Capital costs can also vary depending on how depreciation costs are calculated. A number of methods can be used to calculate depreciation. For example, the straight line method allocates equal amounts of depreciation to each full accounting period in the asset's useful life. Alternatively, the reducing balance method results in decreasing depreciation each period over the asset's life. Capital costs will be lower in earlier periods under the straight line method than under the reducing balance method, all other factors being equal. Thus, in earlier periods of the asset's useful life, asset valuation methods that subtract depreciation give a higher valuation using the straight line depreciation method than when using the reducing balance depreciation method. Depreciation charges can also be related to use rather than time, which can be appropriate where asset usage varies significantly from one period to another.

Competitive neutrality

When government agencies provide services in areas where there is actual or potential competition, cost recovery charges should be consistent with the competitive neutrality requirements contained in the *Commonwealth Competitive Neutrality Policy Statement* (Commonwealth of Australia 1996).

Current competitive neutrality arrangements aim to allow public and private businesses to compete on an equal basis by removing artificial advantages and disadvantages. Competitive neutrality therefore requires that relevant government businesses (and agencies with commercial activities) set prices that cover a wide range of costs, including a return on capital and all relevant taxes and charges. As a result, when costing products, government agencies with commercial activities should include charges such as company tax, payroll taxes, goods and services tax and stamp duties, along with a rate of return (CCNCO 1998b).

Competitive neutrality does not always mean that agencies must charge 'market prices'. It may be appropriate for agencies to charge incremental or avoidable cost (as defined below), to allow for efficient use of idle capacity.

Few of the agencies within the scope of this inquiry undertake significant activity in contestable markets, although some information agencies (such as the Bureau of Meteorology, the Australian Bureau of Agricultural and Resource Economics and the CSIRO) provide commercial as well as non-commercial products. It is less likely that the activities of regulatory agencies would be subject to the competitive neutrality principles, although some regulatory activities such as assessments and approvals could be contracted out to the private sector. In that case, if the regulatory agency retained an in-house provider then competitive neutrality principles could apply to competitive tendering with private outsourced providers.

The existence of a competitive private market for the good or service leads to the question of why government provision is necessary. It is important that the Government make clear the rationale for public sector involvement (for example, provision of services to disadvantaged groups).

H.4 Allocating costs

Once agencies have identified and measured costs, they can allocate those costs to activities or products. Allocating direct costs is relatively simple; it becomes more difficult where indirect and capital costs are involved. Methods to allocate costs include using direct cost, Fully Distributed Cost, marginal cost and incremental or avoidable cost. The different approaches are appropriate in different circumstances

(see chapter 7) and give different results. They have very different efficiency implications for different activities and products.

Direct cost

The direct cost method allocates only those costs that can be directly and unequivocally attributed to an activity or product. It is the simplest way of allocating costs but it does not account for indirect costs such as an appropriate share of overheads. In addition, it may not accurately indicate the increase in cost involved from producing an additional unit of product. Cost recovery agencies may choose to charge direct costs where cost recovered activities or products make up only a small proportion of their total activities and make only a small demand on agency overheads. In such cases, the impact of excluding indirect costs may not be significant.

Fully Distributed Cost

Under the Fully Distributed Cost method, the total costs of an agency are allocated across all activities or products. It includes direct, indirect and capital costs. Direct costs are allocated to their respective output, while indirect costs are allocated across all outputs. Indirect and joint costs can be allocated in a number of ways. They can, for example, be allocated on a *pro rata* basis, according to the number of staff involved in an activity, or on the basis of the share of direct costs devoted to an activity.

Regulatory agencies that recover costs for a large proportion of their activities typically use some method of Fully Distributed Cost; for example, the Australian Radiation Protection and Nuclear Safety Authority and the Australian Quarantine and Inspection Service use a *pro rata* approach. Activity Based Costing is a more sophisticated way of fully distributing costs (see below).

Simple *pro rata* methods are relatively easy to implement and most agencies will have the financial data available to attribute direct costs to products and to identify indirect costs separately. However, it is desirable to allocate indirect costs as closely as possible to the actual pattern of resource use, although there is a trade off involved in terms of the complexity and cost of the system.

Activity Based Costing

This is a more accurate form of Fully Distributed Cost. It links an agency's products to the activities undertaken to produce them. Activities are in turn linked to the

agency's costs. While the form of an Activity Based Costing system can vary from agency to agency, it typically comprises:

- identifying full costs;
- identifying products and the agency's user groups;
- identifying all activities that the agency performs to produce products;
- tracing full costs to the activities; and
- identifying cost drivers that link activities to products to give a cost per unit of product.[2]

Activity Based Costing requires more detailed data than needed for the simple *pro rata* system. Data are required to determine which activities contribute to certain products and how these activities consume resources. As a result, new systems could be needed to record items such as staff time spent on activities and products, numbers of users and indicators of complexity for each product. These requirements are often in addition to data that the agency already has. Typically, agencies collect these data via surveys undertaken at regular intervals. They may also use rosters or timesheets. The increased complexity of Activity Based Costing, and the greater need for data mean that the costs of implementing and using the system are higher than under a simpler Fully Distributed Cost system.

The National Industrial Chemicals Notification and Assessment Scheme, the National Registration Authority for Agricultural and Veterinary Chemicals, the Therapeutic Goods Administration, the Australian Maritime Safety Authority and the Office of Film and Literature Classification make use of Activity Based Costing. The Office of Film and Literature Classification's costing and pricing model is outlined in box H.4.

While an Activity Based Costing system should allocate costs to products in a manner that closely reflects use by each product, some costs can be allocated only on an arbitrary basis because it is difficult to obtain reliable survey information. Corporate overheads can be difficult to allocate, for example, when a number of activities irregularly consume management time. In addition, it can be difficult to record use of capital equipment accurately where it is used to produce several products.

[2] Cost drivers are factors that affect the level of activity, and thus costs, required to produce a unit of product. They can include, for example, customer numbers or the level of service complexity.

Box H.4 **Office of Film and Literature Classification's costing and pricing model**

The Office of Film and Literature Classification used an Activity Based Costing model in costing and pricing its products in 1996. Its model involved a four part process:

- **Identification of the cost pool.** The office's budgeted expenditure for 1996-97, as set out in the Budget papers, was adjusted by excluding 'one-off' items, reducing some capital expenditures that could be amortised over future years, and including minor allocated costs that are not shown in the Budget papers. These calculations resulted in the general cost pool.
- **Attributable cost development.** The general cost pool was apportioned between costs recovered from the industry and the costs of community service obligations that were funded from general taxation revenue. Costs were attributed on the basis of staff activities obtained from a survey that allocated staff time across activities and products. Staff time was then converted into salary dollars.
- **Attributable cost allocation.** The cost recovery component from the general cost pool was then allocated. First, direct service delivery costs were allocated to major activities. The activities included scheduling, screening and support activities. The breakdown was based on the staff activity survey. Second, statutory and non-statutory cost recoverable services were identified and a projected service volume was estimated. The salary dollars by activity for each service were then divided by the number of services performed during the survey, to calculate the unit value for each service by activity. Third, costs were allocated over the activities for each service.
- **Calculation of service costs.** The cost of providing each service was calculated by dividing the cost of each activity for each service by the number of services provided. The cost of each of these activities, for each service, was accumulated to provide the total cost for each unit.

Source: OFLC (1996).

Marginal cost

Marginal cost measures the increase in cost of producing an additional unit of product. Conceptually, marginal cost includes variable costs. Short run marginal cost (SRMC) is the cost of supplying an additional unit of product when at least one of the factors of production, quite often capital or capacity, is fixed. Thus, SRMC excludes costs that are fixed in the short run (such as capital costs) and a range of indirect costs that do not vary in the short run (such as generic advertising or some overheads). SRMC gives the best indication of the cost of producing an additional unit of product at any point in time. It is often much lower than the average cost, for

example, where large fixed costs have to be incurred regardless of how many units are produced.

Long run marginal cost (LRMC) is the cost of supplying an additional unit of product when all factors of production (such as capacity) can be varied. While all factors of production are variable in the long run by definition, in a multi-product organisation, LRMC for a particular product may exclude some indirect or joint costs that do not vary with the production of that product. LRMC includes the cost of capital and can be relevant to investment decisions. If demand is high enough, for example, such that SRMC is greater than LRMC through scarce capacity being rationed through higher prices, then investment in new capacity may be needed.

In relation to marginal cost pricing, Environment Australia stated:

> Short term marginal cost pricing can be a useful costing and pricing technique in situations where marginal output decisions are made. It can also be used to ration demand in instances where the … provider is operating at full capacity and an increase in demand requires a change in the scale of operation. (sub. 76, p. 9)

Marginal cost pricing sets the price for a unit of product equal to the additional cost of producing that product. The advantage of this approach is that it will result in an efficient allocation of resources by catering for the demands of all consumes who have a willingness to pay that equals of exceeds the opportunity costs of supplying the product.

Once the first unit has been produced, the marginal costs of producing further units may be quite low. As discussed in chapter 7, this is important for pricing by information agencies. It may be costly to gather information, but once it has been collected, the cost of disseminating it to many users is low. Other forms of pricing may reduce welfare by discouraging users who would have paid the marginal cost of dissemination. Marginal cost pricing is appropriate for information agencies seeking to recover the dissemination costs of information that has already been produced for other reasons (for example, because it has either public good characteristics or positive externalities).

However, there may be problems in measuring marginal cost. How long is the short run? What should be the increment in product — for example, should the increment be a single publication or a print run of publications? In addition, there may be problems with the allocation of joint costs between different products and with allocating indirect costs.

Marginal cost pricing could also lead to significant price fluctuations. Capacity is often expanded in large blocks while demand grows more steadily over time. While capacity is fixed and demand is growing, prices will rise to reflect the increasing

opportunity cost of producing an additional unit of product; that is, scarce capacity would be rationed through higher prices. However, after an increment rise in capacity, the marginal cost will fall because the opportunity cost of producing the additional unit of product will have fallen.

Given the problems with measuring marginal cost, incremental and avoidable cost are often used as proxies.

Incremental and avoidable cost

Incremental cost is 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. Incremental cost can also be measured as the increment in cost of producing a product for a particular customer. As such, incremental cost is usually related to larger increments in product and a longer period of time than with SRMC.

Because incremental cost is a longer run concept, it is usual to talk about long run incremental cost (LRIC). LRIC includes incremental capital costs and incremental indirect costs. However, it excludes indirect and joint costs that remain unchanged whether the product is supplied or not, as these costs are often not incremental in providing additional product. Per unit incremental cost can also be used. It is calculated by division of the cost of the increment in the type or block of product, by the number of additional units.

Avoidable costs are the costs that would be avoided if an agency no longer provided a particular product. Direct costs will be included in avoidable cost, as will indirect costs that are avoidable. Indirect costs that remain fixed regardless of whether the product is produced are not avoidable and should not be included (for example, corporate overheads and generic advertising).

In practice, there is generally little difference between avoidable and incremental cost. The cost saved by not producing the product is usually the same as the additional cost of making the product available, at least in the long term.

Incremental and avoidable cost approaches may be used as proxies for marginal cost, but are most suitable for agencies seeking to recover the additional costs incurred for undertaking ‘add-on’ work outside their basic products. Because there is no public interest reason to subsidise these products, agencies should be seeking to recover all of the costs they would have avoided if they had not produced them.

However, agencies need to consider a number of issues when measuring avoidable or incremental cost. How long is the long run? The longer the period of time, the greater the number of costs that can be included in incremental or avoidable cost.

For example, a lease on office space or equipment could expire in the medium to longer term.

In addition, there are measurement issues with allocating capital costs to joint products. For example, a particular product may use surplus capacity in assets used to produce another product. In this case, it could be difficult to decide which costs are avoidable.

Moreover, the appropriate level of avoidable cost needs to be determined. Avoidable cost can be considered at the agency level or in terms of the products of the agency. If an agency has only one product, or if the products are similar, then avoidable cost could be taken to be the cost of the agency as a whole, including its total indirect costs. However, if the agency has a number of products, or if they are not closely related, then it could be desirable to calculate the avoidable cost of each product. This could lead to difficulties in allocating joint and indirect costs.

The Bureau of Meteorology's charging for meteorological services, including the use of incremental cost, is outlined in box H.5.

Appropriate methods of cost allocation for different circumstances

The method of allocating costs affects the level of any cost recovery charge. For a given circumstance, Fully Distributed Cost and incremental or avoidable cost will give different results and thus would have implications for the level of cost recovery charges. The price charged under the Fully Distributed Cost would be higher than the price charged under incremental or avoidable cost.

In some situations, the Fully Distributed Cost and long run avoidable or incremental cost will give similar results in the costing of products. This could occur because most variable costs will be included under both cost approaches in the long run. For example, capital costs will be included under both approaches if the incremental or avoidable cost is measured over the long run. However, joint costs would still be included under the Fully Distributed Cost but not under incremental or avoidable cost. As a result, Fully Distributed Cost and long run avoidable or incremental cost only give similar results where joint costs are low. In this case, there will be a small increment to long run cost if a particular product is produced, or the long run costs avoided will be small if the product is not produced.

Different methods will be more suitable under different circumstances. A *pro rata* Fully Distributed Cost system is a simple way of allocating all costs to a product. However, it does not measure the costs of an increase in production that an incremental or avoidable costing approach would measure.

Box H.5 **Bureau of Meteorology's charging for meteorological services**

The Bureau of Meteorology has four charging categories for meteorological services.

- **Free services** include reports of present and expected weather for various locations (including coastal waters) and warnings, made available through the mass media. These services are known as the *basic product set*. They are provided free to emergency services.
- **Cost of access** is charged for the basic national meteorological service that encompasses basic weather, climate, hydrological and consultative services. These services are known as the *basic product service*, which includes the basic product set. Cost of access is charged for the basic product set when it is not provided via the mass media or the Internet, such as by telephone or fax.
- **Incremental cost** is charged for services that satisfy international obligations (for example, weather services to the aviation industry) and services to other government agencies (for example, services to the Department of Defence).
- **Commercial rates** are charged for services that are provided to meet the requirements of a specific user and that are provided in competition, or potential competition, with the private sector.

For the basic product service (including the basic product set when not provided by the mass media or the Internet), the bureau charges only the cost of making access available. The cost of access includes communications and publication costs. The services themselves are provided free of charge.

For services where incremental costs and commercial rates are charged, the bureau includes:

- the cost of additional staff and operating costs involved in providing the service above the basic service;
- the costs of any research and development projects undertaken specifically in support of the service;
- capital costs specific to the service;
- costs in establishing a new service or ceasing an existing service; and
- overhead costs. Where services provided are on a whole-of-program basis, such as aviation and defence, the bureau charges a portion of overhead costs that is determined *pro rata* to product costs. Where services are provided through available capacity, but within a basic service program, the overhead component is attributed *pro rata* to direct labour costs.

For commercial services, the bureau also charges a discretionary component in addition to the other charges.

Source: BoM (sub. 35, att. 7, pp. 4.2–4.6).

It would be desirable to measure increases in costs using incremental or avoidable cost in the short run where there is excess capacity. This capacity could be used if the product is able to earn its avoidable or incremental cost. If a product can earn revenue that is equal to or greater than its avoidable or incremental cost, then idle capacity can be used without imposing an additional cost on the agency.

Incremental or avoidable cost can be appropriate where large fixed costs have to be incurred regardless of how many units are produced. Many information agencies, for example, incur high sunk costs when they collect and compile data required for public policy. Once this information has been collected, the costs of dissemination to many users could be quite low. In these cases the Fully Distributed Cost could overestimate the cost of a product because joint costs will be allocated to that product, even though these joint costs will still be incurred if the product is not produced. A marginal, incremental or avoidable cost approach would exclude these costs.

On the other hand, the Fully Distributed Cost could be more appropriate where full costs, including joint costs, are to be recovered. Agencies will need to choose the appropriate method on a case by case basis, because the circumstances can differ. Agencies will also need to consider competitive neutrality requirements if they are operating in a commercial or contestable market.

I Australian Government Solicitor's legal advice

The Productivity Commission sought legal advice from the Australian Government Solicitor on the Commonwealth's authority to impose fees, charges, levies and taxes in different situations. The advice dated 2 March 2001 is reproduced here.

Fees for services and taxes

1. Thank you for your letter of 16 February 2001 seeking advice on issues arising from the Productivity Commission's inquiry into cost recovery by Commonwealth regulatory, administrative and information agencies.

2. Your questions relate broadly to the Commonwealth's authority variously to impose fees, charges, levies and taxes in different situations. You say that the advice will help the Commission to comment generally on the 'legal constraints on the design and operation of cost recovery arrangements' (term of reference 4[b]). The advice may also be used in the development of suitable guidelines for implementing cost recovery (term of reference 3[g]).

Advice

3. Your questions, together with my answers, are set out below.

1. What is the difference between a fee for service and a tax? What is the distinguishing feature of a tax Act?

Difference between a fee for service and a tax

4. In non-legal contexts, the expressions 'tax' and 'fee for services' sometimes have overlapping meanings. This is because taxes are sometimes imposed for the specific purpose of raising revenue to finance the delivery of specific kinds of government services and fees for services are sometimes structured and imposed as taxes. For constitutional purposes, however, the concept of a tax and the

concept of a fee for services are mutually exclusive. Section 53 of the Constitution, which deals with the powers of the Houses of Parliament in respect of legislation, expressly draws a distinction between the two kinds of imposts. Moreover, the High Court, usually in the context of considering the application of section 55 of the Constitution (which provides, amongst other things, that a law imposing taxation shall deal only with the imposition of taxation), has specifically characterised a tax partly by reference to certain negative characteristics, which include the requirement that the impost not be a fee for services. The classic definition of a tax, albeit qualified in various respects over the years, is: 'a compulsory exaction of money by a public authority for public purposes, enforceable by law, *and ... not a payment for services rendered'* (emphasis inserted) (*Matthews v Chicory Marketing Board (Vic)* (1938) 60 CLR 263 at 276 per Latham CJ; see also *Air Caledonie International v Commonwealth* (1988) 165 CLR 462 at 466–467).

5. A fee for a service may share certain of the positive attributes of a tax. For example, it may (although it may not) be compulsory and enforceable by law. It may be, and often is, imposed by a public authority and for public purposes, for example, where it is imposed in respect of activities which are carried on under the authority of legislation. It is, however, different in one respect from a tax, that is, it is *a payment for services rendered to or at the direction or request of the person required to make the payment* (*Air Caledonie* at 467). The application of this general distinction has been far from clear in practice, given that the delivery of a service may sometimes be made *the occasion of* the imposition of different kinds of imposts, including taxes.

6. Until recently, in practice, fees for services have been distinguished from taxes on the basis not only of their imposition in respect of a service but also on the basis of their relationship to the costs of delivering the service to the individual paying the fee. This approach was based on a statement in *Air Caledonie* suggesting that there had to be 'a discernible relationship' between the fee and the 'value' of what is acquired (by way of a service) and that to the extent that the fee exceeds that value, the fee could be seen to be a tax (at 467). In the absence of other guidance by the High Court, 'value' was assumed to be measured at the level of the individual paying the fee and in terms of the costs of delivering the service to the individual.

7. In December 1999, the High Court handed down a major new decision dealing with the distinction between fees for services and taxes — *Airservices Australia v Canadian Airlines International Ltd* (1999) 167 ALR 392. The High Court confirmed the need for fees for services to be imposed in respect of services delivered to the persons required to pay the fees. However, it endorsed a more

flexible approach to the characterisation of an impost as a fee for services, citing the relationship between the level of the fee and the costs of delivering the service as an important but not exclusive consideration, especially where the provider of the services has a statutory monopoly on the provision of the services. Another important consideration is that the overall fee structure should not be designed with a general revenue raising purpose. For your information, I attach an Australian Government Solicitor Legal Briefing[1] dealing with the decision, which was prepared shortly after it was handed down. This Briefing summarises the approaches in the various separate judgments, which differed somewhat in emphasis.

8. Apart from confirming the important (though not necessarily exclusive) role of cost recovery in the characterisation of imposts as fees for services, the main significance of the decision is in indicating a more flexible approach to cost recovery than was previously thought acceptable. In particular, the High Court indicated that the relationship to the costs of delivering the service can be manifested at the user group level, especially where the services are highly integrated (cf. networks of services with common infrastructure), rather than at the individual level. That is, the fees can be fixed by reference to the costs of delivering services *to all* of the users of the services rather than by reference to the costs of delivering services to a particular individual. Moreover, the High Court has recognised that there can be a degree of flexibility in fixing charges for particular users or classes of users (differential pricing), subject to broad constraints. Those constraints were variously described in the judgments: 'a rational basis for discrimination' (Gleeson CJ and Kirby J); 'a commercial justification for discriminating between different users' (Gaudron and Hayne JJ); 'reasonably and appropriately adapted means of achieving a legitimate public purpose' (McHugh and Gummow JJ).

9. Importantly, too, the High Court acknowledged that a profit component can be included in a fee structure, providing it does not a have revenue-raising purpose and merely allows for a reasonable rate of return on capital or future infrastructure requirements.

[1] Australian Government Solicitor 1999, *Fees for Services and Their Recovery,* Legal briefing number 53, 14 December.

Distinguishing features of a tax Act

10. A tax Act is, of course, an Act which imposes a tax. A tax, as mentioned in paragraph 4 above, is an impost with certain positive attributes and certain negative attributes, one of which is that the impost must not be a fee for services.

11. As also mentioned in paragraph 4 above, the definition of a tax set out in the *Matthews v Chicory Marketing Board (Vic.)*, while a continuing reference point in judicial discussions of what constitutes a tax, has been qualified in various ways over the years. Compulsoriness may be practical as well as legal (see *General Practitioners Society v The Commonwealth* (1980) 145 CLR 542, per Gibbs J at 561). The High Court has also admitted the possibility that an impost constituting a tax may not be in the form of an exaction of *money* as such *(Air Caledonie* at 467). Moreover, the exaction, while made under statutory powers, may not need to be by a public authority, or for public purposes, in order to be a tax *(Air Caledonie* at 467; also *Australian Tape Manufacturers Association Ltd v The Commonwealth* (1992) 176 CLR 480).

12. The High Court has also made it clear that the class of negative attributes which may prevent an impost from being regarded as a tax is not limited to the requirement that the impost not be a fee for services and that indeed the list of negative attributes may not be closed but evolving. In *Air Caledonie* the High Court said (at 467):

> ... the negative attribute — 'not a payment for services rendered' — should be seen as intended to be but an example of various special types of exaction which may not be taxes even though the positive attributes mentioned by Latham CJ are all present. Thus, a charge for the acquisition or use of property, a fee for a privilege and a fine or penalty imposed for criminal conduct or breach of statutory obligation are other examples of special types of exactions of money which are unlikely to be properly characterised as a tax notwithstanding that they exhibit those positive attributes.

13. A tax, even if levied by a non-public authority under a statutory power, must be accounted for as part of the Consolidated Revenue Fund and expended only under an appropriation by Parliament (sections 81 and 83 of the Constitution; *Australian Tape Manufacturers Association Ltd v The Commonwealth* (1992) 176 CLR 480 and *Northern Suburbs General Cemetery Reserve Trust v The Commonwealth* (1992) 176 CLR 555). (The same applies to fees for services if they are received by or on behalf of the 'Executive Government of the Commonwealth' — see section 81 of the Constitution).

14. While the characteristics of a tax are to some extent shifting and it can be difficult sometimes to decide whether a compulsory exaction falls into one of the categories of anomalous compulsory exactions which are not taxes, in most cases it will be a relatively straightforward process to decide whether an impost is a tax.

15. How Parliament itself regards the impost will itself be significant, though not necessarily decisive. Imposts regarded by Parliament as taxes will generally be structured with constitutional requirements in mind, principally, the requirements of section 55 of the Constitution, which, as mentioned above, provides, amongst other things, that laws imposing taxation shall deal only with the imposition of taxation. Under section 55, a tax Act (or, in other words, an Act imposing taxation) can contain not only provisions specifically imposing a tax but also provisions *'dealing with'* the imposition of tax (such as provisions governing the incidence and rate of the tax). A tax imposition Act cannot, however, contain measures merely *related to* the tax imposed, such as provisions dealing with collection matters.

2. Is there a legal distinction between a levy and a tax? How are these differences important in choosing one instrument over another?

16. A levy is merely another expression to describe a tax, although it is sometimes used to refer to a tax that is imposed on a specific industry or class of persons, rather than a tax of general application. The fact that an impost may be imposed on only a limited class of persons does not prevent it from being regarded as a tax, although the notion of a tax carries with it an implication of a certain threshold of generality (thus an impost on one or more named persons may not be tax, but rather an acquisition of property, which under section 51(xxxi) of the Constitution, must be on just terms in order to be valid).

17. For political reasons, taxes can also go under other names, such as charges, surcharges and royalties (although some royalties may not be taxes). The nature of the impost will, however, be determined principally by reference to its legal characteristics rather than by what it is called.

3. What legal authority do Commonwealth agencies need to impose fees, charges, levies or taxes? Some agencies appear not to have any fee or charge setting powers explicitly set out in an Act, but nevertheless are involved in some cost recovery. Under what authority can they do this?

18. It is a general principle of English constitutional law received into Australia that there can be no taxation except under the authority of an Act of Parliament *(The Commonwealth v Colonial Combing, Spinning and Weaving Co. Ltd* (1922) 31 CLR 421, per Isaacs J at 433–434). This obviously applies to a tax under any name, including a charge or levy.

19. The position in relation to charging for services is less clear cut. There is no High Court authority on the point but only several old State cases which interpret early English cases. However, those early English cases appear to have been given a wide interpretation in certain respects by a more recent English case, which has not yet been discussed by an Australian court in any jurisdiction.

20. For present purposes it appears unnecessary for me to discuss the various English and Australian cases in detail, but would be happy to do so, if you wish. Instead, I shall summarise the views which the Australian Government Solicitor holds on this issue.

21. 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. (This proposition is common ground among the early English cases (notably, *Attorney-General v Wilts United Dairies Ltd* (1921) 37 TLR 884 (Court of Appeal); (1922) 38 TLR 781 (House of Lords), the more recent English case of *McCarthy & Stone (Developments) Ltd v London Borough of Richmond upon Thames* (1991) 3 WLR 941 and the early Australian cases, such as *Schilling v City of Melbourne* [1928] VLR 302.) Thus, statutory authority would be required to impose a fee in respect of, say, an inspection which is required to be performed under statute.

22. 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 (the recent English case *McCarthy & Stone* appears to take a stricter view than required by the earlier English cases, including *Wilts United Dairies).* Our view generally is that whether charges can be imposed in respect of discretionary activities (including the discretionary performance of services) depends on the nature and authority for the performance of those activities.

23. Discretionary activities can be performed under the express authority of a statute, under general statutory powers (such as under a general statutory incidental power or a general power to enter into contracts conferred under statute) or, in the case of government Departments, in the exercise of the Commonwealth's executive power.

24. In relation to activities carried on under express statutory authority, whether fees can be imposed depends on the nature of the activity. For example, as a matter of statutory interpretation, in the absence of express or necessarily implied legislative authority, it would be unlikely to have been intended that a fee could be imposed in respect of the issue of a statutory licence, albeit issued as a matter of discretion. An express statutory power to conduct activities normally delivered on a commercial basis would, however, not normally preclude the charging of fees, even in the absence of an express legislative authorisation to impose fees. An example might be an express statutory discretionary authority to conduct training courses.

25. In relation to general statutory authority to engage in discretionary activities, such as a general contracting power, we take the view that there is no impediment to the imposition of fees in respect of the activities. The ability to charge fees would be necessarily implied from the ability to do a thing under a contract. The same applies to the performance of activities under contracts entered into under the Commonwealth's executive power. (There may be exceptional circumstances where charges under a contract could be regarded as taxes, which would be invalid without legislative authority — *Commonwealth v Colonial Combing, Spinning and Weaving Co. Ltd ('The Wool Tops Case'*) (1922) 31 CLR 421 443–445; very generally the circumstances would be where there was some suggestion of compulsoriness, either legal or practical, in relation to the entry into the contracts).

4. Some agencies have explicit wording in their Acts to the effect that they may set charges but that the charges must be reasonably related to the expenses incurred and must not be such as to amount to taxation (for example, s.53 of the Australian Communications Authority Act 1997*). What is the consequence of this clause? Does it, for example, quarantine the rest of the Act from being challenged under s.55 of the Constitution if the charge were found to be a tax? Why do not all fee for service arrangements have such legislative backing? And what does 'amount to taxation' mean?*

26. A provision along these lines was considered in *Canadian Airlines,* namely, section 67 of the *Civil Aviation Act 1988.* Unlike the full Federal Court in the decision appealed to the High Court (*Airservices Australia v Monarch Airlines Ltd* (1998) 152 ALR 656), the High Court accepted that there were two separate

limbs to the provision, which could overlap but which could also raise separate considerations:

> In some cases, there would be substantial overlapping between the considerations relevant to the first limb and those relevant to the second limb. However, it would be wrong to say, as a universal proposition, that the two limbs could never raise separate issues. The second limb is related to, and should be understood in the light of, section 55 of the Constitution. (per Gleeson CJ and Kirby J at 409).

27. The first limb imposes a statutory limitation on the level at which fees can be imposed, that is, a reasonable relationship to the 'expenses incurred'. This involves a consideration of what is ordinarily included in 'expenses' and whether those expenses have been 'incurred'.

28. The purpose of the second limb is, as you suggest and as confirmed in *Canadian Airlines*, to quarantine the validity of other provisions of the Act from the possible effects of section 55 of the Constitution, which generally (except in relation to amendments inserting a tax) invalidates all the provisions of an Act other than the provision imposing a tax (*Air Caledonie*).

29. In the Federal Court at first instance (*Monarch Airlines Ltd v Airservices* (1997) 72 FCR 534), Branson J decided that the relevant charges satisfied the first limb of the provision but not the second. In the light of the High Court's decision in *Canadian Airlines*, in particular, its more flexible approach to cost recovery, it is possible that the first limb might in certain circumstances lead to a narrower result than the second. In most cases, however, the operation of the two limbs will not produce a different result.

30. Some legislation authorising the imposition of fees does not contain a limitation along these lines or contains one limb of the limitation and not the other. This generally merely reflects different practices or differing degrees of caution on the part of drafters. Some drafters rely on the court's interpreting a 'fee' (where it is used in relation to services) as having its ordinary meaning (that is, a fee for services), particularly in the light of the constitutional provisions. A discretion to impose a 'fee' would, in any case, probably be read down within constitutional limits, that is, so as not to authorise the imposition of a tax where this would be contrary to section 55 of the Constitution (*Giris v Federal Commissioner of Taxation* (1969) 119 CLR 365, 378). (I note that the inclusion of the second limb in the case of the Civil Aviation Act was by way of a Senate amendment which was described as being designed 'to restore the second element of the protection against surreptitious revenue raising' found in the previous Act dealing with civil aviation (the *Air Navigation Act 1974*) (Senate *Hansard* 1 June 1988 at 3386–3396; see also 27 April 1988 at 1991–1993)).

31. The words ‘not to amount to taxation’ mean that the fees are to be of such a kind and level as not to constitute taxation for constitutional purposes.

Other comments

32. If the Commission proposes to develop suitable guidelines for implementing cost recovery (term of reference 3[g]), it would be highly desirable for such guidelines to be cleared from a constitutional point of view, particularly, in relation any construction that is placed on the High Court’s decision in *Airservices Australia v Canadian Airlines International Ltd.* We would, of course, be happy to provide further advice, if necessary.

33. Please let me know if you would like to discuss any aspect of this advice or require any further assistance.

J Questionnaire

The terms of reference require the Commission to report on the nature and extent of current cost recovery arrangements across Commonwealth regulatory, administrative and information agencies. To fulfil this requirement, the Commission requested agencies and departments to complete a questionnaire regarding their current cost recovery arrangements. The questionnaire was sent to all regulatory, administrative and information agencies with separate financial reporting arrangements, and to all departments with coverage of those agencies without separate reporting arrangements. A copy of the questionnaire is attached at the end of this appendix.

The responses of those agencies included in the inquiry case studies (appendices C to F) are summarised in appendix B. All responses (except those provided confidentially) are available on the Commission's web site (www.pc.gov.au) and on request from the Commission.

J.1 Departments and agencies surveyed

The following departments and agencies were asked to complete the questionnaire. Those departments and agencies marked with an asterisk did not respond to the questionnaire.

Department of Agriculture, Fisheries and Forestry — Australia

Australian Bureau of Agricultural and Resource Economics

Australian Dairy Corporation

Australian Dried Fruits Board

Australian Fisheries Management Authority

Australian Horticultural Corporation*

Australian Pork Corporation

Australian Wine and Brandy Corporation*

Bureau of Rural Sciences

Murray–Darling Basin Commission*

National Registration Authority for Agricultural and Veterinary Chemicals

Wheat Export Authority*

The Woolmark Company*

Attorney-General's Department

Administrative Appeals Tribunal*

Administrative Review Council*

Australian Customs Service

Australian Federal Police

Australian Government Solicitor*

Australian Institute of Criminology

Australian Law Reform Commission

Australian Security Intelligence Organisation

Australian Transaction Reports and Analysis Centre

Human Rights and Equal Opportunity Commission*

Inspector-General in Bankruptcy (Insolvency and Trustee Service)

National Crime Authority*

National Native Title Tribunal

Office of Film and Literature Classification*

Office of Parliamentary Counsel

Office of the Director of Public Prosecutions

Privacy Commissioner*

Department of Communications, Information Technology and the Arts

Australian Broadcasting Authority*

Australian Broadcasting Corporation

Australian Communications Authority

Australian Film Commission*

Australian Film Finance Corporation

Australian Film, Television and Radio School

National Library of Australia

ScreenSound Australia

Special Broadcasting Service

Department of Defence

Department of Education, Training and Youth Affairs

Anglo–Australian Telescope Board

Australian National Training Authority

Australian Research Council*

Department of Employment, Workplace Relations and Small Business

Comcare

National Industrial Chemicals Notification and Assessment Scheme

National Occupational Health and Safety Commission*

Department of the Environment and Heritage

Australian Greenhouse Office*

Bureau of Meteorology

Great Barrier Reef Marine Park Authority

National Parks and Wildlife*

Department of Family and Community Services*

Australian Institute of Family Studies

Centrelink

Department of Finance and Administration

Australian Electoral Commission

Commonwealth Grants Commission*

Commonwealth Superannuation Administration (ComSuper)

Office of Asset Sales and Information Technology Outsourcing

Department of Foreign Affairs and Trade

Australian Centre for International Agricultural Research

Australian Government Overseas Aid Program*

Australian Trade Commission (Austrade)

Department of Health and Aged Care

Australia New Zealand Food Authority

Australian Institute of Health and Welfare

Australian Radiation Protection and Nuclear Safety Agency

Health Insurance Commission

Department of Immigration and Multicultural Affairs

Migration Agents Registration Authority

Migration Review Tribunal*

Refugee Review Tribunal

Department of Industry, Science and Resources

Australian Geological Survey Organisation

Australian Institute of Marine Science

Australian Nuclear Science and Technology Organisation

Australian Sports Commission

Australian Sports Drug Agency*

Australian Surveying and Land Information Group

Australian Tourist Commission

Bureau of Tourism Research

Commonwealth Scientific and Industrial Research Organisation

IP Australia

National Standards Commission

Department of Prime Minister and Cabinet

Aboriginal and Torres Strait Islander Commercial Development Corporation

Aboriginal and Torres Strait Islander Commission*

Aboriginal Benefit Reserve

Aboriginal Hostels Limited

Anindilyahwa Land Council

Australian Institute of Aboriginal and Torres Strait Islander Studies

Australian National Audit Office

Central Land Council*

Commonwealth Ombudsman

Indigenous Land Corporation

Northern Land Council*

Office of National Assessments

Office of the Inspector-General of Intelligence and Security

Office of the Official Secretary to the Governor General

Public Service and Merit Protection Commission

Tiwi Land Council

Torres Strait Regional Authority

Department of Transport and Regional Services

Administration of Christmas Island*

Airservices Australia

Albury–Wodonga Development Corporation*

Australian Maritime Safety Authority

Civil Aviation Safety Authority

National Capital Authority

National Road Transport Commission

Department of the Treasury

Australian Bureau of Statistics

Australian Competition and Consumer Commission

Australian Office of Financial Management

Australian Prudential Regulation Authority

Australian Securities and Investments Commission

Australian Taxation Office

Australian Valuation Office

National Competition Council

Productivity Commission

Reserve Bank of Australia

Royal Australian Mint

Department of Veterans Affairs

Australian War Memorial

PRODUCTIVITY COMMISSION COST RECOVERY INQUIRY

AGENCY QUESTIONNAIRE

The Government has requested the Productivity Commission to undertake a public inquiry into the cost recovery arrangements of Commonwealth regulatory, administrative and information agencies. The terms of reference require the Commission to report on the nature and extent of these cost recovery arrangements. This calls for the cooperation and participation of Commonwealth agencies.

Please complete this questionnaire on behalf of your agency.

All Departments and agencies with separate reporting arrangements are being surveyed.

The worksheet titled 'Attachment A' provides a Contact Officer within your portfolio.

This questionnaire is not meant to take the place of a formal inquiry submission.

An electronic version of this questionnaire is available on the Commission's web site: http://www.pc.gov.au/costrecovery/index.html

You are encouraged to use the electronic form and return it by email to costrecovery@pc.gov.au.

PLEASE NOTE: The electronic version of the questionnaire is made up of **FOUR** worksheets: *Instructions*, *Part I*, *Part II and Attachment A*.

BACKGROUND

The inquiry has released an Issues Paper which outlines the background to the inquiry, the Commission's procedures and matters about which the Commission seeks comment and information. You are encouraged to read the Issues Paper for further background.

The Issues Paper can be found on the Commission's web site: http://www.pc.gov.au/costrecovery/index.html

PART I

ALL AGENCIES ARE REQUESTED TO COMPLETE PART I.

If you cannot answer a question, please indicate whether the question is NOT APPLICABLE or if INFORMATION IS NOT AVAILABLE.

Section 1: Contact details

1.1	Agency	

1.2 Reporting and financial arrangements are governed by:
(Please indicate with a 'X' whether one or more of the following Acts apply)

	YES	NO
Financial Management and Accountability Act 1997		
Commonwealth Authorities and Companies Act 1997		

	Other	
1.3	Contact Officer	
	Position	
	Phone	
	Fax	
	Email	
	Address	

This section asks about your agency's total revenues, charges and expenses. All agencies should complete this section, whether or not you consider you undertake cost recovery.

Section 2: Agency revenues, charges and expenses
(Please indicate with a 'X' which response applies)

2.1 Has your agency charged any cost recovery fees, levies or other charges in the last five financial years?

YES	NO

Relevant charges include any fees, levies, taxes (including some customs and excise duties programs earmarked for specific purposes) or other charges which arise from the services, or business activities of your agency, and which are collected by your agency or by another agency on your behalf. For example, application fees, processing charges, consultancy fees, publication sales, special industry duties, excises or levies other than general taxation.

2.2 Were any of the appropriations allocated to your agency in the last five financial years linked (hypothecated) to revenue collected from fees, levies or charges (for example, levies paid to the Consolidated Revenue Fund but earmarked for allocation to your portfolio)? (Whether the revenue was collected by your agency or by another agency on your behalf).

YES	NO

2.3 Has your agency considered introducing any cost recovery arrangements in the past that were not implemented? (Please attach any relevant reviews, analysis or other information.)

YES	NO

2.4 Is your agency considering introducing any cost recovery arrangements in the future? (Please attach any relevant reviews, analysis or other information.)

YES	NO

If you answered NO to questions 2.1 and 2.2, you need not answer any further questions. Thank you for your cooperation. Please return the questionnaire to the Commission (see front sheet for instructions).

If you answered YES to EITHER question 2.1 OR question 2.2 OR both, please complete section 3 below, and Part II on the following worksheet.

Section 3: Agency revenues and expenses

	YES	NO
3.1 Does your agency classify revenues and expenses as agency and administered?		

Agency revenues and expenses are those controlled by the department/agency (for example, employee and administrative expenses). Administered revenues and expenses are those which are controlled by Government and managed or oversighted by the department/agency on behalf of the Government (for example, social security payments).

If your agency classifies revenues and expenses as 'agency' and 'administered' then please fill in both tables below. If your agency does not classify revenues and expenses as 'agency' and 'administered' then please put all revenues and expenses in the 'agency' table below.

AGENCY revenues and expenses (Please use $'000)

		1995-96	1996-97	1997-98	1998-99	1999-2000
	Agency revenue from cost recovery (a)					
3.2	Cost recovery revenue retained by your agency					
3.3	Cost recovery revenue paid to CRF and appropriated to your agency (or another agency for a specific purpose (ie. annotated, hypothecated or earmarked revenues)					
3.4	Cost recovery revenue paid to CRF and not specifically appropriated to your agency (or another agency)					
3.5	**Total agency revenue from cost recovery**					
	Agency revenue from other sources					
3.6	Other appropriations					
3.7	Other sources (eg. asset sales, dividends, interest, funding from other government agencies)					
3.8	**Total agency revenue from other sources**					
3.9	**Total agency revenue**					
3.10	**Total agency expenses**					

CRF Consolidated Revenue Fund

(a) Include all revenue from fees, levies, excises and other charges which arise from the services or activities of your agency and which is paid to your agency to another agency or to the Consolidated Revenue Fund.

ADMINISTERED revenues and expenses (Please use $'000)

		1995-96	1996-97	1997-98	1998-99	1999-2000
	Administered revenue from cost recovery (a)					
3.11	Cost recovery revenue retained by your agency					
3.12	Cost recovery revenue paid to CRF and appropriated to your agency (or another agency for a specific purpose (ie. annotated, hypothecated or earmarked revenues)					
3.13	Cost recovery revenue paid to CRF and not specifically appropriated to your agency (or another agency)					
3.14	**Total administered revenue from cost recovery**					
	Administered revenue from other sources					
3.15	Other appropriations					
3.16	Other sources (eg. asset sales, dividends, interest, funding from other government agencies)					
3.17	**Total administered revenue from other sources**					
3.18	**Total administered revenue**					
3.19	**Total administered expenses**					

CRF Consolidated Revenue Fund

(a) Include all revenue from fees, levies, excises and other charges which arise from the services or activities of your agency and which is paid to your agency to another agency or to the Consolidated Revenue Fund.

End of Part I. Please complete Part II, which is on a separate worksheet.

PART II

If your agency operated any cost recovery arrangements in 1999-2000, please complete this part.
Please fill out a separate form for each sub-unit, cost recovery program or activity, or output or outcome for which you are reporting. Similar cost recovery arrangements may be reported in groups.

PART II(a)

Name of sub-unit, agency, program or activity, output or outcome

Section 4: Cost recovery arrangements in 1999-2000

	Descriptive material	
4.1	Nature of cost recovery arrangement (eg. licence fee, service charge, hypothecated excise tax or levy etc)	
4.2	Basic description of arrangements: (Please attach any relevant documents.)	
4.3	Who pays the cost recovery charges?	
4.4	Who benefits from the program or activity, output or outcome?	
4.5	Do you attempt to measure these benefits? If YES, how?	
4.6	Are there alternate providers or substitutes for this program or activity, output or outcome? (Please describe)	
4.7	When was this cost recovery arrangement introduced?	

PART II(b)

Name of sub-unit, agency, program or activity, output or outcome

Program or activity, output or outcome cost recovery arrangements in 1999-2000 (continued)
(Please use $'000)

Program or activity, output or outcome revenues				
4.8	Cost recovery revenue paid to CRF earmarked for appropriation to same agency	$		
4.9	Cost recovery revenue paid to CRF earmarked for appropriation to a third party	$		
4.10	Cost recovery revenue paid to CRF and not earmarked for particular appropriation	$		
4.11	Cost recovery revenue paid to CRF (subtotal)	$		
4.12	Cost recovery not paid into CRF		$	
4.13	Total cost recovery revenue		$	
4.14	Appropriations not related to cost recovery			$
4.15	Other sources (please specify)			$
4.2	**Total program or activity, output or outcome revenues**			$
Program or activity, output or outcome expenses				
4.17	Direct expenses	$		
4.18	Indirect expenses (including corporate overheads)	$		
4.19	Third party expenses (a)	$		
4.20	**Total program or activity, output or outcome expenses**	$		
Administration costs				
4.21	What costs are associated with administering the cost recovery arrangements?	$		

CRF Consolidated Revenue Fund. Direct costs are those directly related to a particular program. Indirect costs include indirect agency overheads and general running costs. (a) Include third party costs where third parties are involved in a program or activity and their costs are being recovered as part of the cost recovery arrangements.

PART II(c)

Name of sub-unit, agency, program or activity, output or outcome

Section 5: Institutional arrangements

5.1 What was the rationale for introducing these cost recovery arrangements?
(Please attach sources, eg. legislative objects clauses, press releases, second reading speeches.)

5.2 What was the legal basis for establishing these cost recovery arrangements: (Please name and attach relevant documents.)

Legislation (eg. s.31 of the Financial Management and Accountability Act, tax or levy Acts)	
Subordinate legislation (eg. regulations, standards)	
Co-regulation or quasi-regulation	
Commonwealth/State/Territory agreement	
Voluntary arrangements (eg. codes of practice)	
Other	

5.3 Who was consulted about introducing these cost recovery arrangements? (Please name relevant bodies and describe the consultation arrangements.)

Commonwealth government (DOFA etc)	
Other governments (state, territory, local)	
Industry	
Consumers	
Other	

5.4	What guidelines were consulted when establishing these cost recovery arrangements? (Please attach source of information, guidelines etc.)	
5.5	Which agency is responsible for the following activities? (Please name relevant agency)	
	Policy setting	
	Price setting	
	Administration	
	Revenue collection	
5.6	Is there any ongoing consultation about these cost recovery arrangements? With whom? (Please name relevant bodies.)	
	Commonwealth government (DOFA etc)	
	Other governments (state, territory, local)	
	Industry	
	Consumers	
	Other	
5.7	Please describe these consultation arrangements.	
5.8	Have the cost recovery arrangements been formally reviewed? What was the outcome? (Please attach copy of review)	

PART II(d)

Name of sub-unit, agency, program or activity, output or outcome

Section 6: Price setting arrangements

6.1 How are these cost recovery charges determined? (Please attach any relevant documents)	
(i) How are charges set? (eg. by formula in legislation or based on 'market prices')	
(ii) Are charges directly related to the costs of particular activities, outcomes or outputs, or charged on some other basis? (eg. levies on users' turnover, profits or assets)	
6.2 If charges are directly related to the costs of particular activities, outputs or outcomes:	
(i) What costs do charges aim to recover? (eg. only direct costs or indirect costs such as overheads)	
(ii) What proportion of these costs do charges aim to recover? (%)	
(iii) Does the charging regime require assets to be valued? (eg. to allow the calculation of user cost of capital or return on assets)	
(iv) If 'YES' to (iii), on what basis are assets valued? (eg. historic, replacement, deprival or replacement cost)	
(v) Do charges include a user cost of capital?	
(vi) If 'YES' to (iv), how is it calculated?	

(vii) Do charges include return on assets? (eg. profit)	
(viii) If 'YES' to (vii), on what basis?	
(ix) Do charges discriminate between types of users?	
(x) If 'YES' to (ix), on what basis?	
(xi) Do charges allow for access and equity considerations (eg. waivers, discounts)?	
(xii) If 'YES' to (xi), on what basis?	
(xiii) Other (Please describe other significant features)	

6.3	How are indirect costs allocated for cost recovery arrangements? (eg. activity based costing, according to share of direct costs or other rule.)	
6.4	Are there any price controls on these charges?	
6.5	How often is the level of charges changed?	
6.6	What happens if revenue recovered is greater than costs incurred?	

End of Part II. Thank you for your cooperation. Please return the questionnaire and attachments to the Commission (see front sheet for instructions)

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