



Submission on Draft Report



Productivity Commission Review of Cost Recovery by Commonwealth Agencies

Austrade welcomes the opportunity to contribute a second submission to the Productivity Commission Review of Cost Recovery by Commonwealth Agencies. Austrade strongly supports the principles of openness and transparency being applied to the pricing of Government services.

However, the cost recovery model as proposed in the Draft Report would not be acceptable to Austrade as it does not adequately meet the needs of our agency in delivering our objectives as set by Government. This submission provides more detailed comment and suggestions for an alternative model. Austrade would be pleased to work with the Productivity Commission to further develop the issues raised and ideas suggested.

Recommendations and Information Requests

Chapter 3 – Legal and Fiscal Framework

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

Under section 28 of the Australian Trade Commission Act Austrade is provided with the power to charge such fees as it considers appropriate for the service provided. In contrast to other agencies that require cost recovery based on actual cost the Act requires Austrade to determine an appropriate level of fees. This concept involves a greater range of consideration than the just cost recovery.

Austrade takes into account a range of factors in determining price. These include –

- The cost of providing the service;
- The market rates that would be charged in Australia for similar services;
- The market rates that would be charged in the market where the work has been conducted;
- Whether subsidisation is appropriate eg in the case of getting companies into export or new entrants to markets, in order to satisfy Government policy or other requirements;
- Simplicity of pricing so that clients understand the fees being charged; and
- The likely client satisfaction effect from altering the fees and fee structure.

Austrade's approach to cost recovery and fees is based upon a premise that exporting benefits Australia economically and that Australian firms need assistance to overcome market failure

and other obstacles to exporting¹. Therefore, in so much as fees are charged Austrade uses a sliding scale approach to cost recovery, to ensure that firms have adequate access to Austrade services, whilst also providing for efficient use of resources.

The rationale for the charging of a fee for some Austrade services is as follows:

- An over-arching Government policy requires Government agencies to charge for service where this is appropriate and Austrade has acted to meet the objectives of this policy.
- The policy provides a filtering mechanism for clients so that they are required to make a focused choice about where they wish to place resources in seeking to export rather than seeking information on whole range of options at once. This allows Austrade to provide tailored solutions and advice and maximise the use of scarce resources.
- As noted in the Draft Report, charging regimes can have the effect of encouraging agency efficiency and efficient allocation of resources. Austrade finds this to be the case and its policy encourages the efficient use of resources so that Austrade does not spend an excessive amount of resources on clients who do not have sufficient resources to undertake export activities. Instead Austrade resources are directed to those clients who are export ready and have the potential to put into practice the advice that they receive about moving into export markets.
- The charge of a fee for service provides for a professional contractual arrangement between the client and the supplier, Austrade. Such a relationship provides an extra discipline on the supplier to provide a high quality service in a timely manner and clarifies for expectations as to what will be provided.

In accord with its charter and with Government priorities to help Australian SME's enter into export and win international business, Austrade's pricing policy aims to balance:

- the need to make our services affordable to Australian SME's, thus maximising their access to our services and maximising the resulting public benefit flowing from increased export activity, and
- the need to ensure that resources are allocated efficiently, with Austrade clients making an appropriate contribution to the cost of service provision and with demand for the more tailored services being moderated by the charging of appropriate fees.

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 the Portfolio Budget Statements.*

Given that Austrade already identifies its client service fees in our Annual Report, we support the recommendation to separately identify this information in all relevant budget documentation.

¹ Tim Harcourt, "The Benefits of Supporting Export Promotion", 2000, in *The Review of the Export Market Development Grants Scheme*, prepared by the Austrade Board – June 2000, pgs 138-152.

- 3.3. *The Regulatory 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.*

Austrade is supportive of this recommendation, subject to comments elsewhere in this submission regarding the proposed model.

- 3.4 *A Cost Recovery Impact Statement (CRIS) process should be developed for application to all significant cost recovery proposals or amendments to existing cost recovery proposals or amendments not covered by an enhanced Regulatory Impact Statement.*

Austrade is supportive of this recommendation, subject to comments regarding the proposed model. However, Austrade also notes the recommendation of the Productivity Commission to review all existing cost recovery activities. Whilst not necessarily opposed to such a process, Austrade would be very concerned if such a process caused disruption to our clients and our stakeholders who understand and are comfortable with our current pricing structure.

Chapter 4 – Current Cost Recovery Arrangements

- 4.1 *The Commonwealth Government should adopt a formal cost recovery policy for regulatory and information agencies. This policy should implement the cost recovery guidelines recommended by this inquiry.*

In terms of export promotion coordination, Austrade supports the principle of a formal Government policy for the introduction, operation and review of Commonwealth cost recovery arrangements. Austrade notes that the ANAO review of the *Coordination of Export Development and Promotion Activities Across Commonwealth Agencies*, found that, the application of a consistent cost recovery approach across the Commonwealth would encourage exporters to seek the most appropriate services for their needs.

Austrade, has serious concerns with the proposed guidelines and has provided some specific comments on the Commission's draft guidelines in our response to recommendations 6.5 – 6.7 and the information requests for Chapter 9.

Notwithstanding these concerns and whilst supportive of the principle, Austrade believes that it is unlikely that a single set of prescriptive guidelines will be suitable for the activities of all Commonwealth agencies or their activities. As such, Austrade recommends that any specific guidelines adopted by the Government be administered flexibly and take into account the varying needs of different agencies. It is Austrade's strong view that the application of cost recovery guidelines should in no way impede an agency fulfilling its charter as defined by Government.

Chapter 5 – Effects of Cost Recovery of Agencies

- 5.2 *The Government should address the effectiveness of the existing performance review processes and the need for a more performance based efficiency audit approach based on stakeholder consultation.*

Austrade welcomes any initiatives that would enhance performance and client satisfaction, and which support the achievement of the overall goal of assisting Australians to win export business and generate inward and outward investment.

Austrade would be supportive of the suggested review process if the objective were to rationalise the various existing price review processes including those of the Department of Finance and ANAO. Austrade supports the principle of CAC Act requirements for Corporate Governance being managed by the agencies themselves.

Given the multitude of existing performance assessment mechanisms and agencies, Austrade believes that the establishment of a separate Efficiency Audit Committee would unnecessarily duplicate these activities. The ANAO performance audits frequently review efficiency and effectiveness, and DOFA's pricing reviews also review efficiency and effectiveness of agencies and their services. In addition Austrade has internal performance improvement programs and internal audit committees.

When setting the price, Austrade consulted extensively with clients and potential clients, with our board and with the Minister. Our client service, including charging, is reviewed annually with a survey of around 2000 clients. There have also been two major reviews of client expectations, including expectations regarding charging, over the past three years. Each of these involved focus groups, one on one interviews and quantitative surveys.

Chapter 6 – Economic Effects

- 6.1 Cost recovery arrangements which are not justified on grounds of economic efficiency should not be undertaken merely to raise revenue for government activities.***
- 6.2 As a general principle, cost recovery arrangements should apply to specific activities, not the agency which provides them.***
- 6.3 The practice of setting targets that require agencies to recover a specific proportion of their total costs should be discontinued.***
- 6.4 Cost recovery arrangements should not include the cost of activities undertaken for Government, such as policy development, ministerial or parliamentary services and international obligations.***

Austrade's client service policy is based upon achieving our primary goal, of maximising access by SMEs to export markets, whilst placing an onus on those consuming services with a higher proportion of private benefit to contribute to the cost of producing the service.

Austrade strongly agrees with recommendation 6.3, as the arbitrary imposition of cost recovery targets, can direct agencies away from their primary goals and towards those services that generate the most revenue. However, it is important that agencies have the flexibility to set internal revenue targets as appropriate.

- 6.5 Information agencies should carefully define the boundaries of their core and non-core activities. This should be a dynamic process, with core activities:***

- *agencies' broad public policy objectives;*
- *the public good characteristics of the activity; and/or*
- *any positive spill overs associated with the activity.*

6.6 *The core activities of information agencies (which may include some defined level of dissemination) should be wholly budget funded and not subject to cost recovery.*

6.7 *Non core activities of information agencies should be charged at marginal (incremental) cost or, where relevant at prices in keeping with competitive neutrality principles.*

Austrade is generally supportive of the Commission's efforts to develop a framework to assist agencies to determine whether their services should be funded by Government appropriations, through cost recovery or a combination of the two. Whilst supportive of these principles, Austrade is concerned that the Commission's proposed guidelines (referred to in Recommendations 6.5 to 6.7) could have serious negative implications for Austrade's client service operations. These concerns are based upon the Commission's definition of services and the subsequent implications for cost recovery. Austrade believes the Commission's proposed guidelines are too prescriptive to accommodate the various cost recovery activities of Commonwealth agencies and would seriously impede it in meeting its goals. In Austrade's view, the distinction between core and non core cannot be usefully and practically applied to Austrade's services. The incremental pricing model suggested for non core services also cannot be usefully and practically applied to Austrade's services.

To illustrate by way of example, Austrade's services reflect the three different stages of the international business learning curve. Our services are designed to help Australian companies move along the curve faster than normal, while also reducing the risks and costs associated with developing an export business.

Austrade's services are grouped into three broad segments.

- Tier 1: Seeking general information and advice about exporting.* At the start, Austrade helps Australians thinking about export, by providing a range of general information and advice that will assist them in the decision making process.
- Tier 2: Selecting, understanding and entering new markets.* When companies are ready to export, Austrade helps them select, understand and enter export markets, through focused advice and assistance in Australia and overseas.
- Tier 3: Expanding overseas business.* Austrade provides tailored assistance and strategic advice to existing exporters looking to expand their overseas business.

Most Austrade services, and particularly those delivered by our overseas posts, are delivered under our Client Service Policy.

- Tier 1 services are delivered free of charge.
- Tier 2 services attract fees of A\$100 per hour for the first 10 hours of service at a given post, and A\$150 per hour thereafter.
- Tier 3 services attract a fee of A\$150 per hour.

The proposed classification system is ambiguous and could see Austrade's core services which have clear public benefit and have significant positive spill over effects to the community as a whole but may also include some private benefit, as being classified as non-core. Given that Austrade's primary goal is to assist Australian companies, particularly SMEs, to export, the definition of any of Austrade's services as non-core would be problematic.

On the other hand, if services *are* deemed to be core services, the guidelines generally indicate that these should not be subject to cost recovery. However, for the reasons outlined earlier the application of a charging policy is a very important means of rationing scarce resources and ensuring high quality services.

Given that Tier 1, 2 and 3 services are all essential to meeting our charter and the goals set by Government, Austrade would be concerned should it be required to recover a greater proportion of the costs than is warranted. To be forced to price services too high would make them inaccessible to many SMEs and therefore would cause (rather than address) a market failure.

Thus, it seems that the proposed classification system does not sufficiently provide for a graduation of proportion of costs recovered according to the proportion of private (versus public benefit and spill over benefits) benefit embodied in the service. Rather it places all services which have any significant proportion of private benefit into the non-core category which would see the recovery of all associated incremental costs. The guidelines are also somewhat ambiguous and could result in inappropriate and inconsistent classification of services.

Nor does the model allow for other factors which must be taken into account by agencies such as Austrade seeking to meet objectives set by Government. It is essential that the issues of cost effectiveness of cost recovery, practicability of the charging regime, comparability with other services, the particular market failure to be addressed and the impact of charging regimes on clients may be taken into consideration by the agency in setting fees.

Austrade suggests that the Commission consider implementing a more flexible process to allow the agency discretion in determining core and non-core services based upon a sliding scale of public and private benefit. That is, a service with a very high proportion of public good should generally be wholly budget funded, whilst services with varying proportions of public and private good could be funded through varying levels of cost recovery. This would allow an agency to have the flexibility to classify their services and determine appropriate levels of cost recovery whilst remaining within the boundaries of its charter. It is extremely important however that as previously stated, the public versus private benefit of the service is only one factor used to determine appropriate level of cost recovery.

To facilitate this proposal, Austrade suggests an alternative model whereby, if it is determined by the agency that a service warrants cost recovery, it can further classify the service according to the proportion of public benefit involved. From this classification a varying degree of cost recovery would be applied (for simplicity) from 25% to 75% of the incremental cost of providing the service. Further consultation would be required to determine the appropriate criteria for determining the level of public versus private benefit embodied in a service.

Austrade is somewhat unique in that it provides a range of services in Australia and overseas. It is very important that any cost recovery guidelines recognise the need for a standard charging system and the extreme difficulty and costliness of determining various cost recovery rates for different services in different markets. Not only would the administrative costs of such a requirement be onerous, it would be very likely to cause confusion and dissatisfaction among clients. The agency would need to be able to establish the appropriate rate of cost recovery based on standard charges for particular services, for example in Austrade's case Tier 2 or 3 services in Australian dollars.

As stated, agencies would determine the appropriate rate of cost recovery based upon the level of public to private benefit, the complexities of the task, the costs involved and their overall charter or goals.