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**NFF's submission to the
Productivity Commission
on
the Draft Report on
Cost Recovery**

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1. Introduction

1.1 This submission is made by the National Farmers' Federation (NFF). The NFF did not initially respond when the terms of reference for this inquiry were announced in August 2000. In the broad, NFF shares the general approach taken by the Australian Chamber of Commerce and Industry (ACCI) in its initial submission to the Productivity Commission (PC). NFF now wishes to comment on the Draft Report, published in April 2001.

1.2 The NFF endorses the principles outlined in the ACCI response to the Productivity Commission's Draft Report on Cost Recovery in Government Agencies, June 2001, stating that it supports a cost recovery approach that will (page 2):

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

1.3 Part of the rationale for a separate NFF response relates to one principal departure from ACCI. NFF does not share ACCI's concerns raised in ACCI's first submission entitled *Cost Recovery*, of December 2000, thus:

“One notable inconsistency is the cross-subsidisation of establishments. A case in point involves the travelling time of inspectors visiting regional/rural establishments, where the travel costs are not being fully borne by the establishment where the inspection is taking place but transferred, at least in part, to urban-based establishments.”

In instances where cost recovery is warranted the NFF supports arrangements that allow the government to recover the marginal cost of providing the service Australia-wide. The total additional cost of the provision of the service Australia wide is the important characterisation of the expense and this cost should not be recovered in higher proportions from rural and regional Australia when compared with urban communities but should be set at a standard rate or measure.

- 1.4 The NFF believes that costs should be recovered only where it is clear that these charges can be cost effectively matched to the individual or discrete group of individuals who are receiving the benefit. If the service provides a public good, then funding for this service should come from consolidated revenue. This gives the public the opportunity at budget and election time to provide feedback to the Government on its expenditure on the service. If the public thinks the allocation is warranted, the funding will survive debate at budget and election time.
- 1.5 The NFF shares the concerns expressed by the ACCI regarding hypothecated taxes and their possible evolution into general consolidated revenue measures. NFF opposes any arrangement whereby an agency attempts to cost recover by way of taxation.
- 1.6 The discipline on Government to seek productivity increases, efficient mechanisms and to keep costs down comes from having to win support for increases in consolidated revenue. The more services that they can fund through cost recovery or hypothecated taxes, no matter how transparently the first are calculated, the less discipline government needs to exercise on their spending. Hence, the NFF supports cost recovery guidelines that

stipulate that charges should not be indexed or if they are to be indexed, they should be indexed by the underlying CPI less an appropriate percentage to ensure the relevant agency continues its pursuit of productivity improvements and to ensure that those who foot the bill will be adequately consulted when increases are required.

- 1.7 In general, the NFF supports the broad thrust of the Productivity Commission's recommendations set out in the draft report.

2. The Productivity Commission's Recommendations

- 2.1 NFF recognises the importance of the PC's inquiry into cost recovery by Commonwealth agencies. We endorse the development of consistent and transparent guidelines and principles for the future application of cost recovery by the Commonwealth Government. NFF appreciates that the Commonwealth Government currently uses two broad methods to recover costs - fees and taxes - and that the inquiry relates to both categories. As the Draft Report states:

"Fees include fees for services (which include goods) and royalties, whereas taxes include levies, excises and customs duties." (page 1)

- 2.2 The NFF agrees with recommendation 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 services are not vulnerable to challenge as amounting to taxation.

- 2.3 The NFF agrees with recommendation 3.2:

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

Such identification would ensure a more transparent cost recovery system and reflect good accounting practices. At present the data on cost recovered and non-cost recovered revenue at an agency level is generally not sufficient to allow these costs to be identified separately: page 42-43 Draft report. Greater transparency and comprehensive information allows policy makers to understand fully the impact of charges. These costs, like all taxes, have the immediate effect of raising the prices of the services and potentially reducing the amount of the service utilised (except where the service provision is mandatory). Hence, they should be completely transparent.

2.4 The NFF supports recommendations 3.3 and 3.4:

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.

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 arrangements not covered by an enhance Regulatory Impact Statement (RIS).

It is imperative that the case is made for any increase or imposition of a charge based on cost recovery principles. As the Commission has identified, this must be a rigorous cost benefit analysis including adequate identification of who will pay, assessment of the cost of collection and analysis of interaction with policy objectives.

2.5 The NFF agrees with recommendation 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.

Cost recovery in the Commonwealth Government sector is fraught with anomalies and inconsistencies and has developed in an ad hoc manner: Draft Report page 69. Thus, this recommendation is vital.

2.6 The NFF agrees with recommendation 5.1:

As a general rule, the funding of cost recovered regulatory activities should be subject to the same budgetary and parliamentary oversight as budget funded government activities.

2.7 The NFF agrees with recommendation 5.2:

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

Whilst the NFF 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 (EAC) referred to in the PC's draft report. NFF believes that the establishment of yet another bureaucracy such as the EAC is unnecessary and that the PC, an independent Commonwealth agency, should be provided with an expanded charter to include an annual assessment of cost recovery arrangements. These assessments should then be made publicly available through the Productivity Commission's annual report. If this is not possible, then NFF would be prepared to concede that the EAC should be established and that its findings be made public.

2.8 The NFF strongly supports recommendation 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.

The NFF opposes any cost recovery arrangements that are implemented purely for the purpose of revenue raising. NFF also opposes cost recovery arrangements where the opportunity costs of collecting fees for a cost recovery activity direct resources from an agency's principal purpose. Further, it would be an instructive exercise for the PC to establish the percentage of revenue recovered through agency processes that is expended on administration of the cost recovery process itself. This figure together with other data from the Draft report would enable the efficiency of Government cost recovery exercises to be properly measured.

2.9 The NFF strongly supports recommendation 6.2:

As a general principle, cost recovery arrangements should apply to specific activities, not to the agency which provides them.

NFF is keen to see the removal of agency wide cost recovery targets (eg the ABARE 30 per cent cost recovery target (Draft Report, page 73)) and prefers cost recovery arrangements to pertain directly to specific activities.

As stated in the Draft Report:

“Where agencies have specified cost recovery targets (for up to 100 per cent of their costs), revenue raising would appear to be an important objective of the arrangements.

It could be argued that if cost recovery is used purely as a revenue raising mechanism ... without regard for identifying the beneficiaries or efficiency implications, then it is serving the function of a tax ” (page 114)

Guidelines that would prevent Government agencies from using statutory powers to recover more than the cost of an activity are endorsed by the NFF.

2.10 The NFF supports recommendation 6.4, 6.5 and 6.6:

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.

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 determined with reference to:

- The agencies’ broad public policy objectives;
 - The public good characteristics of the activity; and/or
- Any positive spillovers 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.

NFF supports the clear identification of activities into core and non-core areas with consideration given to the provision of services for rural and regional areas. The NFF believes activities such as policy development,

international obligations, internal administration and parliamentary services are all public goods activities and should be classified as core activities funded from consolidated revenue.

- 2.11 A narrow approach should not be taken when defining core activities. Similarly revenue raising or political promises (such as compliance cost reduction objectives) should not drive the definition so that industries or firms, for example, end up paying full cost for what should be core information collection activities. Information service's core activities should include more than information gathering for national accounts reporting. It should also include the collection of base data for social, environmental and economic policy development. A specific example is the need to obtain information at sufficient regional detail in the Agricultural Census to permit identification of emerging industries, adjustment patterns and to target disaster relief.
- 2.12 In situations where a government activity has both public and private benefits, the NFF supports the funding of the activity from both sectors. For example, as discussed in the Red Meat Advisory Council's (RMAC) submission to the Inquiry, the cost of AQIS meat inspection and export certification are "clearly activities that benefit a broad range of Australian and international stakeholders ... [and that these] 'external benefits' and policy consideration should be factored into cost recovery arrangements for AQIS meat inspection" (page 35). In the case of inspection charges for export beef, there is a benefit to the farmer and to the abattoir in the 'certification' but there is also a public health benefit and a general economic benefit. As there is more than one beneficiary resulting from the inspection service, it should not be expected that the farmer pays the total cost of the service but that this cost should be shared amongst all beneficiaries, included the taxpayer.
- 2.13 The NFF supports recommendation 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.

- 2.14 The NFF supports recommendation 6.8 provided the charges to regulated firms for the costs of regulation only occur when all four conditions listed in the dot points below are met:

Where the main objective of regulation is to provide benefits to the users of regulated products, a ‘beneficiary pays’ approach should be adopted. Under this approach regulated firms would be charged for the costs of regulation only where:

- It is not feasible to charge beneficiaries directly;
- Costs can be passed onto beneficiaries;
- It is cost effective; and
- It is not inconsistent with policy objectives.

- 2.15 The NFF supports recommendation 6.9:

Where the main objective of regulation is to minimise the detrimental effects of external spillovers, a ‘regulated pays’ approach should be adopted. Under this approach, regulated firms should be charged for the cost of regulation only where:

- Those businesses are the source of the negative spillovers;
- It is cost effective; and
- It is not inconsistent with policy objectives.

- 2.16 The NFF supports recommendation 8.1:

Government equity or social objectives should be funded through direct cash transfer to users or direct funding of agencies, rather than through cost recovery arrangements.

3. Other Issues

- 3.1 The NFF supports the undertaking of additional research to analyse the impact of cost recovery arrangements on rural and regional areas. The PC should prepare a cost/benefit study of the effects of cost recovery at full cost and at a level of cost that is amortised over all users (see paragraph 1.3 above) and in particular assess the costs and benefits upon rural and regional Australia. The NFF would like to see the PC analyse whether or

not rural and regional areas are currently and/or would be disadvantaged by current or proposed cost recovery arrangements.

- 3.2 The implementation of cost recovery strategies for new products such as new agricultural chemicals that may prove to be more environmentally friendly or safer than current products also needs to be considered in the development of cost recovery guidelines. 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. Accordingly, the NFF supports the incorporation of strategies such as levy caps and minimisation of upfront payments into the cost recovery principles developed by the PC. Recognition of these costs as a disincentive to invest in, say biotechnology must be part of the relevant principles.
- 3.3 The NFF supports cost recovery guidelines which would ensure that the benefits of revenue raised from a particular sector are delivered back to that sector. For example, where public funds have been allocated to an agency either through its budget allocation or through sector specific research levies to develop new products, the provider of these funds should benefit from the new products developed. If these products however are then commercialised using cost recovery guidelines and without clauses that require the product to be made available to the Australian public and the product is sold overseas, the taxpayer does not benefit from the dollars spent. Although the costs of developing the products are recovered from the sale, where sector specific research levies have been used to fund the project, this sector fails to receive the benefit of the revenue raised as the funds are usually attributed to the agency's general revenue.
- 3.4 The NFF also supports cost recovery guidelines outlined in the PC's Draft Report which include reviews of current cost recovery charges and mechanisms and ongoing monitoring and periodic review of all cost recovery arrangements.

- 3.5 The NFF strongly supports ongoing consultation with relevant stakeholders in the development of Commonwealth Government agency cost recovery arrangements.
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