



National Farmers'
F E D E R A T I O N

**Submission to the
Department of Finance
Draft Australian Government Cost
Recovery Guidelines**

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MEMBER ORGANISATIONS



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1. Introduction

The National Farmers' Federation (NFF) welcomes the opportunity to make a submission on the Draft Australian Government Cost Recovery Guidelines (Draft CRG).

Over the past 15 years, the Australian Government has increasingly moved towards cost recovery. A 2001 Productivity Commission report¹ noted that between 1999 and 2000, cost recovery raised \$3 billion for Commonwealth agencies alone, and grew by 24% in the previous five years. The Productivity Commission further noted that cost recovery had the potential to create perverse financial incentives such as to "*encourage regulatory creep and cost padding by agencies*"².

Since this 2001 report, cost recovery has continued to be implemented across a wide range of agencies and government entities. A major issue has been the huge variation in the way the previous version of the CRGs have been interpreted by agencies, and encourages different parts of the same department to work at cross-purposes. For example, in DAFF a lot of effort is put into trying to help exporters to access markets, while the Biosecurity area applies a raft of charges on businesses (that have increased rapidly in recent years). Some of these charges go towards funding the core business of the department (a public good).

As a result, the NFF welcomes the approach taken by the Department of Finance, to ensure greater clarity, consistency and coherence of the cost recovery policy and its requirements to better meet the needs of government and industry stakeholders.

However, cost recovery may not be warranted where it:

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

NFF remains concerned by the manner in which the Draft CRG has been drafted. Moreover, NFF seeks clarification on implementation arrangements, specifically for inconsistent cost recovery, and those cost recovery proposals which have not yet been implemented.

¹ 2001 Productivity Commission, *Cost Recovery by Government Agencies Inquiry*, Report No 15, AusInfo, Canberra

² Ibid, p.xxviii

2. Monopoly Service Provider Vs Efficient Service Provision

The Australian Government is a monopoly service provider, i.e. it is the sole provider of the good or service for which it is seeking cost recovery. By definition, monopolies are usually bad for an economy because they restrict free trade, preventing the market itself to set prices.

Governments as monopolies can therefore set any price they choose and the consumer has no alternative choice. Just as concerning is that monopoly service providers can also deliver an inferior product or service, and there is no incentive to innovate or become efficient.

It is this last point that is of concern to NFF. The Draft CRGs have been developed through the lens of Government. Therefore, there is a focus on risk management and recovering all an agency's cost in relation to the service. However, the same service delivered by the private sector will consider the cost of the service through a different lens that weighs the value for money proposition against the risk and will most likely be less risk adverse than Government.

The Draft CRG seeks to recover efficient and effective costs. However, there is also compelling evidence to demonstrate that large chunks of the public sector cannot run themselves efficiently or effectively ... or both. The same task undertaken by the private sector will be done in less time, and for less cost than that sought by government.

As an example, during the 1990s the NSW Government tasked the Independent Pricing and Regulatory Tribunal (IPaRT) with determining costs to be recovered for water, amongst a range of government services like gas and electricity. IPaRT heavily criticised the government agencies until more recent years, because they could not demonstrate that the costs they were seeking to recover were prudent, and efficient. As part of the remedy, IPaRT applied an efficiency dividend to the regulated water prices effectively to create efficiency in the government agencies.

The Productivity Commission³ had the following comments in relation to monopoly service provision in the urban water sector, and these are just as appropriate to the Draft CRG:

Government agencies that deliver services such as water have weaker incentives to minimise costs and seek out new and better ways of doing things compared to their private sector counterparts, for two main reasons. First, private businesses that do not minimise costs may be driven out of business by more efficient rivals or

³ 2011 Productivity Commission, *Australia's Urban Water Sector*, Report No. 55, Final Inquiry Report, Canberra

disciplined by the capital market in a range of ways. Government agencies, including ones that are corporatised, do not face market tests for survival. Second, the profit motive is a powerful driver of efficiency and innovation for private businesses, but does not operate in the same way for government agencies. Where a government agency is also a monopoly service provider these problems can be compounded by X-inefficiency.

Government departments and regulators may also have relatively weak incentives to undertake their functions efficiently. Further, relevant data on the efficiency of these agencies is likely to be much less tractable than that which is available for water utilities, providing a greater potential for inefficiencies to remain undetected.

The Productivity Commission suggested the need for clear separation of policy, regulatory and service delivery functions and that the latter be subject to governance arrangements designed to ensure:

- clear objectives both commercial and non-commercial;
- ensure that ad hoc government directions are either eliminated or allowed only through transparent processes; and
- performance monitoring and other means to achieve transparency and accountability.

Any costs associated with policy must be specifically excluded from any cost recovery.

Monopoly service providers should avoid monopoly rents. Outsourcing may be an option to address inefficiencies, oversupply and improve service quality.

However, the Productivity Commission noted that there is likely to be residual inefficiencies mainly because of perceived or actual government pressure to make politically expedient decisions, incentives for efficiency and innovation will be weaker than for private business operating in a competitive environment, and performance monitoring imposes costs and is an imperfect means of achieving the accountability of non-elected officials. The Productivity Commission suggested that there is merit in reviewing the tasks assigned to regulators to ensure that they are appropriate.

The NFF supports cost recovery but only where those costs are reflective of the efficient, relevant, prudent costs of service provision. The Draft CRG does not deliver confidence that this will be delivered.

3. Prudent, efficient, reasonable and relevant costs

To avoid perverse cost recovery outcomes⁴, the NFF recommends that the Draft CRG be re-written with a focus on the recovery of reasonable or relevant, prudent and efficient costs, for the agency and for any outsourcing undertaken by the agency that is cost recovered (including inter- agency cost recovery).

The Draft CRG notes that “*efficiency means delivering a government activity for the lowest cost for government*”. However, as described above, governments are by their nature inefficient meaning that governments cannot deliver a low cost value for money service as would be expected by the clients who will be required to pay for the service. For NFF, the efficiency test requires that the service be produced at minimum cost, short run or long run, time series or across entities – and is benchmarked against the same or similar service undertaken by private sector – not other government entities.

Relevant or reasonable cost in its amount and nature is consistent with what a reasonable person would incur in the conduct of the same business in the same or similar circumstances.

Prudent cost or expense is attributable or chargeable to one or more activities on the basis of benefits received or some other logical relationship.

These principles are consistent with regulated pricing for government services such as water and electricity, and vary from the concepts espoused the Draft CRG.

Other useful principles to consider are:

- The fees are simple and are not cumbersome to administer;
- The nature and use of the service is understood by users;
- The fees provide value for-money for users; and
- Users are clear about when and how fees apply⁵.

The NFF also is concerned that a monopoly service provider ascertains and determines its own cost recovery. This creates opportunities for gold plating and regulatory gaming. A remedy may be to require this to be determined by a third party, either a consultant report, another agency (e.g. Department of Finance) or through a regulated pricing decision.

⁴ Including monopoly rents and inefficient expenditure

⁵ 2006 G.D. Carnegie and C. Baxter, *Price Setting for Local Government Service Delivery : An Exploration of Key Issues*, Australian Journal of Public Administration, 65(3):103-111, Blackwell Publishing Limited, Australia

At present, the NFF experience is that it is unclear how agencies consider cost recovery input of stakeholders, and NFF has been unable to ascertain how some costs have been determined. This is clearly not transparent. Biosecurity is an example where exporters regularly state that they are unsure how costs have been determined, particularly following rapid price increases.

NFF notes that the Draft CRG encourages government entities to periodically re-examine business process to ensure they are the most efficient way of delivering business. NFF would recommend that this also occurs prior to determining the cost recovery model and its related cost items.

Moreover, in determining costs, NFF recommends that Ministerial costs and capital unrelated to the cost recovered activity are specifically excluded, for example, in Table 1 on page 26).

4. Cost recovery fee or levy?

The description given in Table 1 on pages 25-26 creates confusion. Cost recovery should not apply to policy development, and yet this is included in cost recovery levy. Moreover, compliance, monitoring and enforcement activities should also be excluded from levies.

The description of costs that can be recovered from fee (individual) versus levy (group of individuals) is confusing. For example, DSEWPaC are proposing to introduce cost recovery for *Environment Protection and Biodiversity Conservation Act 1999* (EPBC Act) referrals and approvals. This would mean that the cost recovery as proposed by DSEWPaC most closely aligns to the Draft CRG "levy", i.e. based on the costs being recovered from a group of individuals or organisations. Yet the Draft CRG description of "fee" actually best fits the cost recovery being proposed.

NFF suggests that all policy development, monitoring, compliance and enforcement be specifically excluded from cost recovery, consistent with the Productivity Commission's advice.

5. Inter-agency cost recovery

One specific area of concern is cost recovery where the service (or regulation) is partly provided by another agency. Importantly, where that agency outsources reports and other supporting material to third parties in order to make regulatory decisions, there is likely to be no imperative for attention to prudent and efficient costs.

An example is the Australian Pesticides and Veterinary Medicines Authority (APVMA) is required to obtain regulatory approval on environmental impacts from the Department of Sustainability,

Environment, Water, Population and Communities (DSEWPaC). However, DSEWPaC regularly outsources the required reports from consultants external to the Department. A more cost effective approach might be for APVMA to contract this work directly, and then seek a regulatory decision from DSEWPaC.

The NFF recommends a review of inter-agency cost recovery to ascertain the most cost effective and efficient method to implement improvements to standards of service and reduce unnecessary duplication and/or inefficient cost structures.

6. Levels of service

Cost recovery makes it incumbent on Government to discuss and get concurrence with those clients who will be paying the cost recovery, to agreed levels of service. This will determine what services are provided and what standards clients can expect from the payment of cost recovery.

There should also be a plan for continual improvement in the service delivery over time, for example, the time taken to provide the service. Quality and timeliness of service delivery would be two key areas to address. It should also ensure that the service delivery remains relevant and aligns to the needs of clients over time.

The Blueprint for Reform of Australian Government Administration notes that the best public services in the world are integrating and simplifying the delivery of services, streamlining transactional services and making better use of online communication⁶. Yet the Draft CRG does not address levels of service in the context of cost recovery.

Larger businesses, such as mining or petroleum companies, have an ability to absorb costs, due to comparative size of project, particularly where service delivery is improved. Whereas, small business are always in a more difficult position and reduced ability to absorb increasing costs as a proportion of their business. Farmers, generally, will always reject any cost recovery that reduces business profitability.

In some situations, it may be worthwhile considering recovery from some groups but not all. An example here is DSEWPaC's proposal to introduce cost recovery, which is being driven by mining and petroleum development and to a lesser extent urban development. Agriculture, fisheries and forestry are minor sectors seeking referral and approval. However, in this situation, agriculture is being penalised for drivers outside its control. There are good reasons to provide exemptions including that the costs proposed will mean that farmers will not refer which is surely a perverse outcome. While a partial exemption has been

⁶ http://www.dpmc.gov.au/publications/aga_reform/aga_reform_blueprint/part4.1.cfm

proposed, over 2500 farm businesses are likely to be required to pay for future EPBC Act referrals and approvals. Ongoing environmental regulatory creep (due to increased listings of species and ecological communities) will continue to increase the need for farmers to referral and seek approval where required.

The NFF would recommend that cost recovery guidelines are amended to require negotiation of agreed service standards to ensure that improvement over time is delivered for those who will be paying the cost recovery.

7. Stakeholder engagement

Experience to date shows that most government entities do not understand that early engagement of stakeholders is crucial to cost recovery. Most engagement occurs with the public release of the draft Cost Recovery Impact Statement (CRIS) and then ceases.

The NFF recommends that very early consultation is required, and that government entities ensure that all relevant information that underpinned the cost recovery proposal is made available.

NFF suggests that Figure 4 on page 13 be amended to include stakeholder engagement during the pre and post government decision processes. Moreover, the NFF recommends that stakeholder consultation be included as a key consideration in Stage 1, and specifically when developing a high-level model for cost recovery. In other words, stakeholder engagement must be wider than on developing the rationale as required and outlined on page 20.

8. Other payment activities

The NFF recommends that the Draft CRGs ensure that policy development and Ministerial office expense are specifically excluded from cost recovery. Moreover, the expenses relating to regulatory decisions for public goods (for example, those relating to the listing of threatened species under the EPBC Act) are also specifically excluded. However, the NFF has previously suggested that those individuals or organisations seeking to have particular matters of national environmental significance listed under the EPBC Act ought to be asked to pay the cost for those regulatory decisions to offset the costs of the science and policy decision.

9. Implementation concerns

The Draft CRG proposes that government entities report cost recovery in the Federal and Departmental Budgets (page 30). However, tracking this can be difficult from year to year as for most budgets, only the variations

are published. The NFF suggests that this is taken a step further and that government entities publish on their websites cost recovery budgets in Excel formats.

One issue of concern is how government agencies will review cost recovery in the light of the new CRGs. Specifically, review of all existing and implemented cost recoveries by government entities for consistency with the final CRGs, and review of proposed cost recovery activities which have not yet been implemented but have gone through consultation processes.

The NFF strongly supports a review be undertaken of all existing and proposed cost recovery for consistency with the revised guidelines across individual agencies, and across government.

10. Conclusion

The NFF has welcomed the Department of Finance's Draft CRG. The NFF has made a number of observations that could improve the Draft CRG. In particular, cost recovery should be transparent, objectively verifiable, generally well understood, simple to calculate, and be stable over time. Moreover, government entities must avoid gold plating of services, regulatory gaming, avoid politicisation of cost recovery, and must deliver improved service standards.

As governments are monopoly service providers, there is a need for demonstrated cost savings through increased pressure on expenditure so as to overcome the lack of competitive forces that reduce the incentive for minimisation of cost of supply.

Where cost recovery is implemented, government entities should also be required to develop service standards that drive continual improvement for those who will be paying the costs of that service.

There is clearly a need to ensure that the cost recovery does not work at cross purposes to the intention of the function such as facilitating exports or increase regulatory compliance.

Finally, NFF is seeking a review of all current and proposed cost recovery arrangements to ensure consistency with the revised guidelines.