Ministry for Primary Industries
Manatū Ahu Matua

Developing a Cost Recovery Framework for the Ministry for Primary Industries

Discussion document

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New Zealand Government

Growing and Protecting New Zealand

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Executive Summary

The Ministry for Primary Industries (MPI) is one of many government agencies that recovers costs for some of the services we provide. Cost recovery makes up more than a third of MPI's total funding. Those that pay for services should have confidence in the way in which charges are set, how those charges are implemented, and the way cost recovery is managed.

MPI is currently undertaking a First Principles Review (the review) of the way it recovers costs. The review seeks to, among other things, ensure a strong and consistent foundation for the way we charge. Development of a guiding framework is the first step.

This document sets out the objectives, principles, policies and processes that make up MPI's proposed charging framework. A summary is provided on the following page. MPI is seeking submissions from interested parties on the content in this document.

In developing this document, MPI has worked to align its approach with the Treasury and Office of the Auditor-General Guidelines, as well as ensuring consistency with existing legislative requirements for cost recovery.

Once finalised, the framework will be used to inform a detailed review of MPI's existing charges. In addition, MPI is undertaking work to:

- Improve information related to costs and service performance, and establish routine reporting of cost recovery information to key stakeholders.
- Assess whether legislative amendment is needed to align cost recovery requirements across legislation we are responsible for, or to improve how cost recovery works in specific areas.

At this stage, MPI plans to develop proposals for changes to existing charges before the end of 2016 for subsequent consultation. This will enable Ministers to consider implementation of high priority improvements for 1 July 2017.

Table 1: Summary of the proposed cost recovery framework

OBJECTIVES /PRINCIPLES	**Cost recovery should seek to:** • Recover costs in a way that ensures MPI can continue to provide services essential to growing and protecting New Zealand and meet regulatory objectives. • Ensure those who use services which enable commercial or private benefits pay for the services that deliver those benefits. • Encourage those that undertake certain activities to take responsibility for managing risks to public health, biosecurity, or the sustainability of New Zealand's primary resources by ensuring they pay for the costs of managing those risks. • Encourage service efficiency and minimise transaction costs for service users and stakeholders wherever possible.
	Guiding principles: • Equity, efficiency, justifiability, transparency.

DEVELOPING POLICY	**Consider who should be charged:**
	• In general, charge the individual that uses or most directly benefits from the service provided, or whose actions or inactions most directly create the risk that the service is designed to manage.
	• If that is not practical or efficient, charge the group that uses or most directly benefits from the service provided, or whose actions or inactions most directly create the risk that the service is designed to manage.
	• If that is not practical or efficient, the only feasible option is likely to be general taxation.
	• Where there is both a beneficiary and a risk exacerbator[1] that could be charged, consider which party is best positioned to take steps to influence the long term supply of the service either by using the service less, or by taking steps to reduce the risks they create.
	• Exceptions may be justified where charging would:
	    o Result in negative or perverse incentives.
	    o Be inconsistent with international obligations.
	    o Be administratively inefficient.
	    o Be inconsistent with government policy.
	    o Have a significant negative effect on market viability.

	Consider which costs should be recovered: • In general, charge the full costs of the service; direct costs (both fixed and variable) and indirect costs (operational and corporate support costs, and capital related costs). • In general, recover capital costs (e.g. buildings, vehicles, plant and equipment) through depreciation and capital charges.
	Consider how charges should be designed: • Use fixed fees where an individual's level of use can be identified and there is little variation in the cost between users. • Use combined charges (e.g. a fixed fee plus an hourly rate) where mostly there is little variation, but there are sometimes exceptional cases. • Charge actual costs (e.g. hourly rates) where each individual's level of use can be identified but costs vary significantly each time. • Use levies where each the individual's level of use, or costs associated with that use, cannot be easily identified.

MANAGEMENT PROCESSES	**Consider how frequently to review:**
	• Aim for a minimum of three yearly review, but consider:
	    o Status of memorandum accounts.
	    o How much the population of service users is likely to change.
	    o How much the demand for the service (and other cost drivers) changes.

	Consider how to involve stakeholders:
	• Consultation should be meaningful, and stakeholders provided with adequate information to ensure they understand:
	    o The principled basis for charges.
	    o The forecast of actual costs of service delivery, including any historic under or over recovery.
	    o Relationship between costs, volumes of outputs and, where appropriate, quality standards of MPI services.
	    o The rationale for how charges have been designed, including whether charges represent average or actual costs.
	• Stakeholders should have an opportunity to input into the future planning for services. Where regulatory services are designed to manage risks and ensure compliance, care must be taken to avoid conflicts of interest.
	• Regular information should be provided to stakeholders about service costs and performance and a balance must be found between the level and frequency of reporting and the associated administrative costs.

[1] A beneficiary is a person who receives benefits from MPI services. A risk exacerbator is a person whose actions or inactions create risks that MPI services are designed to manage.

1 Introduction

1.1 CONTEXT

The Ministry for Primary Industries' purpose is "Growing and Protecting New Zealand". Our focus is enabling the primary sector to double the value of its exports by 2025, while protecting New Zealand's international reputation for biosecurity, food safety and sustainable use of natural resources.

MPI provides a range of services designed to grow and protect New Zealand including:

- Negotiating market access and facilitating trade for our primary industries.
- Ensuring food is safe for consumption.
- Ensuring the humane treatment of animals.
- Managing biosecurity risks to people, environment and industries.
- Overall management of the pest management system in New Zealand.
- Ensuring the sustainability of New Zealand's primary resources.

MPI is one of many government agencies that recovers costs for some of the services it provides. The total cost of all MPI services was $416 million in 2014/15. In 2015/16 cost recovery is forecast to exceed $150m. While this amount is in the context of total primary sector exports of $37.6 billion[2], it is a significant cost for industry and a large part of MPI's business. It is important that stakeholders have confidence in the way charges are determined and how funding is managed and reported.

In 2014/15 MPI completed a wide ranging review of biosecurity and food safety charges. This was the first cost recovery review since the formation of MPI[3] and resulted in updates to more than 254 charges. In undertaking that work, it became clear that there were still opportunities to improve our charging practices so that they work better for our customers and stakeholders.

In September 2015, MPI initiated a First Principles Review of cost recovery arrangements to achieve the following objectives:

- Provide a clear description of the principles and policy considerations that will guide MPI's approach to cost recovery and how they will be applied.
- Ensure that MPI's approach is aligned with available best practice guidance issued by the Treasury and the Office of the Auditor-General and consider approaches taken by other government agencies.
- Improve transparency of the basis for determining where fees, charges and levies will be imposed and the levels at which they will be set.
- Enable greater harmonisation of arrangements across all of the Ministry's cost recovery activities, where appropriate.
- Improve communication, collaboration and certainty for stakeholders on the frequency, timing and process for reviewing and updating fees, charges and levies.
- Enhance transparency of costs and service performance for stakeholders.

The review is progressing in two phases. The first phase aims to establish a framework to guide MPI's approach to setting and reviewing charges and encourage greater consistency.

[2] Expected revenue in the year ending June 2016 (of which 36% is dairy, 26% meat and wool, 14% forestry, 5% seafood, and 13% horticulture). From the Situation and Outlook for Primary Industries 2015 December update.
[3] The Ministry for Primary Industries (the Ministry or MPI) was formed on 1 July 2011 from the mergers of the Ministry of Agriculture and Forestry (including Biosecurity New Zealand), Ministry of Fisheries and the New Zealand Food Safety Authority.

The second phase of work will comprise a detailed review of existing MPI's charges to identify areas where we can better align with the framework.

This discussion document sets out the objectives, principles, policies and processes that make up MPI's proposed charging framework. MPI is seeking submissions from interested parties on the content in this document. We will use this feedback to inform our approach to the detailed review we will undertake over the remainder of 2016.

The final framework will also be a resource to assist in policy development, support compliance with our legislative requirements, and supplement guidance available elsewhere.

1.2 HOW TO MAKE A SUBMISSION ON THIS DOCUMENT

MPI seeks feedback on the content in this document. Key points are summarised in blue boxes at the end of each section, and submitters are asked to particularly consider the 25 questions set out in the summaries. Please include these question numbers as references in your submissions.

MPI encourages respondents to forward comments electronically, and will accept emailed submissions until 5pm on Thursday 21 July 2016. Please send your submissions to: costrecovery@mpi.govt.nz.

Please include the following in your submission:

- The title of the consultation document in the subject line of your email (in this case *Developing a cost recovery framework for MPI*).
- Your name and title (if applicable).
- Your organisation's name (if you are submitting on behalf of an organisation), and whether your submission represents the whole organisation or a section of it.
- Contact details (phone number, address and email).

Should you wish to forward submissions in hard copy, please send to the following address to arrive by close of business on Thursday 21 July 2016.

Cost Recovery Team
Ministry for Primary Industries
PO Box 2526
Wellington 6140
New Zealand.

1.2.1 Submissions and the Official Information Act

Please note that your submission is official information and it is MPI policy to publish submissions and the review of submissions on the MPI website. Submissions may also be the subject of requests for information under the Official Information Act 1982 (OIA). The OIA specifies that information is to be made available to requesters unless there are sufficient grounds for withholding it, as set out in the OIA. Submitters may wish to indicate grounds for withholding specific information contained in their submission, such as the information is commercially sensitive or they wish personal information to be withheld. Any decision to withhold information requested under the OIA is reviewable by the Ombudsman.

1.2.2 Next steps

All submissions received within the timeframes will be considered and used to inform the final policy and detailed review that will be carried out over the remainder of 2016. MPI aims to propose changes for consultation before the end of 2016, so that initial changes could be implemented from 1 July 2017.

2 Scope

The policies set out in this document are intended to apply to all of MPI's charging activities including services which are non-regulated. The range and diversity of services we provide and sectors we work with means we are not able to use a 'one size fits all' approach to setting charges. MPI does not intend to define rules that all charging activities conform to. Instead we want a framework that brings together elements of available guidance and good practice to identify issues that need to be thought through, and describe how MPI might weigh up the trade-offs. A principle-based approach is important to this.

To illustrate the application of principles, this document includes discussion of key aspects of the policy design of charges. It also sets out the minimum processes we think will support good management of the cost recovery system, including how to engage stakeholders through the process.

This document is set out according to the key elements of the framework, as described below. The colour key in the column on the right will assist with navigating the document.

Table 2: Navigating the document

Relevant part of the document		Elements of the framework	
Part 3 – Objectives and principles	Section 3.1	Objectives of cost recovery	
	Section 3.2	Guiding principles	
Part 4 – Developing policy	Section 4.1	Who should be charged?	
	Section 4.2	Which costs should be recovered?	
	Section 4.3	How should charges be designed?	
Part 5 – Management processes	Section 5.1	Managing changes in costs and revenue	
	Section 5.2	Planning and reporting	

This document does not discuss different service delivery options such as outsourcing or devolving service provision to other entities. New Zealand Treasury's Guidelines for Setting Charges in the Public Sector 2002 (Treasury Guidelines), state that this is an important step before analysis of options for user charges.

We agree this is an important part of policy development and service design. This document, however starts from the assumption that MPI will, or is already, providing services and focusses on the different considerations in designing charges for those services.

2.1 RELATIONSHIP WITH LEGISLATION AND OTHER GUIDANCE

In developing the policies set out in this document, MPI met with a range of government agencies and regulators to understand their approaches and practices for setting charges.

We have drawn heavily on the Treasury guidelines, and the Good Practice Guide issued by the Office of the Auditor General: Charging Fees for Public Sector Goods and Services 2008 (OAG guidelines). We also reviewed previous cost recovery policies developed by the New Zealand Food Safety Authority and the Ministry of Agriculture and Forestry, and other guidance, including in other jurisdictions[4]. The framework we propose builds on the guidance available and applies it to MPI's current context.

We paid particular attention to the cost recovery requirements already set out in the range of legislation that MPI administers. We are satisfied that the approach set out in this document supports compliance with these requirements. While there is some variation of cost recovery requirements in the legislation, we think they all operate toward the same fundamental principles. In some areas we have highlighted additional, but not conflicting, considerations. Nonetheless, if improvements are progressed, care will be taken to ensure consistency with existing legislative requirements.

As we progress the second stage of this work (the detailed review) we will also assess whether change to primary legislation is needed to support better practice, or to enable more consistency. If so, this could have implications for the scope and timing of changes to fee and levy regulations. We will consider this when we make our recommendations about which changes to progress for 1 July 2017.

[4] In particular the 2014 Productivity Commission report on Regulatory Institutions and Practices, the Australian Government Charging Framework and Cost Recovery guidelines, and the OECD Report on user charging for Government Services.

3 Objectives and principles

3.1 THE OBJECTIVES OF COST RECOVERY

3.1.1 Why recover costs?

Where individuals or industry groups get specific benefits from government services, cost recovery is likely to be more equitable than taxpayer funding.

Cost recovery can also improve the efficiency of resources[5]:

- Encouraging users of regulated services to adjust their use of services in line with their willingness to pay for them, or take steps to reduce the risks they create.
- Providing regulators with information about the level of demand for different services.
- Providing better information to industry about the costs of services.
- Enabling expenditure and service performance to be scrutinised, which may encourage greater efficiency.

Treasury guidelines also set out a number of objectives that user charges should seek to achieve. These are provided in appendix 6.1 to this document.

In most cases, MPI legislation requires the Minister and/or the Director-General to take steps to ensure that the costs of administering the Act are recovered.

Having reviewed the Treasury and OAG guidance, and working through the matters outlined in this document, we consider that objectives MPI should seek to meet by recovering costs are to:

- Recover costs in a way that ensures MPI can continue to provide services essential to growing and protecting New Zealand and meet regulatory objectives.
- Ensure those who use services which enable commercial or private benefits pay for the services that deliver those benefits.
- Encourage those that undertake certain activities to take responsibility for managing risks to public health, biosecurity, or the sustainability of New Zealand's primary resources by ensuring they pay for the costs of managing those risks.
- Encourage service efficiency and minimise transaction costs for service users and stakeholders wherever possible.

Cost recovery also needs to take account of wider government objectives and of competition issues. These objectives are in line with the objectives for user charges set out in Treasury guidelines and broadly consistent with objectives of user charges in other jurisdictions.[6]

[5] Summarised from Regulatory Institutions and Practices 2014 (p332), New Zealand Productivity Commission and the Australian Government Cost Recovery Guidelines July 2014 (p1), Australian Government Department of Finance.
[6] Refer to survey of cost recovery objectives in the United Kingdom, Australia, Canada and the OECD guidance in Regulatory Institutions and Practices 2014 (p339), New Zealand Productivity Commission.

3.2 GUIDING PRINCIPLES

Guiding principles help us to weigh a range of different considerations against the objectives of cost recovery, while providing flexibility to take into account the different characteristics and needs of the industries we work with and the services we provide.

3.2.1 Commonly used principles

Equity and efficiency principles are central to cost recovery. They are well established ‘first principles’[7] and underpin the proposed objectives set out in the previous section. OAG guidelines also refer to principles of authority and accountability[8].

Much of MPI’s legislation requires consideration of equity and efficiency. Justifiability, transparency and the inclusion of specified criteria related to consultation are also common. We think these are closely related to accountability. Ease of administration and flexibility are also features of the National Animal Identification and Tracing Act 2012.

Cost recovery principles in the Fisheries Act 1996 are different in that they outline the circumstances which determine which costs can be recovered and who should pay. Even so, equity and efficiency are key underpinning considerations as the Act seeks to assign costs to those that use or benefit from services, or create risks.

This document focuses on the application of the principles of **equity, efficiency, justifiability and transparency** as they are common features of legislation MPI administers and a range of available guidance.

These principles are defined in appendix 6.2. Definitions take into account relevant legislation as well as other available guidance.

While there is a range of other concepts referenced as principles in other cost recovery guidance and in the Acts that MPI administers, we have generally found these concepts to be aspects of efficiency, equity or accountability or more related to the achievement of the objectives of cost recovery (e.g. policy consistency or effectiveness).

We also consider that having appropriate authority is a fundamental consideration for setting charges. Authority is not discussed extensively in this document as we consider it a core requirement of cost recovery, rather than something to be weighed against objectives.

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[7] First principles are those that are fundamental, rather than an aspect of another concept.

[8] While authority and accountability are not first principles, they are two key aspects of legitimacy which could be considered a first principle.

Table 3: Existing cost recovery principles specified within some legislation that MPI administers

	Equity	Efficiency	Justifiability	Transparency	Ease of administration	Flexibility
Agricultural Compounds and Veterinary Medicines Act 1997	√	√	√	√		
Animal Products Act 1999	√	√	√	√		
Animal Welfare Act 1999	√	√	√	√		
Biosecurity Act 1993	√	√				
Food Act 2014	√	√	√	√		
Forests Act 1949	√	√	√	√		
Wine Act 2003	√	√	√	√		
National Animal Identification and Tracing Act 2012	√	√	√	√	√	√

Section 262 of the Fisheries Act 1996 - Cost recovery principles

(a) If a conservation service or fisheries service is provided at the request of an identifiable person, that person must pay a fee for the service

(b) Costs of conservation services or fisheries services provided in the general public interest, rather than in the interest of an identifiable person or class of person, may not be recovered

(c) Costs of conservation services or fisheries services provided to manage or administer the harvesting or farming of fisheries resources must, so far as practicable, be attributed to the persons who benefit from harvesting or farming the resources

(ca) Costs of fisheries services relating to any observer performing or exercising a function, duty or power in accordance with the observer programme must, so far as practicable, be attributed to the person who benefits from those services

(d) Costs of conservation services or fisheries services provided to avoid, remedy or mitigate a risk to, or an adverse effect on, the aquatic environment or the biological diversity of the aquatic environment must, so far as practicable, be attributed to the persons who caused the risk or adverse effect; and

(e) The Crown may not recover under Part 14 the costs of services provided by an approved service delivery organisation under Part 15A.

Key points from sections 3.1 and 3.2

- Cost recovery is an appropriate way to fund services that MPI provides.
- Objectives of cost recovery proposed for MPI are to:
    - Recover costs in a way that ensures MPI can continue to provide services essential to growing and protecting New Zealand and meet regulatory objectives.
    - Ensure those who use services which enable commercial or private benefits pay for the services that deliver those benefits.
    - Encourage those that undertake certain activities to take responsibility for managing risks to public health, biosecurity, or the sustainability of New Zealand's primary resources by ensuring they pay for the costs of managing those risks.
    - Encourage service efficiency and minimise transaction costs for service users and stakeholders wherever possible.
- These objectives are well aligned to those set out by the Treasury and other jurisdictions.
- It is proposed principles of equity, efficiency, justifiability and transparency should underpin charging decisions as they are common features of legislation MPI administers and a range of available guidance.

Questions for submitters

1. Do you agree with the objectives of cost recovery as set out in this section? If not, why not?
2. Do you agree that equity, efficiency, transparency and justifiability are the principles that should guide MPI's approach to cost recovery? If not, why not?
3. Should MPI consider any other principles when considering cost recovery?
4. Do you see value in having a common set of principles which apply generally to all of MPI's cost recovery activities?
5. Are there areas that should be treated differently? If so why?

4 Developing policy

4.1 WHO SHOULD BE CHARGED?

This section looks at how MPI determines who should be charged for services; service users, industry groups or the taxpayer (through general taxation, sometimes referred to as *Crown funding*).

Treasury guidance emphasises that understanding the outputs and outcomes of services (both in terms of benefits and risks) is the first step when deciding who to charge. This assists in identifying possible candidates. Who is best to charge involves weighing up equity and efficiency considerations.

4.1.1 Charging beneficiaries

Potential candidates for charging may be those that receive benefits from MPI services. Identifying which beneficiaries to charge however, is not always straight-forward.

In economic terms, services are **private goods** when it is possible to exclude certain people from receiving those benefits (excludable), or where benefits received by one person mean another person cannot get that specific benefit (rival). Issuing an Export Certificate is a service that has private good characteristics. The certificate is provided to an individual exporter who will receive direct commercial benefits from being able to export goods. No other group or individual is able to benefit from using that particular certificate.

Services are **club goods** when benefits are excludable (limited to the members of the club) but non-rival (one member receiving benefits does not prevent another from doing so as well). Fisheries stock assessment to set catch limits may be a service that has club good characteristics; only those who catch fish from that stock receive the benefits of those catch limits but one person benefiting does not prevent another from benefiting as well.

A **public good**[9] service is one where excluding people from its benefits is either difficult or costly and its use by one person does not mean another person can't also use it. Treasury guidance notes that in practice, pure public goods are rare. MPI services such as developing policy advice have more public good characteristics.

Most (if not all) services that MPI provides have some wider public benefit. However public benefits are often indirect, tend to be less tangible, and much more difficult to quantify. Wider public benefits will often be additional to some specific benefits the user receives.

We think it will usually be more equitable for those receiving **direct** benefits to pay for the services rather than the taxpayer. This approach may also encourage people to use the service only when benefits outweigh costs.

Table 4 on the next page outlines the efficiency and equity considerations in charging for different types of services.

[9] There are two other types of goods sometimes referred to:

- Common goods are not excludable, but are rival. These types of good are not discussed here as MPI services don't tend to exhibit these characteristics. In our view they tend towards the same charging options as public goods.
- Merit goods create spill-over or external benefits for others, but are likely to be under-consumed if charged for at full cost. In some circumstances government may choose to fund these types of goods to encourage consumption because of the external benefit they create. Services provided under MPI's legislation tend not to exhibit merit good characteristics.

Table 4: Efficiency and equity considerations when determining who to charge

Type of good	Efficiency and Equity considerations
Private good	• Charges directed at the individual service user are likely to be administratively efficient because a clear link can be drawn between the user and the benefit they receive. • Incentivises people to use the service only when its benefits outweigh the costs (allocative efficiency). • More equitable to charge the direct beneficiary vs the taxpayer.
Club good	• Charges directed at the club are likely to be administratively efficient because it is generally not possible to identify individual members or determine how much each benefits. • Most equitable to charge the group of direct beneficiaries vs the taxpayer.
Public good	• Charges directed at an individual or club who benefits would not be equitable because everyone receives direct benefits.

4.1.2 Charging risk exacerbators

Treasury guidance defines risk exacerbators as those (individuals or groups) whose actions or inactions have negative effects which regulatory services are designed to manage or mitigate. In most cases, charging risk exacerbators will be more equitable than taxpayer funding as they create the need for the service. Charging may also be efficient as it can create incentives for the risk exacerbator to take actions to limit the risk.

4.1.3 Dealing with more than one beneficiary or risk exacerbator

Some services delivered by MPI have more than one group of direct beneficiaries or more than one group of risk exacerbators. In other cases there may be both beneficiaries and risk exacerbators.

The key consideration here, is whether it is practical and efficient for costs to be shared between the groups. This will generally involve estimating the proportion of benefit each party receives, or how much each party contributes to the risk. In most cases this will present practical problems. Similarly, where there are both beneficiaries and risk exacerbators, it may not be practical to divide the costs between them.

In these situations deciding who to charge may come down to:

- Which party is easiest and least expensive to charge (administrative efficiency).
- Which party is best positioned to take steps to influence the long term supply of the service either by using the service less, or by taking steps to reduce the risks they create (allocative efficiency).

There are some situations where cost sharing does happen between MPI and industry, but this tends to be for practical or efficiency reasons, rather than a reflection of public benefit. Cost sharing is discussed in more detail in the next section of this document.

4.1.4 Charging related parties

In some situations it may be more efficient to charge a related party. If many direct beneficiaries use the services of a single company, it could be more efficient to charge that company rather than each beneficiary separately. However, it is only equitable to charge related parties to the extent that there are ways for the person charged to pass on costs to the direct beneficiaries or risk exacerbators.

Summary of the funding policy:

While there is often wider public benefit from MPI services, MPI considers it appropriate to charge direct beneficiaries and risk exacerbators for services they receive.

Individual beneficiaries or risk exacerbators should be charged where it is practical and efficient to do so. If that is not practical or efficient then groups of beneficiaries or risk exacerbators should be charged. If that is not practical and efficient then taxpayer funding is likely to be the only feasible option.

Where there are both beneficiaries and risk exacerbators, deciding who to charge involves assessing which party is more likely to influence the level of service provided in the long term, either by using the service less, or by taking steps to reduce the risks they create.

4.1.5 Exceptions

The policy set out above should apply to all MPI services, but there may be situations that justify an exception. Exceptions could be from all charges or just part. In these situations, seeking funding from the Crown is likely to be the only alternative, which means that there must be compelling rationale and evidence. Reasons that may justify departure from the policy are set out in Table 5 below. These reasons are not conclusive, but are situations where additional factors may need to be considered.

Table 5: Situations where exceptions to cost recovery may be justified

Reason	Description
It would result in negative or perverse incentives	For instance, charging suppliers for food recalls could deter them from reporting food safety problems.
It would be inconsistent with international obligations	For instance, if cost recovery would be in breach of international trade agreements.
It would be administratively inefficient	The costs of collection exceed the costs to be recovered.
It would be inconsistent with government policy	Government policy over-rides the need to recover costs of a service.
It would have a significant negative effect on market viability	If cost recovery has a significant negative effect on market participation, innovation or competition, there may be a case for partial or temporary reduction in charges.

4.1.6 Application of the funding policy to MPI services

The table on the following page illustrates some examples of the types of services MPI provides and applies the policy set out in this section. In general, we think MPI recovers for the right types of services. More detailed examination will be carried out in phase 2 of the review.

Charging for compliance activities

Compliance is an area where there tends to be debate around whether charges should be applied, and how much should be charged.

We think the types of work MPI does to ensure compliance with regulatory requirements (monitoring, investigations and some enforcement activities) have club good characteristics.

There are direct benefits for an industry that operates in a well regulated market with high levels of compliance. These include competitive neutrality, reputational benefits and market access. Only those participating in the industry get these specific benefits, but they are available to all industry participants. Individuals and industries undertaking activities that present risks to biosecurity, food safety, animal welfare or the sustainability of natural resources are also risk exacerbators.

The policy set out in this document suggests it is more equitable that the industry pay than the taxpayer. Cost recovery may also contribute to incentives for industry to ensure their sector as a whole is compliant. Over the long term a more compliant sector could reduce the need for these activities and bring overall costs down.

There are wider public benefits when regulated sectors are compliant – high levels of public health and safety, sustainable resources and broad economic benefits from export growth. Whether the government chooses to bear some of the costs of compliance activities to reflect public benefit is a different matter, and discussed further in the next section of this document.

The approach taken by government agencies and regulators (here and in other jurisdictions) varies. The extent of cost recovery also varies across MPI activities. Reasons for this may be:

- The way we organise our services.
- Different regulatory objectives for each sector.
- The nature and extent of compliance activities.
- Characteristics of different sectors, including the extent to which there are commercial incentives that encourage compliance.
- The extent to which charging creates negative incentives, or creates a conflict with regulatory independence.
- The extent to which it is feasible or practical to charge.

These issues are not straightforward, and need to be considered on a case-by-case basis. Further work is intended to assess whether funding arrangements are appropriate. We seek submissions on reasons why charging for compliance activities may or may not be appropriate in your industry.

Table 6: Indicative application of the proposed funding policy to examples of MPI services

Service Category	Type of good	Individual can be charged efficiently?	Group can be charged efficiently?	Exceptions?	Who should be charged?
Policy and technical advice	Public	X	X		Public/taxpayer
Maintaining international relationships, contributing to international policy, negotiating free trade agreements	Public	X	X		Public/taxpayer
Administration and management of grants and programmes	Private	√	√	Charging funding applicants is inconsistent with the purpose of these activities	Public/taxpayer
Developing and maintaining export standards	Club	X	√		Club beneficiaries
Developing and maintaining import health standards	Club	X	√	May be inconsistent with international agreements or create perverse incentives (were NZ to charge, foreign governments may reciprocate to the detriment of NZ exporters)	Public/taxpayer
Development of overseas market access requirements and guidance	Club	X	√		Club beneficiaries
Fisheries and conservation research	Club	X	√	Where research is related to impacts of non - commercial fishing it is likely to be inefficient to charge	Club (both beneficiaries and exacerbators), but tax-payer funds on behalf of non-commercial fishers
Approvals, registrations, recognitions and listings	Private	√	-		Individual beneficiary
Official assurances and certification	Private	√	-		Individual beneficiary
Verification	Private	√	-		Individual beneficiary
Biosecurity screening and clearance activities	Club	√	√		Individual exacerbator
Compliance activities (including monitoring, investigations, and some enforcement activities)	Club	X	√		Club (both beneficiaries and exacerbators)
Readiness and Response activities	Club	X	√		Club beneficiaries[10]
Food recalls	Public	√	-	Charging may create incentives not to report	Public/taxpayer

[10] Biosecurity Response activities in particular is a situation where the Government has moved to ensure relevant industries contribute to funding. Discussed further in section 4.2.

Key points from section 4.1

- MPI services tend to have private good, club good or public good characteristics.
- While there is often wider public benefit from the services that MPI provides, MPI will generally charge direct beneficiaries and risk exacerbators for services they receive.
    - Individual beneficiaries or risk exacerbators should be charged where it is practical and efficient to do so.
    - Groups of beneficiaries or risk exacerbators should be charged where it is practical and efficient to do so.
    - If that is not practical and efficient then taxpayer funding is likely to be the only feasible option.
- There may be exceptions, but these need to be supported by strong rationale and evidence.
- There may be a case for charging for a wider range of compliance activities in all sectors as these services are generally club goods, but there are a range of factors that need to be considered on a case-by-case basis.

Questions for submitters:

6. Do you agree with the funding policy outlined? If not, why not?
7. Do you agree with our assessment of the economic characteristics of our services? If not, please provide details.
8. Do you support the exceptions that have been identified? Are there other exceptions that may be justified?
9. Do you support charging for compliance activities? If not, why not?

4.2 WHICH COSTS SHOULD BE RECOVERED?

Once it has been established who should be charged for services, we need to consider how much should be charged; i.e. whether all costs should be recovered, or only partly recovered. This section discussed the different types of approaches that could be taken.

Important considerations include:
- Whether the costs we recover from service users are commensurate with their use or benefit, or the risks they create.
- The extent to which the price of services influences decisions about when to use a service (or participate in a regulated market) and the level of service that will be provided in the long term.
- Whether reduced fees for service users and stakeholders are better for New Zealand than the alternative uses for taxpayer funding.
- The extent to which level of charges will help to drive down the costs of service delivery.

The principle of justifiability means we should, as much as possible, only charge the service user for the costs we incur in actually providing the service. The relationship between costs of the service and charges should also be transparent enough to enable scrutiny (particularly of indirect costs), and encourage incentives for improving service performance.

Where there is cost recovery, MPI considers that in the majority of cases **the full costs of service delivery should be recovered** from the direct beneficiary or risk exacerbator **including indirect costs.** Cost recovered services comprise a large portion of MPI’s business. These services could not be provided without incurring indirect costs.

4.2.1 Shared funding arrangements to reflect public benefit

It is sometimes argued that, because the wider public also receives some type of benefit from the delivery of a service, it is more equitable for costs to be shared by the public/taxpayer. In general, we do not think this is appropriate for two reasons:

1. In most cases the direct beneficiary or risk exacerbator will be able to pass on costs to other beneficiaries or parties that contribute to risk. For example; food producers are able to pass some of the costs for MPI’s charges on to consumers who also benefit. Shared funding arrangements are not required to ensure the consumer contributes to costs; and it is more equitable the consumer pays than the taxpayer.

2. Identifying and quantifying wider public benefits to assign costs is difficult and may be costly.

Wider public benefits will often be additional to specific benefits for the user(s). Treasury guidelines note that many goods supplied under market conditions and charged at full cost provide some element of wider public benefit. For example, gardening and landscaping services enhance the value of a house, and also help the value of neighbours' homes, although this is not reflected in the price paid.

There are some shared funding arrangements with industry. One example where costs are shared is stock assessment research for fisheries. This research is necessary to inform management of risks created by both commercial fishers and non-commercial fishers. The Fisheries (Cost Recovery) Rules 2001 set out the proportion which industry will pay, and the remaining costs are funded by MPI.

This is a situation where MPI funds on behalf of the party that cannot be charged. In this case it is possible to identify the existence of two groups of risk exacerbators, but it is not possible to efficiently charge them both. The members of one group (commercial fishers) can be identified and charged, but the members of the other group may not be distinguishable from the general public.

The Government Industry Agreement (GIA) for Biosecurity Readiness and Response activities is another example where MPI contributes funding on behalf of risk exacerbators and beneficiaries that cannot be identified or efficiently charged. In this situation, however there is some public benefit explicitly recognised and factored into the cost sharing arrangement. This is pursuant to specific agreements negotiated between government and industry. This is appropriate because of the significance of costs and benefits involved, but wouldn't be a practical option for most of MPI's charges.

4.2.2 Partial recovery to reduce compliance costs

All businesses face costs of compliance when participating in regulated markets. The level of charges can also impact on the ability of businesses to comply with market entry and ongoing participation requirements. Where there is a significant adverse impact on the effective operation of markets, the government may choose to reduce costs by reducing charges or other means.

This will need to be assessed on a case by case basis and underlines the importance of good quality regulatory impact analysis when developing charges. The analysis should assess whether a departure from a prima facie case for charging is justified (see section 4.1.6) or whether is desirable to phase in cost recovery in order to manage implementation issues, or impacts for service users.

4.2.3 Other costing approaches

There are other approaches to the recovery of full costs which may be appropriate in certain circumstances. These are described in table 7 on the following page.

Table 7: Other approaches to cost recovery

Approach	Equity and efficiency considerations
Charging at more than full cost – Charging higher fees or levies in order to generate a surplus or to enable future investment.	OAG guidelines state that government agencies are limited to recovering only the costs of providing the goods or services unless expressly authorised by statute. Recovering more than full costs would be viewed as a tax; and Parliament's explicit approval is required to impose a tax. Treasury guidance states that charging at more than full costs may be justified to enable recovery of capital expenditure as it is incurred, rather than over the life of the asset (through depreciation charges). However, this may result in inequitable treatment of current service users (who have paid for the asset) and future users (who have not paid for it).
Short-run marginal cost charging – Charging only the cost to the MPI of providing slightly more of a service. In practice this means charging only the variable costs but not any fixed costs or other overheads.	Short-run marginal cost charging can help support efficiency by promoting customers to make more efficient decisions about how much of the service to use. Charging only short-run costs however, will mean that MPI under recovers for the services it delivers. Long term under recovery may have impacts on service sustainability or performance.
Incremental cost charging – Similar to short-run marginal cost charging, relates to minor activities that are incidental to core service delivery.	Whether or not these services should attract overheads, or be charged for at all, will depend on how much resource is required to deliver them. While small in isolation, together these outputs can consume significant resource and not charging for those costs can result in shortfall, or cross-subsidy (where resources assigned to one service are used to perform other outputs) and have performance impacts.
Charging based on averaged costs – Standardising costs for all service users or over a particular time period to address variation in costs (e.g. related to the region or time of day in which the service is delivered). *(Also a factor when considering the design of charges – discussed in section 4.4)*	This needs to be considered on a case-by-case basis because equity considerations are complex – on one hand average costs means some degree of cross-subsidisation is inevitable. Some pay more than the actual cost of delivery, others pay less. On the other hand, average costs may be more in line with the benefits that all service users receive or the risks they create. How much the costs vary is an important consideration; the greater the degree of variation, the less equitable average cost charging may be. Charging average costs over time can smooth fluctuations in costs and when combined with memorandum accounts can be useful for managing both the impact of fee adjustments for service users and inequities where costs or service users vary significantly over time.
Charging only efficient costs – This approach can be combined with those outlined above, but seeks to recover only to the extent these would have been incurred by an efficient operator.	This approach is challenging both because it is sometimes difficult to agree what efficient costs are and because there is a risk of under recovery and/or impacts on service quality. It can be difficult to fully anticipate how much it will take to deliver a service especially where demand fluctuates – deviations between efficient costs and actual costs could arise even where services are delivered as efficiently as possible.

4.2.4 Transparency of costs

MPI's costs in delivering services can be broken into two categories:

- **Direct costs** are the costs directly tied to providing a service. Direct costs include fixed or support costs that are incurred, such as service specific equipment or vehicle costs, or the management time associated with the delivery of a service, as well as variable costs such as staff time involved in providing the service.

- **Indirect costs** are not directly tied to the service provision but are required in order for MPI as a whole to function effectively. Examples are business technology and information services, finance and corporate legal functions. Depreciation and capital charges (capital costs) are also included.

Establishing a clear relationship between indirect costs and services is more difficult, and transparency of how we allocate these costs is important to ensure that costs are reasonable and justified. Treasury guidance recommends that departments should take steps to demonstrate their reasonableness (for example, through external verification).

MPI commissioned an external review of its overhead cost allocation model from Deloitte in 2014, which found that the methodology and how it has been applied in practice was appropriate and unlikely to lead to any material misallocation of cost.

In some areas, the current approach to attributing costs relies on assessed effort estimates (i.e. an estimate of the effort spent on particular services). MPI is implementing an improved organisation-wide time recording system which will provide more robust information for budgeting and future fee reviews.

Work that is being carried out as part of the second phase of this review includes collation of improved data to support:

- Clearer line of sight between activities, services and costs.
- Improved analysis of cost drivers (volume data and other information that assists in developing a picture of how costs are changing over time).
- Service performance data to improve understanding of cost/time and quality relationships.
- Information (strategies and plans) that supports understanding of likely service pressures or changes to inform better forecasts.

We also intend to develop a consistent reporting framework for stakeholders to facilitate transparency and encourage dialogue about overall service performance. This is discussed further in section 4.5.

Key points from section 4.2

- Where there is cost recovery MPI will generally seek to recover the full costs of providing a service, including indirect costs.
- Wider public benefits would have to be significant to justify shared cost arrangements.
- Even then it may still be more efficient and equitable to charge direct beneficiaries or exacerbators where they can pass costs on to other beneficiaries or risk exacerbators.
- MPI is undertaking further work in phase 2 of the review to improve transparency of costs and encourage dialogue about opportunities to improve service performance.

Questions for submitters:

10. Do you agree with the costing policy outlined? If not, why not?
11. Are there approaches we have not considered? If so, what are they?
12. Are there efficiency or equity considerations we have not described? If so, please describe.

4.3 HOW SHOULD CHARGES BE DESIGNED?

The design of charges can encourage improvement in the efficiency of our services, and should seek to minimise transaction costs for service users and stakeholders wherever possible. This section discusses a range of ways that services can be designed, and the merits of different approaches. Key considerations are:

- Which party will pay if the service delivery is not efficient (the efficiency risk).
- Managing variation in costs between service users.
- Ensuring charges are simple, predictable charges and inexpensive to administer.
- Ensuring transparency.

4.3.1 Types of charges

Fees

Fees can be used where there is a relationship between the amount of use, or benefit from, a service and the costs of the service. The individual service user must be able to be identified.

The cost of delivering a service can vary based on how complex that service is (e.g. completing a verification audit for a small factory compared to a large factory). Costs can also vary because of other factors – such as the time of day the service is performed (e.g. after-hours), or by geographical location.

A central consideration in designing fees is whether we should charge each service user based on actual costs of delivering the service to them, or adopt fixed fees – so everyone pays the same.

Depending on the type of service provided, fixed fees may encourage more efficient services. MPI will try and ensure that, each time a service is delivered, it doesn't exceed the costs recovered by the fixed fee. On the other hand, charging actual costs (e.g. an hourly rate) can also encourage more efficient services because it motivates the service user to work with MPI to get the service done quickly (e.g. by making sure all relevant information is provided in an application form).

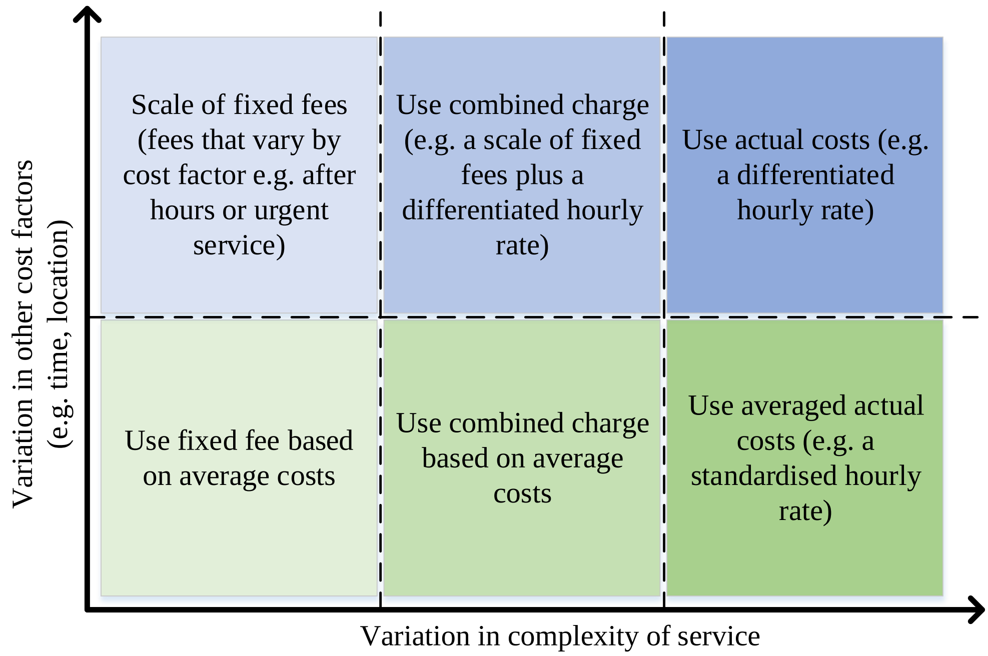
Table 8: Merits of using actual costs vs fixed fees

	Advantages	**Disadvantages**
Actual costs (e.g. hourly rates)	• Can help to manage peaks in demand as services may be used less when (or where) they are more expensive to deliver. • Could be considered more equitable and justifiable as each service user will be charged the true cost of the service.	• Generally more complex and can be more expensive to administer. • May not be seen as equitable as customers could be charged different rates for the same service. • Service user faces the efficiency risk.
Fixed fees (using averaged costs)	• Predictable for service users. • Simple and inexpensive to administer. • MPI faces the efficiency risk[11].	• May not reflect actual costs. • May not be seen as equitable as, depending on variability of costs, may involve some cross-subsidisation.

[11] Only to the extent that under-recoveries are foregone. Efficiency incentives may not be as strong when deficits can be recovered through future adjustments to charges.

Where costs vary it can sometimes be appropriate to use a scale of fixed charges (e.g. having a standard service fee and an after-hours fee or urgent processing fee) or a combined charge (a fixed fee for 90% of cases, but the ability to charge an hourly rate in the 10% of cases which take a significantly longer period of time).

These types of charges can provide the best of both approaches. The best choice will depend on the **significance and type** of cost variation, shown in the diagram below.



Levies

Unlike direct charges or fees, levies are used when it is difficult to establish a direct link between a particular customer and their potential or actual use of/benefit from the service[12]. Levies are generally calculated based on actual costs incurred by MPI in delivering the service but spread across all members of an industry or sector.

Where it is practical, the cost that is recovered from individual levy payers should reflect the level of resources used to provide the service, or the level of benefit received, or risk created by each levy payer. Selecting an appropriate method of distributing the levy is important to ensure the levy is spread equitably. There will be cases where it is not possible to do so and this may necessitate distributing the levy evenly among members of the group.

Compared with other types of charges, levies are less transparent as there is often not a clear link between the use of specific services and the levy payer. This means it is important to provide information on what activities are being funded using the levy.

[12] Or the level of risk, in the case of an exacerbator.

Two-part tariffs

This type of fee comprises two components[13]; a unit fee for 'use' of a service and a fixed 'entry fee' – charged to all users (regardless of their use). A common example of a two-part tariff is landline phone charges. Users are charged a fixed line rental fee, regardless of their telephone use, to cover the costs of the landline infrastructure. On top of this, users are charged for the calls they make.

One advantage of a two-part tariff is that it means the charge per service use (e.g. the charge for each phone call made) can be lower because the fixed costs are covered by the entry fee. Given this lower cost, service users might use more of the service.

These types of charges are more complex and are best suited for situations where:

- Fixed costs are significant.
- There is uncertainty about how much the service will be used.
- How responsive service demand is to the level of the charge.
- There are benefits from encouraging more frequent service use.

We are interested in submissions about whether any of MPI services may be good candidates for this type of charge.

Key points from section 4.3

- It will generally only be possible to charge fees where a clear relationship can be drawn between a service user and their use of the service.
- Fixed fees and combined charges can encourage MPI to improve efficiency, and provide more certainty to service users, but there may be equity trade-offs.
- Where levies are used, additional steps to ensure transparency of costs and their relationship to services should be taken.

Questions for submitters:

13. Do you agree with the analysis of the various charging options above? If not, why not?
14. Which types of charges do you favour and why?
15. How do you think cost variations should be dealt with - should all service users be charged an average cost, or in line with actual costs? Why?
16. Are there any services that MPI provides that you think would be particularly good candidates for a two-part tariff?

[13] This is different to a combined charge. A two-part tariff distinguishes between fixed and variable costs. Combined charges distinguish between variability of the services; e.g. charging a fixed fee most of the time, and an hourly rate in exceptional circumstances.

5 Management processes

This part of the document discusses the types of processes that we think are necessary to keep charges up to date, including how we work with service users and stakeholders, and improve service performance over time.

5.1 MANAGING CHANGES IN COSTS AND REVENUE

5.1.1 Encouraging service efficiency

Demand for services continues to increase, driven by increasing trade volumes as well as expansion of New Zealand's food industries. These factors all contribute to the complexity of MPI's operating environment. MPI continues to look for ways to keep operating costs down while continuing to improve services to respond to changes in demand and changing needs of service users.

In recent years, MPI has worked to:

- **Reduce corporate costs** - savings of $23.6m from the 2014 merger, of which $2.8m has been used to offset additional cost increases for industry.
- **Increase productivity** - monitoring and clearance of passengers, volumes of freight, mail and sea vessels has improved by approximately 15% over the period 2012/13 – 2015/16.
- **Invest in technology systems to improve the efficiency of services** - introduced the Joint Border Management System, expanded export e-certification and commenced development of an Integrated Electronic Monitoring and Reporting System to capture fishing data electronically on commercial fishing boats.
- **Make improvements to regulatory systems to lower compliance costs and make doing business easier** - in particular the new Food Act which takes a risk based approach to managing food safety by focussing on the processes of food production, and treats each business differently according to the level of food safety risk. Lower risk businesses will face lower compliance costs.

Work undertaken in the second phase of the review will support further improvements, by ensuring transparency of service costs and service performance. Appropriate use of benchmarking will also aid in fee reviews, to provide service users and stakeholders with information about current levels of efficiency. Reporting of information to stakeholders is discussed further in section 5.3.

5.1.2 Frequency of review

If we don't review charges frequently enough, there can be significant changes once charges are reviewed. This may have equity effects – some service users experience low charges in some years, others may experience much higher costs later. On the other hand, reviewing charges too often results in high administrative costs and can create uncertainty about the costs that services users may face, making it more difficult to plan effectively.

MPI's costs can vary from year-to-year. This could be due to changes in demand for services (e.g. biosecurity cargo and passenger clearance fluctuates annually and seasonally) or changes to the nature of services delivered each year (e.g. work programmes related to the development of export standards or fisheries research).

These fluctuations can be managed through the use of memorandum accounts[14] and well timed fee reviews.

As well as the balance in any memorandum account, relevant factors when considering the timing of fee reviews are the *stability of the service users* that is, how frequently players enter and exit markets (sometime referred to as churn) and the *stability of demand for the service*.

Table 9: Determining frequency of reviews

	High volatility of demand	**Low volatility of demand**
High churn of service users	Frequent reviews necessary. When deficits/surpluses arise these should be addressed as soon as possible.	Periodic reviews appropriate except where significant deficits/surpluses arise - these should be addressed as soon as possible.
Low churn of service users	Frequent reviews necessary. When deficits/surpluses arise they can be addressed quickly or over a longer period (smoothed).	Periodic reviews appropriate. When deficits/surpluses arise they can be addressed quickly or over a longer period (smoothed).

Where these factors are both stable, charges will not need to be reviewed often. However periodic reviews will always be necessary because of general cost changes (e.g. inflation). These changes can only be managed through reviews. Memorandum accounts can be used to smooth charges over time but on their own would not be effective for managing costs that are rising generally.

New Zealand's largest primary industry companies tend not to enter/exit markets frequently. These companies pay the most fees. There is more churn amongst MPI's smaller industry members.

In general we think three yearly reviews will be appropriate. Memorandum accounts can be used to manage year-on-year cost variation. This is because any fee adjustments will be borne mostly by the relatively stable group of large funders.

However, it will still be necessary to closely monitor memorandum accounts and levels of forecast expenditure against revenue to identify where a fee review may be required sooner. Reasons for early fee reviews may include:

- a significant unforeseen rise or drop in service volumes
- a known upcoming event (e.g. an industry re-structuring or re-negotiation of major contracts)
- new services being introduced and/or existing services being altered to reflect changes in government policy or customer need.

An example of more frequent review includes fisheries and conservation levies which are carried out annually. The basis for this may be that annual adjustments are made to the port price, catch limits, research programmes and observer coverage. These are important factors for apportioning levies across fish stocks.

[14] These are accounts that show whether charges are accurately recovering costs: over-recoveries increase the memorandum account balance while under-recoveries reduce it.

However, quota owners hold long term rights and there is limited quota trading at present, this may mean there is little change in industry members. There may be benefits in less frequent reviews. This could provide additional certainty in costs over a longer timeframe. We are particularly interested in submissions from the commercial fisheries industry on the advantages and disadvantages of a longer period between levy reviews.

As most of MPI's charges are set out in regulations, the process for making adjustments involves a number of steps and will generally take a minimum of six months, depending on the scope and/or scale of changes proposed.

There are situations where MPI has greater flexibility to make adjustments to fees; for example the Biosecurity (Systems Entry Levy) Order 2010 and the Biosecurity (Border Processing Levy) Order 2015 allow the Director-General to make adjustments to levies up to a specified maximum.

We are interested in submissions on how well this works for industry and if there are other areas where this type of flexibility could be explored.

5.1.3 Recovery of historic deficits and return of surpluses

Memorandum accounts are expected to track towards a zero balance over time. Memorandum accounts ensure that any deficits or surpluses are transparent to MPI and to industry and MPI will know when action is required to adjust charges.

The longer the period between a deficit being recorded and the fee adjustment intended to correct it, the greater the chance that the deficit will not be recovered from the customers that were originally under-charged (for example, due to companies entering/leaving an industry). On the other hand, the longer the time period over which MPI has to recover deficits, the more effectively adjustments can be smoothed or 'eased' in. The same applies to the return of any surplus.

There are sometimes time limits placed on the ability to recover deficits in MPI's memorandum accounts. When the time limit is exceeded the deficit becomes unrecoverable.

Every charging review should include a consideration of the current balance of the account and the changes necessary to neutralise the balance in the account. The time period over which a historic deficit can be recovered should be slightly longer than the charge review period (to allow time to collect any under-recovery through the revised charges).

These time limits vary in MPI legislation – between one and four years. As part of the second phase of the review; we will be assessing whether these provisions are practical and appropriate. We are interested in submissions on this issue now.

5.1.4 Consultation

For the most part, MPI legislation includes consultation requirements which require the Director-General to do everything reasonably practicable to consult with the persons or organisations likely to be substantially affected. The Director-General must also advise the Minister of the results of consultation.

The process for consultation should include adequate and appropriate notice, a reasonable opportunity for interested persons to make submissions and adequate and appropriate consideration of any such submissions.

To ensure consultation is meaningful, stakeholders should be provided with information to ensure they understand:

- The principled basis for charges and the level of cost recovery (the considerations set out in part 3 and 4 of this document).
- The forecast for actual costs of service delivery, including any historic under or over-recovery.
- The relationship between costs, volumes and service standards.
- The rationale for how charges have been designed; including whether charges represent average or actual costs.

MPI is also working to improve on-going engagement with stakeholders about cost recovery, through routine service planning and reporting activities, discussed in the next section.

Key points from section 5.1

- Key factors in considering the frequency of review are the status of memorandum accounts, the stability of the service users and the stability of demand for the service.
- Where possible, MPI will aim for periodic reviews at least every three years.
- Regulatory reviews are time consuming and can have high administrative costs, so mechanisms which enable more agile review processes may be worth exploring elsewhere.
- Rules around historic under recoveries need to be reviewed for effectiveness.

Questions

17. Are there other factors that should be considered when determining the frequency of review?
18. Are there charges you would like to see reviewed more or less frequently and why?
19. What information would you expect to see provided when charges are reviewed?
20. How can consultation processes be improved?

5.2 PLANNING AND REPORTING

Good strategic and operational planning underpins effective budgeting and forecasting which in turn supports more accuracy in setting of charges. Information from MPI's service users and stakeholders can assist MPI to understand likely changes in service demand and emerging risks that will have implications for how MPI prioritises its resources.

Service users should have input into planning or services where services are provided at the request of, or seek to provide a benefit to, specific individuals or groups. MPI engages with industry representatives routinely when developing standards, and developing forward work programmes and on issues affecting sectors as a whole.

It is sometimes less straightforward for service users to have input where services are designed to manage risks or ensure compliance with regulatory requirements. Conflicts of interest could potentially arise if a sector can influence the way those services are designed or delivered, or how resources are prioritised.

MPI must also ensure that work programmes and allocation of resources also consider Ministerial priorities and government objectives. Even where service users and other stakeholders provide input into service design and planning, decision-making remains the responsibility of MPI and Ministers as appropriate.

MPI currently reports financial and other non-financial information related to cost recovered services in a number of areas, although the nature, level and frequency of information provided varies.

As part of phase 2 of this review, it is intended to assess information provided to develop a more consistent approach. Routine reporting could include (at a minimum):

1. Financial performance (e.g. a description of budgeted and actual costs, forecast and actual revenue and variance explanations).
2. Actual and forecast volume/demand information.
3. Work programme progress (e.g. whether plans and projects are proceeding to timeframes and budget and variance explanations).

MPI reports publicly against Statement of Service Performance measures and other aspects of the work programme in our Annual Report. Ideally a common framework would form the basis of reporting on cost recovered services, but further work is required to determine whether this provides a useful basis for reporting to stakeholders. When considering what to report and how frequently reporting should occur, a balance will need to be found between stakeholders' desire for greater transparency, and the administrative burden (and associated costs) of reporting.

Once a reporting framework is agreed, MPI will need to ensure appropriate systems to capture and report information and this may take time. As part of the second phase of review, MPI will develop a proposal for a reporting famework for discussion with representatives of key industries. Your feedback on this document will be used to inform the development of this work.

Key points from section 5.2

- MPI sees benefit in engaging service users in service planning while avoiding real or perceived conflicts of interest.
- Prioritisation of resources must balance the views of stakeholders against Ministerial priorities and government objectives.
- Reporting of cost recovery information must balance the need for transparency with administrative costs.

Questions

21. How frequently do you meet with MPI staff and what is the nature of this engagement?
22. What types of matters are discussed?
23. How could the engagement be improved?
24. What types of information would you like MPI to report on?
25. How frequently should MPI report?

6 Appendices

6.1 TREASURY GUIDELINES OBJECTIVES FOR USER CHARGES

1. Encouraging decisions on the volume and standard of services demanded and supplied that are consistent with:
   i. the efficient allocation of resources generally, and also
   ii. the outcomes the government is seeking in providing the service.
2. Minimising the cost of supply over the short term, and over the long term when capital costs are significant.
3. Keeping transaction costs low, and evasion at acceptable levels.
4. Reducing reliance on funding from general taxation (with its associated costs)
5. Dealing equitably with the taxpayer, those who benefit from the service, and/or those whose actions give rise to it.
6. Looking for new ways to lower costs and find appropriate providers.

6.2 DEFINITIONS OF PRINCIPLES

This document focuses on the application of the principles of equity, efficiency, transparency and justifiability. These principles are defined below. Definitions take into account available guidance as well as relevant legislation.

Efficiency

Key dimensions of efficiency relevant to cost recovery decisions may be:

- Productive efficiency – concerned with maximising outputs at minimum costs.
- Allocative efficiency – concerned with encouraging users to make the best decisions about whether to use a service, and influence longer term supply.
- Dynamic efficiency – concerned with the improving productive efficiency over time.
- Administrative efficiency – this refers to the idea that charges should be easy to understand and implement, in order to minimise transaction costs for all parties.

Existing legislated definitions generally refer to a mix of productive and allocative efficiency; ensuring that maximum *benefits* are delivered at minimum cost.

Equity

In an economic context this is generally the fair distribution of resources or allocation of costs. The definition used commonly in relevant legislation is the idea that funding should be sourced from the users or beneficiaries of the relevant function, power, or service at a level commensurate with their use or benefit from the function, power, or service. Whether or not it is appropriate to recover the costs of a certain service will often come down to whether this is a more equitable option than taxpayer funding. This is discussed in more detail in part 4 of this document.

Discussion of equity can give rise to tensions. For example, when there is geographical cost variation or variations in cost associated with the type of customer. On one hand some may view it most equitable to charge all recipients of a service the same fee for the same service. On the other hand differential pricing may be most equitable because people pay in line with what it costs to deliver the service regardless of where or to whom it is delivered.

Transparency and justifiability

MPI is accountable to Parliament and the public. However, service users or other stakeholders that contribute funding to deliver services have a reasonable expectation of appropriate and justifiable charges, that funding is well managed and that services are effective.

Transparency, as defined by relevant legislation means costs should be identified and allocated as closely as practicable in relation to tangible service provision for the recovery period in which the service is provided. Transparency of costs along with the level of output delivered provide an ability for funders to scrutinise value for money.

Justifiability as defined by relevant legislation means costs should be collected only to meet the reasonable costs (including indirect costs) for the provision or exercise of the relevant function, power, or service.

Transparency and justifiability are also principles that should underpin the ongoing management of cost recovery; including the regular review of charges. Clear and predictable processes that involve meaningful consultation should involve the provision of adequate cost and service information to ensure that those impacted by charges can understand and have an opportunity to comment the basis on which charges are calculated and imposed.