

NEW ZEALAND BUSINESS ROUNDTABLE

Submission on the Domestic Food Review NZFSA Paper
*Principles and Possible Methods for a Cost Recovery
Framework*

February 2005

1. Introduction

- 1.1 This submission is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall New Zealand interests.
- 1.2 The New Zealand Food Safety Authority (NZFSA) has released five papers that are part of a review of the government's role in the domestic food sector. The fifth paper, *Principles and Possible Methods for a Cost Recovery Framework* (the Cost Recovery Paper), states that its purpose is to "propose principles and possible methods for a cost recovery framework for domestic food safety that will determine the funding of functions undertaken by the regulator or on its behalf and who will fund those functions" (p 5).
- 1.3 The NZBR's submission focuses on the Cost Recovery Paper. The NZBR has taken a close interest in the government's approach to cost recovery across a range of activities. Where services of a private good nature are involved, it supports user charging as long as there are sound reasons for government production of outputs and the charges are economically efficient. The NZBR is, however, concerned that some cost recovery charges are little more than discriminatory taxes imposed by government agencies to increase funding. Given the increasing scope of cost recovery across the government's activities, the NZBR believes that it is important for cost recovery to be based on sound principles.
- 1.4 This submission discusses the overall framework for cost recovery proposed in the Cost Recovery Paper before considering some more detailed issues raised in the Paper. Concluding comments are then provided.

2. Comment on Cost Recovery Paper

- 2.1 The NZBR is concerned that the efficiency, equity and other criteria and mechanisms proposed in the Cost Recovery Paper are too broad to guide the design of a sound cost recovery framework.
- 2.2 The NZBR strongly advocates using efficiency as the sole or primary criterion in determining the domestic food safety regulatory regime and the associated cost recovery regime. An efficiency criterion in the context of food safety is concerned with ensuring that the level of food safety and consumer protection desired by consumers is delivered at a minimum cost.
- 2.3 The preference for a single efficiency criterion does not mean that the NZBR believes that equity objectives are unimportant. Rather, it reflects the NZBR's view that equity objectives are better pursued through the government's tax and welfare system rather than through industry regulation.
- 2.4 Adoption of a single or primary criterion is essential to establishing a robust cost recovery regime. Conflicts can easily arise between different criteria and lead to different rules being adopted in similar circumstances. The use of multiple criteria can result in rules that change in inconsistent and unpredictable ways and may provide the regulatory agency with wide discretion to impose user charges in an arbitrary and unprincipled manner.
- 2.5 Given the scope for conflict between different criteria, the NZBR is concerned that the Cost Recovery Paper proposes four principles that should be used for determining cost recovery: equity (users or beneficiaries should usually pay), efficiency (maximum benefits delivered at minimum cost), justifiability (costs should be reasonable and justifiable), and transparency (cost should be identified and allocated in a transparent manner). The last two principles appear to be aimed at constraining the regulator's costs, preventing the recovery of non-related costs and facilitating monitoring. They are therefore largely encapsulated in an efficiency criterion.

- 2.6 While an efficiency objective can be consistent with the benefit principle, these criteria may conflict in many circumstances.¹ Further, the benefit principle is just one of many possible equity considerations, and there is no clear basis for choosing it over alternative concepts of equity.
- 2.7 The NZBR's view is that the simultaneous pursuit of efficiency and equity criteria as proposed in the Cost Recovery Paper will result in conflicting and inconsistent approaches being applied to cost recovery. Moreover, without a sound framework, there is a serious risk that cost recovery is used to fund an excessive expansion of regulatory activity. This is of particular concern because user charges can provide a source of funding for which there is limited accountability.
- 2.8 The NZBR has observed an increasing tendency for government agencies to expand their funding by imposing user charges for the supply of public goods, despite general agreement among economists that public goods should be funded by taxation. The imposition of user charges is often 'justified' by redefining the nature of public good outputs. Thus, public goods are redefined as 'club goods' by assuming that the producer of a regulated output benefits from regulation that protects consumers, or alternatively by describing producers going about their lawful business as 'sources of risk' that create a need for public good outputs that benefit others. The resulting user charges are little more than discriminatory taxes. By labelling such taxes as user charges the agency imposing them can bypass many of the normal protections and processes that apply to the imposition of taxes.
- 2.9 The NZBR believes that the Paper needs to more tightly constrain the cost recovery rules to better ensure the adoption of a consistent and principled approach to cost recovery. A sound approach would be greatly assisted by the NZFSA adopting economic efficiency as the

¹ See Credit Suisse First Boston, *Regulation of the Food and Beverage Industry*, 1998, pp 49-50 for a discussion of the conflicts between the efficiency and benefit principles. A copy of this report is enclosed as part of this submission.

primary or sole criterion in establishing the cost recovery framework, rather than the multiple conflicting criteria proposed in the Cost Recovery Paper.

2.10 The Cost Recovery Paper also proposes that the cost recovery framework should:

- (a) be principles based;
- (b) recover the full cost of service provision, including overheads;
- (c) not over-recover costs or be excessive;
- (d) be sustainable;
- (e) to the extent possible, be simple rather than complex;
- (f) be consistent and applied equitably across sectors and groups;
- (g) provide for monitoring and review of charges in response to changes in cost and supply and demand conditions;
- (h) provide for stakeholder consultation;
- (i) have a sound statutory base;
- (j) be flexible so that charges can be closely aligned with costs and different cost drivers;
- (k) allow different methods of cost recovery such as fees, charges and levies as appropriate.

2.11 Points (b), (c), (e), (g), (j) and (k) are concerned with ensuring that services are supplied at minimum cost and that prices reflect costs and are therefore compatible with the efficiency criterion. The requirement that the regime be 'sustainable' (point (d)) is not clear. A consistent and equitable regime (point (f)) is unlikely to be achieved using the multiple criteria proposed in the Cost Recovery Paper.

- 2.12 Points (h) and (i) propose processes (consultation and a sound statutory base) as constraints on the regulator. Section 7.2 suggests that provision should be made for the Minister to review the level and methods of cost recovery every three years. The NZBR notes that robust processes are important in ensuring efficient outcomes, and therefore concurs with the Cost Recovery Paper's suggestion that processes can be used to improve monitoring and the accountability of the regulatory agency. However, ensuring that processes are effective in practice is problematic.
- 2.13 Point (k) and section 7.2 define the different types of charges (fixed, variable and so on) that may be adopted. However, without a clear criterion for developing the cost recovery regime, there is no guidance as to what options might be adopted in particular circumstances. An efficiency criterion, on the other hand, provides strong guidance on the nature of charges that may be appropriate.²
- 2.14 User fees potentially have a useful role in promoting efficient resource use by imposing on users the costs that their demands would impose on society at the margin. Such charges can therefore induce individuals to trade off at the margin the costs and benefits of more or less output. Their behaviour in response to such price signals can convey information to producers as to the optimal level of output. A user fee can also correct for a market failure.
- 2.15 Generally user charges have desirable incentive effects when the output is a private good. When this is the case the greatest level of efficiency is achieved if the output is supplied in a competitive market by private, rather than government providers. The NZBR therefore agrees with the Cost Recovery Paper's suggestion that "where possible provision will be made for functions to be carried out by third party providers in a contestable environment. Competition among providers helps to ensure that market pressures keep costs fair" (p 5).

²

The implications of the efficiency standard for cost recovery charges are detailed in Credit Suisse First Boston (1998) pp 41-47.

- 2.16 Where government agencies are statutory monopolies and businesses are required to buy their outputs, user charges are less likely to induce efficient outcomes. In these circumstances, competitive disciplines, which normally result in pressure to ensure output is produced at minimum cost, are absent. Government ownership may further weaken the incentives for cost minimisation. User charging for mandatory outputs may result in inflated costs and expansion of the regulatory agency.
- 2.17 Providing adequate constraints and protections in these circumstances is problematic even if a clear efficiency criterion is adopted in the design of the regulatory and cost recovery regimes. Such difficulties are likely to be substantially exacerbated when multiple conflicting objectives are used, as proposed in the Cost Recovery Paper.
- 2.18 The NZBR notes that while it is useful to have a paper that discusses the principles that should apply to the design of a cost recovery regime, the way such principles are implemented is critical to determining the efficiency or otherwise of the regime. Because of the general nature of the principles and approaches discussed in the Cost Recovery Paper, it is difficult to discern the likely structure and nature of actual charges. Until these are known, it is not possible to determine whether the NZBR's concerns about the proposed regime would be realised in practice.

3. Conclusions

- 3.1 The principles stated in the Cost Recovery Paper are so broad as to provide little guidance or constraint on NZFSA in the design of the cost recovery framework to apply to the domestic food sector. The use of multiple criteria risks creating confusing and conflicting cost recovery rules. The vague and all-encompassing nature of the different objectives and criteria gives the NZFSA wide discretion to adopt different approaches. The NZBR is concerned that without a sound framework there is a serious risk that user charging would not

lead to more efficient outcomes and instead would be used to fund an excessive expansion of regulatory activity.

- 3.2 The NZBR recommends that the NZFSA adopt economic efficiency as the single or primary criterion in determining the cost recovery regime. A single efficiency criterion would increase the clarity and consistency of the regime, reduce the NZFSA's discretion as to the nature and incidence of user charges, and better ensure that the food safety regime contributes to national welfare.