



Independent Pricing and Regulatory Tribunal

Review of funding framework for Local Land Services NSW

Other Industries — Final Report
March 2014



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1 Executive summary

1.1 Overview

The NSW Government engaged IPART to recommend a cost recovery framework that the 11 Local Land Services' boards (LLS boards) could apply to fund their operations. The full terms of reference are at Appendix A.

Local Land Services (LLS) commenced operations in January 2014 drawing together the functions formerly performed by Livestock Health and Pest Authorities (LHPAs), Catchment Management Authorities (CMAs) and parts of the Department of Primary Industries (DPI).

The LLS boards will deliver a variety of services including:¹

- ▼ advice on production for farm businesses
- ▼ biosecurity including plant and animal health
- ▼ plant and animal pest control
- ▼ natural resource management, and
- ▼ emergency response.

It is proposed some services will be fully funded by government. Other services will be priced to recover part or all of their costs from landholders.

We have developed a step-by-step process LLS boards can apply to determine:

- ▼ if they need to act
- ▼ what activities to undertake
- ▼ who should pay
- ▼ how much they should pay
- ▼ on what basis they should pay
- ▼ how fees-for-service and rates, where charged, should be collected.

¹ Local Land Services Act 2013 (NSW), s 4; and http://www.dpi.nsw.gov.au/__data/assets/pdf_file/0020/470144/Local-Land-Services-flyer.pdf, 2013 accessed 28 February 2014.

In addition, we propose a methodology to assess how well LLS boards implement these steps.

This is our Final Report presenting our recommendations and explaining how we reached these recommendations.

1.2 What have we been asked to do?

The terms of reference (see Appendix A) asked us to:²

1. Develop an efficient and transparent cost recovery framework that LLS boards can use to set service fees for the different categories of services they provide to the different groups of beneficiaries. In undertaking this task, we were to assess the strengths and weaknesses of cost recovery frameworks used by similar service providers.
2. Advise on an efficient rating base for compulsory fee collection and an efficient fee collection mechanism.
3. Develop an appropriate audit methodology for assessing the extent to which efficient cost recovery pricing has been applied to the services offered by LLS boards.

1.3 IPART's process for this review

We have conducted this review as a public process. In May 2013, we released an Issues Paper and received 30 submissions. We considered these submissions in our deliberations for the Draft Report, held public seminars in Wagga Wagga, Tamworth and Penrith in June/July and met separately with key stakeholders including the authors of past reports on the delivery of land services.

We released our Draft Report in September 2013, receiving 25 submissions, and held a roundtable with stakeholders in October 2013.

At the request of the Minister for Primary Industries we accepted a late submission, received on 2 December 2013, from the new LLS Board of Chairs. We gave other stakeholders an opportunity to respond to the Board of Chairs submission by 20 December 2013 and received 83 submissions.

Table 1.1 sets out the timetable for the review.

² Minister for Primary Industries, Letter to IPART, dated 22 February 2013, p 1.

Table 1.1 Timetable for review

What	When
Received terms of reference	2 April 2013
Released Issues Paper	21 May 2013
Held public seminar Wagga Wagga	14 June 2013
Held public seminar Tamworth	18 June 2013
Submissions on Issues Paper due	2 July 2013
Held public seminar Penrith	8 July 2013
Released Draft Report	10 September 2013
Submissions on Draft Report due	15 October 2013
Held public roundtable	28 October 2013
Late submission – LLS Board of Chairs	2 December 2013
Submissions on LLS Board of Chairs submission due	20 December 2013
Released Final Report to DPI	5 March 2014

1.4 IPART's analytical approach for this review

In conducting this review we undertook our own extensive research and consulted with other jurisdictions on their approaches to cost recovery.

Our approach was to:

1. Research and analyse cost recovery in general, and assess the cost recovery frameworks used by service providers similar to LLS to determine whether an existing framework provided a suitable model for the LLS funding framework.
2. Decide the objectives the LLS funding framework should meet, and the key principles its design should reflect, taking account of our research and analysis and stakeholder comments.
3. Develop a cost recovery framework that meets these objectives and principles and is tailored to LLS' needs.
4. Review the current funding arrangements, and form our advice on the specific rating issues we were asked to address.
5. Develop an audit methodology to assess the extent to which LLS boards comply with the framework.

1.5 What do we recommend?

We recommend LLS boards follow the 6-step cost recovery (funding) framework, shown in Figure 1.1. This framework requires LLS boards to respond to a series of questions at each step that will enable them to determine the funding approach for a specific service.

The Government has stressed that LLS is to be managed by local people on local boards to deliver services that are relevant to local needs.³ At the same time NSW Farmers expressed concern with possible inconsistency in charging approaches between boards.⁴

We have therefore developed a common framework for application by LLS boards supported by examples to demonstrate its application.

1.5.1 Relationship between the funding framework and strategic plans

The purpose of strategic plans is to link objectives to outcomes, actions (activities) and resourcing. The framework will enable a LLS board to identify how its planned outcomes should be funded.

While the funding framework is based on recovering costs for specific activities, it allows for recognition of the interrelationships between different outcomes and activities.

Application of the funding framework will influence the demand for local land services and how those services are delivered. This occurs as a result of the funding framework determining who will fund a service, the amount they will fund and how any charge will be structured.

We have developed a set of principles,⁵ consistent with the concepts of transparency and efficiency that underlie the funding framework. The framework is also consistent with the NSW Biosecurity Strategy⁶ and the recommendations of the Productivity Commission.⁷

³ http://www.dpi.nsw.gov.au/__data/assets/pdf_file/0020/470144/Local-Land-Services-flyer.pdf, accessed 28 February 2013.

⁴ NSW Farmers submission to IPART Issues Paper on LLS funding framework, July 2013, p 8.

⁵ The principles are discussed in Chapter 3.

⁶ NSW Department of Primary Industries, *NSW Biosecurity Strategy 2013 – 2021*, p 44.

⁷ Productivity Commission, *Cost recovery by Government Agencies*, August 2001, p xxxii (from now referenced as PC (2001)).

Figure 1.1 LLS Funding Framework

1.5.2 Step 1: Is action necessary?

LLS boards will need to clearly define the issues to be addressed and identify the relevant stakeholders.

Before taking action, a LLS board needs to confirm that it has the statutory power to take action. It should also confirm that the action is necessary, for instance, to achieve an approved strategic plan commitment.

The application of the framework could encourage LLS boards to limit their services to where there is a market failure.⁸

⁸ Former Better Regulation Office, NSW Government, *Guide to Better Regulation*, November 2009, p 29.

LLS should not crowd out the private sector where the private sector is able to efficiently provide a service. This includes where an industry, community group or an individual landholder is taking action to enhance production, address a biosecurity threat or improve the environment.

1.5.3 Step 2: What is the proposed solution?

The action taken by a LLS board should be the least cost solution for the community. This may require a LLS board to market test the cost of delivering services and compare its costs with those of other service providers.

Some activities will contribute to multiple outcomes and LLS boards should look to minimise their overall costs rather than simply minimising the costs of providing a particular service.

1.5.4 Step 3: Who should pay and how much should they pay?

Step 3 involves selecting the funder(s), allocating costs to the selected funder(s), costing the activity and undertaking a cost-benefit analysis.

Adopting risk creator and beneficiary principles to select the funder(s) and allocate costs

The terms of reference specify that services are to be funded in accordance with 'risk creator' and 'private, industry and public benefit principles'.⁹

The 'risk creator pays' approach requires that the parties undertaking activities which create risk for others should pay the cost of managing that risk. In contrast, the 'beneficiary pays' approach requires the parties that benefit from an activity to pay for the cost of the activity.

Which approach is appropriate would depend on whether a risk is created (or exacerbated) and who would be the most efficient and effective to charge. We note that not all of LLS boards' activities are directed at managing risks, for instance extension services.

Management of risks is a shared responsibility. Some risks are managed at a Commonwealth Government level and for many risks there are already costs sharing arrangements in place between governments (state and Commonwealth) and industry. Others are managed at a state level, and in NSW are the responsibility of LLS.

⁹ Minister for Primary Industries, Letter to IPART, dated 22 February 2013, p 1.

Where a risk is created and government intervention is required, the producer is usually best placed to manage that risk and influence the extent of government intervention. The cost of managing the risk will vary between producers and the impact will be reflected in the market price paid by consumers.

Our recommended funding framework for LLS follows a hierarchy to determine who should fund a service.

- ▼ **Impactors or risk creators** - at the top of the hierarchy are those causing an adverse impact (for instance, degrading the environment) or creating a risk (for instance, harbouring pest animals on their property). They are best placed to control the demand for LLS' services. This includes public land management agencies. The cost of the activity should be allocated to the impactor(s) or risk creator(s) in proportion to their contribution to the impact or risk created, where it is efficient and cost effective to charge them.
- ▼ **Beneficiaries** - second in the hierarchy are landholders benefitting from a LLS board's service where it is either not practical to charge the impactor or risk creator or there is no adverse impact or risk created (for instance, extension services).
 - Where the direct beneficiary captures sufficient benefits to meet the costs of the activity, indirect beneficiaries should not pay.
 - Where the direct beneficiary is unable to capture sufficient benefits to meet the cost of the activity, the direct beneficiary should pay up to the point where benefits equal costs. The indirect beneficiary should pay the residual to meet the cost of the activity for the additional benefits, where it is efficient for them to do so.
- ▼ **Taxpayers** - as a last resort the cost of a service should be borne by taxpayers. That is where it is not feasible, efficient or cost effective to charge either an impactor or beneficiary. As discussed above, where public land management agencies are identified as impactors or beneficiaries then they should pay for their share of services provided by LLS boards.

This hierarchical approach ensures that the selected funder is the party closest to and most able to influence a problem.

Deciding which costing approach to use

Having identified who should pay, the next question is how much they should pay.

For the next 4 years the Minister for Primary Industries has committed in aggregate:¹⁰

¹⁰ The Hon Katrina Hodgkinson, MP, Minister for Primary Industries, *LLS Funds Clear*, The Land, 22 August 2013, p 22.

- ▼ recurrent funding of \$105m
- ▼ NSW Government catchment action grant funding of \$112m.

In addition, for agricultural advisory services the Minister has committed:

- ▼ recurrent funding of \$22m
- ▼ the use of an efficiency dividend of \$20m.

The Minister has also indicated the interest on the \$35m Future Fund¹¹ will be available to LLS boards to meet local needs and priorities.

Under the framework some services, as now, will be fully funded by government. Other services will be priced to recover part or all of their costs from landholders.

LLS boards should recover fully distributed costs (ie, the sum of direct, indirect and capital costs) for core services.

In compliance with NSW Treasury Guidelines¹² LLS boards should at least recover avoidable costs (for instance, those costs that would be avoided if a service was not provided) where services are provided in contestable markets (for instance, some production advice).

LLS boards may also provide services that are an adjunct to core services and are not in competition with the private sector. Short run marginal costs (ie, direct costs) should be recovered for these services.

Undertaking cost-benefit analysis

Cost-benefit analysis is required for a LLS board to decide if it should proceed with an activity. The aim of cost-benefit analysis is to ensure the activity results in a net benefit to society.

Some LLS activities, for instance in response to biosecurity threats, may be undertaken irregularly and LLS will need to make a long term assessment of benefits and costs.

Not all benefits may be able to be quantified and any quantitative analysis will need to be supplemented by qualitative analysis.

NSW Treasury has published guidelines on undertaking a cost-benefit analysis.¹³

¹¹ The Future Fund is a consolidation of the cash reserves of the Livestock Health and Pest Authorities and Catchment Management Authorities.

¹² NSW Treasury, *Policy Statement on the Application of Competitive Neutrality*, January 2002, p 16.

¹³ NSW Treasury, *NSW Government Guidelines for Economic Appraisal*, July 2007.

1.5.5 Step 4: How should they be charged?

Fee-for-service is the default funding mechanism for LLS. It provides a strong link between the activity and the charge. In general, the stronger the link between a service and its charge, the stronger the pricing signal and the more efficient the outcome will be.

A clear price signal allows each beneficiary or impactor to assess the level of benefit they receive from the service and/or compare the charge imposed on them with the cost of taking mitigating action. If the cost (price) of the service is higher than the cost of taking mitigating action or the benefit received, the individual or group is likely to alter its behaviour.

For many natural resource management services a clear price signal can be provided by direct negotiation with landholders. This would involve landholders applying for government investment in projects on their land. It allows the LLS boards and landholders to assess the benefit to the public and the private individuals respectively and ensures efficient and targeted outcomes can be reached for all parties.

Rates

While a fee provides a clear price signal it may not be the most efficient way to recover the costs of a service. For example, a fee may be more expensive than a rate to administer, especially where the impactors or beneficiaries are a group.¹⁴ A rate is preferable to a fee where:

- ▼ the activity is of a general industry nature rather than of immediate application to one identifiable landholder
- ▼ it is difficult or impossible to identify the users of a particular service or the extent of their use
- ▼ although the users can be identified, charging a direct fee would impede the objectives of the activity, for example, by creating a disincentive for a landholder to report a biosecurity threat
- ▼ administrative complexity means that it is simpler and cheaper to recover regulatory costs for a defined industry through a single industry levy rather than by collecting a large number of smaller fees.

¹⁴ PC (2001), p 176.

The rates allowed under the framework are:

- ▼ a general purpose rate
- ▼ livestock specific rates
- ▼ intensive industry rates
- ▼ specific purpose rates.

The general purpose rate will fund base LLS services that apply to all rateable landholders. We encourage the use of specific purpose rates, where administratively efficient, to improve transparency.

Public landholdings

The framework is intended to apply equally to private and public landholdings for determining risk creators and beneficiaries. Some lands are currently exempt from LLS charges¹⁵ and some public landholders (for instance, local authorities)¹⁶ have existing obligations to maintain land assets. In addition, local authorities are unable to recover costs they may incur in managing Crown Lands.¹⁷ In other cases, however, local authorities may be the landholder of lands used for the purpose of an agricultural enterprise and are not exempt.¹⁸

We consider that if LLS incurs costs on behalf of other public landholders it should negotiate a fee with the public landholder rather than charge the rates applying to private landholders. Local authorities and the Catchment and Lands Division of DPI, where relevant, should jointly be parties to such negotiations (see Sections 5.2 and 6.5).

Minimum area

We recommend that LLS boards have the discretion to reduce the minimum rateable land area from 10ha to 2ha. This recommendation stems from concerns that the biosecurity threat posed by small landholdings is not recognised in the current rate structure. Small landholders often have less developed land management practices than larger commercial landholders.

Given administrative costs and the potential to compromise local authorities' rates, we consider that the costs of setting a lower minimum than 2ha would outweigh the benefits at this time.

¹⁵ LLS Regulation, cl 15.

¹⁶ Local Government NSW, *LLS Board of Chairs Submission on Funding Framework*, 9 December 2013, p 2; Orana Regional Organisation of Councils, *Response to LLS Board of Chairs Submission*, 16 December 2013, p 2.

¹⁷ *Local Government Act 1993* (NSW), s555; Orana Regional Organisation of Councils, *Response to LLS Board of Chairs Submission*, 16 December 2013, p 2.

¹⁸ LLS Regulation, cl 15(1)(c).

In addition, NSW taxpayers contribute from the State Budget to partial funding of LLS. The extension of LLS' funding base to below 2ha particularly where funds raised are not tied to a specific function of LLS or level of service, would introduce inefficiencies in cost recovery. Where LLS has a program of activity that extends across the whole of the NSW population (for instance, general education on biosecurity) then such activity would be most efficiently funded out of general taxation.

Rate base

We propose that land area is used as the general rate base with the exception of the Western LLS board which should have the option of using notional carrying capacity as the general rate base. This recognises:

- ▼ LLS boards provide a broad range of services that extend across horticulture and lifestyle landholdings as well as livestock landholdings
- ▼ the circumstances that apply in the Western LLS where landholdings are large and there are fewer of them, as well as landholdings are predominantly used for livestock.

Notional stock carrying capacity is retained as the rate base for livestock related charges because of the close link between this rate base and the intended use of the funds.

In recognition of the special circumstances that apply to intensive industries (feed lots, piggeries, poultry, horticulture and orchardists) we also recommend that intensive industries be charged irrespective of the minimum rateable land area. These charges may apply to part of a landholding.

Allowing exemptions

We propose that exemptions (partial or full) be allowed to provide incentives to landholders to address problems that are under the jurisdiction of LLS.

Under existing legislation, some industries (for instance, sugar cane) and specific use landholdings do not attract LLS charges. We recommend that all existing exclusions be removed. The LLS Board of Chairs should develop common criteria for exemptions that can be applied across all rateable landholdings in recognition of government policy and the risk created or benefit received.

We recommend that any exemptions granted to a specific industry or group of landholders be formalised in an agreement with LLS. These agreements can take into account expenditures or actions by landholders.

We recommend a partial exemption for broad acre cropping landholdings with few livestock for livestock related charges where their entire landholding may otherwise attract a livestock charge in addition to the general rate.

1.5.6 Step 5: How should the charge be collected?

LLS is responsible for collecting its fees and rates. It could contract with other parties, including local authorities, who are agreeable to undertake this activity and where it is efficient to do so.

1.5.7 Step 6: Has efficient cost recovery pricing been applied?

In recognition of the strong link between the strategic planning process and the funding framework, we recommend that the audit of the extent to which efficient cost recovery pricing is being applied should occur simultaneously with the audit of whether local strategic plans are being given effect.¹⁹

To ensure uniformity in the audit approach over time and between boards, we recommend that the audit be undertaken in accordance with Australian auditing standards.

The NSW Government does not propose that LLS boards should be subject to price regulation. Therefore, there should be avenues for local ratepayers to have a major say in the services provided and how charges are set.

We suggest that consultation with local ratepayers can be enhanced by the preparation of a Cost Recovery Impact Statement (CRIS) for release with local strategic plans. In addition, we recommend that the annual reports of LLS boards (to be published prior to 30 March each year)²⁰ include a statement showing the actual charges to apply in the coming year with an explanation of any deviation from the CRIS.

1.6 What have we changed from the Draft Report?

We have responded to stakeholder comments on the Draft Report by:

- ▼ strengthening the link between the strategic planning process and the funding framework
- ▼ explicitly recognising the interdependence between different outcomes and different activities
- ▼ adopting the one hierarchy to apply to both regulatory and non-regulatory activities
- ▼ highlighting the role of special rates and adopting common criteria for their introduction
- ▼ deleting the proposal that consideration be given to reducing the minimum rateable land area to below 2ha

¹⁹ LLS Act, s 54.

²⁰ LLS Act, s 30.

- ▼ removing the minimum rateable landholding constraint for applying an intensive industry rate
- ▼ extending the application of intensive industry rates to cover poultry and horticulture
- ▼ restricting to the Western LLS board the option of adopting notional stock carrying capacity as the general rate base
- ▼ clarifying that exemptions may be partial or full and proposing that a livestock related rate should not apply to the entirety of the landholdings of broad acre cropping enterprises with few livestock
- ▼ recognising the existing obligations of local authorities to maintain public lands and the limitations on their recovering cost they may incur on behalf of other public landholders
- ▼ allowing an individual industry or landholders with a common purpose (eg, countering a specific pest) to negotiate for a group exemption based on a formal agreement committing to specific actions, and
- ▼ providing additional explanation of the proposed audit methodology for assessing the extent efficient cost recovery pricing is being given effect.

1.7 Response to issues raised in submissions

Stakeholders had concerns that the framework described in the draft report:

- ▼ over emphasised activities to the detriment of outcomes
- ▼ failed to assign responsibility for risks created by landholdings of less than 2ha
- ▼ inadequately responded to the risk potential of intensive industries.

Our response to these matters is:

Transparency

LLS was established to integrate local agricultural, biosecurity and natural resource management services.²¹ Individual activities undertaken by LLS boards will contribute to one or more of these. The framework emphasises charging for individual activities and stakeholders are concerned that this approach could over-emphasise activities to the detriment of outcomes and fail to recognise the interdependence of different outcomes.²² One suggestion is to pool the funds from the different income streams.²³

²¹ http://www.dpi.nsw.gov.au/__data/assets/pdf_file/0020/470144/Local-Land-Services-flyer.pdf, 2013.

²² Australian Land Management Group submission to Draft Report, 9 October 2013, p 1 and B. Tomalin (individual) submission to Draft Report, 15 October 2013, p 1.

²³ LLS Board of Chairs response to IPART Draft Report, December 2013, p 2.

The Government highlighted the following concerns in the lead up to the formation of LLS:²⁴

- ▼ ‘Why should citrus growers pay LHPA rates for wild dog and sheep lice control when they want more resources for fruit fly control?’
- ▼ Why should North Coast dairy producers pay for plague locust control when they need more resources for tick control?’

This suggests stakeholders are also concerned about transparency and cross-subsidies. LLS boards need to account for funds collected and how they are applied. We recommend fee-for-service as the default charging mechanism. It provides the strongest link between a charge and an activity.

If rates are introduced, we support specific purpose rates where practical. Over-reliance on general rates can introduce cross-subsidies and remove the link between funds collected and their application, weakening price signals to risk creators and beneficiaries. This link is essential to maintain LLS boards’ accountability to stakeholders and the pressure on LLS boards to provide services at minimum cost. It also enables benchmarking with similar service providers.

Where an activity contributes to multiple outcomes or a single outcome requires multiple activities, the framework provides for an apportionment of responsibility and cost sharing. For instance, Table 4.2 distinguishes between different services, their private and public good characteristics and highlights the associated charging considerations.

Minimum rateable land area

Landholdings of less than 2ha may contribute to biosecurity risks and may also benefit from the actions of LLS.²⁵

Efficiency in charging suggests that it may be inappropriate for LLS to apply a levy to these landholdings, particularly where not linked to a specific LLS action. Such levies may:

- ▼ potentially overlap with the rates charged and functions provided by local authorities
- ▼ remove the clear nexus between rates charged and services provided that is the foundation of the guidelines
- ▼ fail to recognise the efficiency in funding from general taxation (ie, the State Budget) of programs that are not tied to a specific LLS service and extend across the whole of the NSW population.

²⁴ http://www.dpi.nsw.gov.au/__data/assets/pdf_file/0005/444803/minister-primary-industries-presentation.pdf, p 10, accessed 14 February 2014.

²⁵ Mr Wilde, IPART, Review of Funding Framework for Local Land Services – Roundtable – 28 October 2013, p 13.

Intensive industries are a special case and are discussed below.

Intensive industry rates

We have further developed our approach to charging intensive industries. This was informed by, but differs from, the submission from the LLS Board of Chairs.²⁶

Intensive industry rates, in common with all rates, are recommended to have a fixed and a variable component. The fixed component would be a set amount for each intensive operation. The variable component would be based on:

- ▼ Notional carrying capacity for intensive livestock.
- ▼ Land area or notional carrying capacity for intensive poultry.
- ▼ Land area for intensive horticulture.

An intensive industry rate is intended to cover the same risks for a specific activity (for instance, a piggery) that arise from a non-intensive enterprise but which are magnified by the level of intensity. It is also designed to provide for the different level of risk pertaining to different enterprises (for instance, a poultry enterprise and cattle feed lot). To acknowledge the risk associated with intensive operations the minimum rateable land area has been set to 0 hectares for all intensive industry rates.

We have not included turnover of an intensive enterprise, as suggested by the Board of Chairs,²⁷ in the formulation of intensive industry charges. We are concerned it may vary substantially from one year to the next based on market prices of the produce being rated, which may have no relationship to the efforts required of LLS to counter potential risks.

1.8 Structure of this report

This following chapters and appendices explain our findings and recommendations in detail:

- ▼ Chapter 2 describes the functions LLS will provide, how these services are provided at present and other reviews into government provision of these services. It also introduces the concepts of impactors/risk creators and beneficiaries to identify who should be paying for the services.
- ▼ Chapter 3 sets out how we approached the task and the objectives and principles we adopted in developing the framework.

²⁶ LLS Board of Chairs, Response to IPART Draft Report, December 2013, p 2.

²⁷ Ibid.

- ▼ Chapter 4 outlines our findings and recommendations for an efficient and transparent cost recovery (funding) framework for LLS. It also details steps 1 and 2 of the funding framework.
- ▼ Chapter 5 discusses step 3 of the framework - who should fund the activities of LLS and what proportion of the costs they should fund.
- ▼ Chapter 6 details step 4 of the framework - what costs should be recovered and the choice between fee-for-service and rates, and step 5 - how the funding option chosen will be collected.
- ▼ Chapter 7 sets out our findings and recommendations on rate types and structures, the establishment of new levies, and the appropriate minimum rateable land area for LLS rates.
- ▼ Chapter 8 outlines our findings and recommendations for the most efficient rating base for LLS and other rating issues.
- ▼ Chapter 9 discusses implementation of the framework including the timeframe and flexibility LLS boards should be allowed.
- ▼ Chapter 10 outlines our findings and recommendations for developing an audit methodology to ensure compliance with the funding framework.

1.9 Findings

A list of our findings and their corresponding page numbers is shown below.

- | | | |
|---|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----|
| 1 | The funding framework for Local Land Services (LLS) should be consistent with the principles developed by the Productivity Commission, and incorporate features of the Biosecurity NSW approach. | 32 |
| 2 | Property rights are important when considering which cost recovery strategy, impactor pays or beneficiary pays, should be used. The existence of “property rights” means that a landholder who fails to achieve a certain standard may generate costs for other landholders. In general, LLS should recover the cost from the landholder creating the need for the activity before considering those who may benefit. This idea is consistent with the principles identified in Finding 1. | 32 |
| 3 | When those who benefit are charged, consideration should be given to: | 32 |
| | – recovering the full costs of a service from those directly benefiting from the service when their benefits exceed the costs of providing the service, even though there may be other indirect beneficiaries | 32 |
| | – the opportunity for facilitating additional private funding when public funding is applied. | 32 |
| 4 | The LLS funding framework should be designed to meet 2 key objectives: | 34 |
| | – Improve allocative efficiency in service delivery. | 34 |

– Improve horizontal equity in funding.	34
5 LLS funding framework should be consistent with the principles of:	39
– full cost recovery	39
– administrative efficiency	39
– compliance with legislation and government policy	39
– transparency	39
– consistency in the application of the framework.	39

1.10 Recommendations

A list of our recommendations and their corresponding page numbers is shown below.

1 LLS boards should adopt the 6-step cost recovery framework summarised below.	60
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Summary of funding framework for LLS

Phase	Step
Review	1. Understand the problem, and confirm that LLS should take action: <ul style="list-style-type: none"> – Link to statutory functions and strategic plan outcomes. – Conduct market failure test.
	2. Specify the activity required to address the problem.
Design	3. Determine who should fund and how to allocate costs: <ul style="list-style-type: none"> – Select appropriate funder using hierarchy. – Cost the activity. – Allocate costs to selected funder(s). – Undertake cost-benefit analysis in consultation with stakeholders.
	4. Decide on the funding approach (fee or rate) to use.
	5. Decide how the fee or rate will be collected.
Implementation	6. Assess the extent to which efficient cost recovery pricing has been applied.

Source: IPART.

Cost Recovery Steps 1 & 2 – Identify problem and solution

2 Each LLS board should use the cost recovery framework to assess its operations at the activity level. These activities are determined by the strategic plans developed by the LLS Board of Chairs and LLS boards. The LLS Board of Chairs can also apply the cost recovery framework at the strategic level to assess if there are economies of scale between the LLS boards.	60
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Cost Recovery Step 3 – Cost Allocation

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| 3 | LLS boards should follow a hierarchy to identify who should pay the cost of a program or an activity (ie, regulatory and/or non-regulatory): | 75 |
| | – At the top of the hierarchy are those causing an adverse impact or creating a risk including government land management agencies. The cost of the activity should be allocated to the impactor(s) or risk creator(s) in proportion to their contribution to the impact or risk created, where it is efficient and cost effective to charge them. | 75 |
| | – Second in the hierarchy are beneficiaries, also including government land management agencies, where it is efficient and cost effective to charge them, subject to the following: | 75 |
| | o Where the direct beneficiary captures sufficient benefits to meet the costs of the activity, indirect beneficiaries should not pay. | 75 |
| | o Where the direct beneficiary is unable to capture sufficient benefits to meet the total cost of the activity, the direct beneficiary should pay up to the point where benefits equal costs and the indirect beneficiary should pay the residual to meet the cost of the activity for the additional benefits, where it is efficient for them to do so. | 75 |
| | – Third on the hierarchy are taxpayers, as funders of last resort, where risk creators or beneficiaries have not been identified, or although identified it is inefficient to charge them. | 76 |
| 4 | LLS Boards should adopt the following costing approaches for activities: | 82 |
| | – Fully distributed cost for core activities (ie, direct, indirect and capital costs). | 82 |
| | – Marginal cost for discretionary non-regulatory activities that are additional to government funded activities (ie, direct costs). | 82 |
| | o However, where an additional activity competes with the private sector, as a minimum the avoidable costs should be recovered – ie, all costs that would be avoided should the activity not be provided (ie, direct, and avoidable indirect and capital costs). | 82 |
| 5 | A sliding scale approach should be considered as a method of last resort for determining cost shares of non-regulatory activities where it is administratively inefficient to identify specific cost allocations. | 86 |

Cost Recovery Step 4 – Funding approach

- | | | |
|---|-------------------------------------------------------------------------------------------------------------------------------------------------|----|
| 6 | Fee-for-service should be the default funding mechanism for LLS. | 92 |
| 7 | Rates and levies should be considered when a fee-for-service has been ruled out on the grounds that it is not feasible, efficient or effective. | 92 |

- 8 Government funding should be available to the LLS as a funding mechanism where: 92
- a public land management agency has been identified as the primary impactor or beneficiary of the activity, or 92
 - as the funder of last resort, where it is inefficient to target actual impactors or beneficiaries with a fee or levy. 92
- 9 LLS should negotiate with Commonwealth and State Government public land agencies, local government and Aboriginal Land Councils for contributions to fund the net costs they impose on LLS. The negotiations should have regard to any offsetting action taken by the relevant bodies. Funding arrangement should be formalised under an instrument such as a deed of agreement or a Memorandum of Understanding. 92

Cost Recovery Step 5 – Collection mechanism

- 10 LLS should develop an efficient, centralised billing system and charge each LLS board its share of the costs of the system. LLS should compare the costs of an in-house system to that of contracting with a service provider. 95

Other Rating Issues

- 11 LLS boards should retain the ability to charge a general rate, and specific purpose rates (including the current animal health rate). 101
- 12 All LLS rates should comprise a fixed and a variable component. 103
- 13 The minimum rateable land area should be reduced from the current 10 hectares to 2 hectares for all landholdings (except land used for intensive operations, which should be 0 hectares). 105
- Individual LLS boards should retain the ability to set a minimum above the proposed state wide 2 hectare minimum. 106
 - The reduction, where adopted by an LLS board, should occur by 1 July 2016, providing time for LLS boards to educate and inform small landholders. 106
- 14 LLS boards should continue charging the animal health rate, and should widen the group liable to pay this rate to include all landholders with a rateable land area and 30 or more stock units. 110
- 15 The allowance given to properties with 5 or less horses when determining liability for the animal health rate should be removed. 110

- 16 LLS boards should consider establishing a partial exemption on the animal health rate for broad acre cropping landholdings with few livestock under a broader exemptions policy. 110
- 17 Poultry should be included in the count of stock units when determining liability for the animal health rate. 110
- 18 LLS should continue to collect the meat industry levy on behalf of the NSW Food Authority from rate payers liable to pay the animal health rate. Once it has established its rate collection mechanism, LLS should charge the NSW Food Authority a fee that reflects the marginal cost of collecting the meat industry levy. 111
- 19 If LLS continues to collect the pest insect levy on behalf of the Department of Primary Industries (DPI): 112
- DPI should limit the areas from which fees are collected to those LLS regions where there are either impactors or beneficiaries in accordance with the cost recovery framework, and 112
 - LLS should charge DPI a fee that reflects the marginal cost of collecting the pest insect levy, once it has established its rate collection mechanism. 112
- 20 The Hunter LLS board should continue to charge the Hunter flood mitigation levy as a specific purpose levy. Where applicable, other LLS boards should investigate charging a flood mitigation levy to eliminate cross subsidisation of flood mitigation services. 112
- 21 Any new special purpose rate established by a LLS board should satisfy the common rating criteria of being: 114
- efficient 114
 - targeted 114
 - simple and cost effective to administer 114
 - clear and easily understood. 114
- 22 LLS boards should charge an intensive animal health rate (separate from the animal health rate) and an intensive horticultural rate with a minimum rateable land area of 0 hectares. 117
- 23 The intensive animal health rate and the intensive horticultural rate should each comprise a fixed and a variable component. The variable component for: 117
- the intensive animal health rate (for all industries except poultry) should be based upon notional stock carrying capacity 117
 - the intensive animal health rate for the poultry industry should be based on either notional carrying capacity or land area 117

- the intensive horticultural rate should be based on land area. 117
- 24 The LLS should continue to fund the operation of the Property Identification Code system through charges that reflect the efficient cost of operating the scheme. Charges imposed should be shown on rates notices. 119
- 25 Land area should be used as the rating base for any general or broad-based rate (such as those that target all LLS ratepayers as the beneficiary). However the Western LLS board should retain the option of using notional carrying capacity as the rating base for any general or broad-based rate. 129
- 26 Notional Carrying Capacity should be used as the rating base for specific purpose rates that target the livestock industry as the risk creator or the beneficiary (such as the animal health rate and the meat industry levy). 129
- 27 LLS boards should be allowed to standardise their current rates to avoid different landholders paying different rates for the same service. 129
- 28 LLS boards should consider phasing in changes to rates (eg, over 5 years), if there are expected to be large increases in landholder rates. This may involve capping the maximum annual increase in rates. 130

Exemptions

- 29 All current exemptions from LLS rates should be removed. Any new exemptions (partial or full) should be assessed under an LLS exemptions policy. 131
 - In assessing exemptions, the LLS should consider work being done by industry groups, volunteer groups and individuals to address biosecurity and other issues. Service arrangements could be formalised under an instrument such as a deed of agreement or a Memorandum of Understanding between the LLS and industry and volunteer groups. 131
- 30 LLS should establish a policy for assessing applications and granting exemptions (partial or full) from specific fees and rates. 134

Annual Returns

- 31 LLS should use the National Livestock Identification System as a cross check on the annual return to make sure it is getting correct information. 136
- 32 LLS should impose a penalty for failure to submit an annual return on time. This should be separate from any rates that landholders are liable to pay. 136

Implementation

- 33 The funding framework should be fully implemented for fees and rates applying from 1 July 2016. LLS boards will need to prepare for this implementation with early reviews of existing and planned activities and associated funding. 138

Cost Recovery Step 6 - Audit

- 34 The audit of the extent to which efficient cost recovery pricing has been applied to the services offered by LLS boards should be undertaken simultaneously with the audit of local strategic plans. 152
- 35 The audit in recommendation 34 should be conducted in accordance with the Standard on Assurance Engagements, ASAE 3100. 152
- 36 The funding framework described in this report should be adopted as the audit criteria. 152
- 37 A Cost Recovery Impact Statement should be developed simultaneously with the draft local strategic plan. It should be published in a form that enables stakeholders to effectively engage in the service fee setting process. 154
- 38 Each LLS board should include in their annual report a statement affirming their charges are set in accordance with efficient cost recovery pricing. 155

2 Context and process for this review

As outlined in Chapter 1, IPART has been asked to develop a funding framework for Local Land Services NSW (LLS), and provide advice on related issues. This chapter provides background information on local land services and previous reviews to put our review in context.

LLS was formed by merging the Livestock Health and Pest Authorities (LHPAs), Catchment Management Authorities (CMAs) and part of the NSW Department of Primary Industries (DPI) into a single entity. LLS is responsible for a diverse range of activities and services to regulate and support commercial and non-commercial landholders.

Our terms of reference indicate that to ensure efficient service delivery, LLS' activities and services will be funded by individuals, specific landholder or industry groups, or will be jointly funded with government, in line with an 'impactor/risk creator pays' or a 'beneficiary pays' approach. The sections below:

- ▼ provide an overview of activities and services provided by LLS and how these were funded before the formation of LLS
- ▼ outline the risk creator and beneficiary pays funding approaches, and the parties likely to be risk creators or beneficiaries of LLS activities
- ▼ discuss previous reviews of landholder service agencies, that we have considered in forming our advice, and
- ▼ outline the process we followed in conducting the review.

2.1 LLS activities and services

The 3 organisations merged to form LLS provided a diverse range of services – including pest control, stock identification, natural resource management activities and extension services. They also received their funding from a diverse range of sources – including fees for service, general and special purpose rates, co-contributions from landholders, and state and federal government funding.

2.1.1 Livestock Health and Pest Authorities

Livestock Health and Pest Authorities (LHPAs)²⁸ delivered frontline agricultural services throughout NSW – including safeguarding livestock health, controlling pests, monitoring stock movements and stock identification, and managing travelling stock reserves.²⁹

LHPAs were funded by a mix of fees for service, rates, and grants from Catchment Management Authorities (CMAs).

LHPAs charged fees for specific goods and services, such as equipment hire, stock identification tags and baits. In addition, LHPAs were required to charge a general and an animal health rate, with flexibility to charge specific purpose rates. Any grants they received from CMAs were tied to specific catchment related projects and outcomes.

Table 2.1 shows total income and expenses for LHPAs in 2011/12.

Table 2.1 Sources of funds for LHPAs 2011/12 (\$Nominal)

LHPA		\$million	% of total
Sources of income	General rate	19.1	38.4
	Animal Health rate	10.6	21.3
	Special purpose rate (pest insect)	5.9	11.8
	Grant income	1.4	2.8
	Other income	12.8	25.7
	Total income	49.8	100.0
Expenses	Personnel services	23.2	47.1
	Core services & reserve maintenance	10.6	21.5
	General operating income	10.6	21.7
	Depreciation & asset write downs	3.0	6.1
	Director fees & associated costs	1.8	3.7
	Total expenses	49.3	100.0

Source: Livestock Health and Pest Authorities, *Annual Report 2011/12*, p 22.

²⁸ Livestock Health and Pest Authorities were created under s37 of the *Rural Lands Protection Act 1998* (NSW).

²⁹ LHPA website: <http://www.lhpa.org.au/about-us>.

2.1.2 Catchment Management Authorities

CMAs were responsible for managing natural resources within their designated region.³⁰ Key roles included developing Catchment Action Plans and providing loans, grants, subsidies or other financial assistance for the purpose of natural resource management activities. There were 11 CMAs³¹ across NSW working with farmers, Landcare and other 'carer' groups, Aboriginal communities, local government, industry and state agencies to respond to the key natural resource management issues facing their catchments.

In 2011/12, CMAs incurred expenses of \$102m³² funded from NSW Government contributions,³³ operating grant funding, and specific works funding. The Hunter Central Rivers CMA also levied a special purpose rate (the Hunter Catchment Levy).³⁴

CMAs also leveraged investment from the community to achieve natural resource management objectives. CMAs estimated that they leveraged \$2.20 community investment (in cash or in kind) for every \$1 invested by NSW and Commonwealth Government.³⁵

2.1.3 Department of Primary Industries

The Department of Primary Industries (DPI) is a division of NSW Trade & Investment. Its role is to develop and sustain diverse and profitable food and fibre industries in NSW, and ensure best-practice management of the state's natural resources.³⁶ DPI is responsible for:

- ▼ developing profitable, sustainable and biosecure agricultural and fishing industries
- ▼ ensuring best practice management of catchments, natural resources and water
- ▼ regulating the state's food sector
- ▼ undertaking research and development into productive systems.

³⁰ Catchment Management Authorities were established under s6 of the *Catchment Management Authorities Act 2003* (NSW).

³¹ The number of CMAs in NSW was reduced from 13 to 11 on 12 October 2012. See: *Catchment Management Authorities Amendment Order 2012*.

³² NSW Government, *Budget Estimates 2012/13, Budget Paper 3*, pp 8-11.

³³ NSW Government, *Budget Estimates 2012/13, Budget Paper 3*, pp 8-11.

³⁴ Hunter-Central Rivers CMA, 2011/12 Annual Report, p 67.

³⁵ NSW Catchment Management Authorities, *Celebrating five years of achievements*, <http://www.sydney.cma.nsw.gov.au/publications-mainmenu-116/celebrating-5-years-of-achievements.html>, Part 1, p 5.

³⁶ DPI website: <http://www.dpi.nsw.gov.au/aboutus> accessed on 28 February 2014.

Former DPI services that are now provided by LLS include:

- ▼ programs aimed at improving the production efficiency of agricultural industries
- ▼ advice on research, emerging trends, markets and risks to agricultural industries
- ▼ formal training for agricultural productivity
- ▼ advice on agricultural legislation and policy.

The Minister for Primary Industries has advised that, over the coming 4 years, LLS boards will have access to \$22 million of recurrent NSW Government funding and the proceeds of an efficiency dividend of \$20 million to fund agricultural advisory services previously provided by DPI.³⁷

2.2 'Impactor/risk creator pays' and 'beneficiary pays' approaches

As noted above, the terms of reference for this review (see Attachment A) indicate LLS' activities and services will be funded in line with the 'impactor/risk creator pays' or 'beneficiary pays' approach. These are well-established approaches for determining the most appropriate and efficient parties to fund government services. In general, the impactor pays approach requires the parties (individuals or groups, commercial or non-commercial) that directly cause a problem to pay the cost of overcoming the problem (and thus internalises the costs they impose on others).

The risk creator pays approach requires the parties that undertake activities which create risk for others to pay the cost of managing that risk. For example:

- ▼ the risk creator may be undertaking an activity that is susceptible to a potential threat (such as a particular biosecurity threat), or
- ▼ the risk creator may be someone that exacerbates the risk of a potential threat by not undertaking actions to reduce the risk or by taking actions that increase the risk (such as failing to control pests, or allowing weeds to proliferate on their property).

The impactor and risk creator approaches are equivalent, and both are commonly used to recover costs associated with regulatory activities and services. However, the concept of an impactor is more logical for environmental or natural resource management problems and activities, and the concept of a risk creator makes more sense for biosecurity problems and activities.

The terms impactor and risk creator are used interchangeably throughout this report.

³⁷ The Hon. Katrina Hodgkinson MP, Minister for Primary Industries, *The Land*, Sydney, 22 August 2013, p 22.

In contrast, the beneficiary pays approach requires the parties that benefit from an activity to pay for the cost of the activity. Typically, applying this approach involves identifying the beneficiaries, assessing the net benefits they receive, and allocating the cost to them in proportion to these benefits. Beneficiaries can include:

- ▼ Direct beneficiaries – those who derive a direct private benefit from the activity, such as the users of an information service.
- ▼ Indirect beneficiaries – those who derive an indirect benefit, such as landholders that benefit by knowing natural resources are used efficiently, or are protected.

2.3 Likely impactors, risk creators and beneficiaries of LLS services

In our Issues Paper for this review, we identified 3 broad groups of impactors, risk creators and beneficiaries as potential funders of LLS activities – landholders, industry and the community. These groups are consistent with those suggested by the Ryan Review.³⁸ However, stakeholders indicated that the groups were too broadly defined to be helpful. In response to this feedback we have developed a more descriptive group of definitions. Our view is that impactors, risk creators and beneficiaries of LLS activities could include (but are not limited to) the following:

- ▼ private parties, such as individuals or businesses (including landholders)
- ▼ collectives, including industry or community organisations or distinct groups of individuals
- ▼ the community, either all LLS ratepayers or all landholders within the LLS boundary or the entire NSW (or Australian) community.

2.4 Previous reviews of land service agencies

In developing the funding framework and forming our other advice, we considered the findings and recommendations of previous reviews of land service agencies – including the Bull Report and the Ryan Report.

³⁸ Terry Ryan, *Report on the Review of the NSW Livestock Health and Pest Authority (LHPA) Model*, February 2012, p 7.

2.4.1 The Bull Report (2007)³⁹

In 2007, the Minister for Primary Industries commissioned a review of the NSW rural lands and protection boards rating system. Undertaken by The Hon. Richard Bull, the review consulted on the following areas:

- ▼ effectiveness of the current ratings system
- ▼ equity considerations of the current structure
- ▼ systematic discrepancies in the current ratings system
- ▼ alternative rating structures.

The report, *Review of the Rural Lands Protection Boards Rating System in NSW* (Bull Report), was delivered to the Minister for Primary Industries in July 2007. It recommended a new ratings system with the following features:⁴⁰

- ▼ a base charge applicable to all ratepayers
- ▼ land area used as the basis for calculating all rates and special purpose levies (incl, the meat industry levy)
- ▼ an environmental rate paid by all ratepayers
- ▼ ability to apply a differential rate for anomalous situations over certain areas or land use types
- ▼ reductions in rates for voluntary conservation agreements and for pensioners
- ▼ reduction in minimum livestock threshold to 30 stock units
- ▼ a standard animal health charge for all eligible ratepayers
- ▼ a return to a minimum 10ha threshold for rating eligibility
- ▼ exemptions to no longer apply to sugar cane growing and intensive poultry production
- ▼ changes to the Annual Return to simplify compliance and to increase accuracy in livestock declarations.

³⁹ The Hon. Richard Bull, *Review of the Rural Lands Protection Boards Rating System in NSW*, July 2007.

⁴⁰ The Hon. Richard Bull, *Review of the Rural Lands Protection Boards Rating System in NSW*, July 2007, p 7.

All recommendations of the Bull Report were fully considered, and 2 were adopted by the NSW Government. The legislated minimum rateable land threshold was increased to 10ha for all boards.⁴¹ Land area was to become available as a basis for calculating rates through legislative amendment.⁴² However, the previous legislative framework was repealed by the *Local Land Services Act 2013* (NSW).⁴³

2.4.2 The Ryan Report (2012)⁴⁴

In 2011, the Minister for Primary Industries commissioned Mr Terry Ryan to review the NSW Livestock Health and Pest Authority (LHPA) service model. The final report was delivered to the Minister for Primary Industries in February 2012 (Ryan Report). The Ryan Report:

- ▼ highlighted the importance of biosecurity and the related services provided by the Government
- ▼ discussed weaknesses in corporate governance, recommending that a new model be established to meet the changing needs of farmers and their communities
- ▼ discussed the need for developing a risk-based funding model for biosecurity and other functions, recognising that responsibility lies with risk-bearing and risk-creating stakeholders.

The 9 key findings of the Ryan Report are presented in Table 2.2.

In response to the Ryan Report's findings, the NSW Government authorised the amalgamation and consolidation of services provided by CMAs, LHPAs and DPI.⁴⁵

⁴¹ *Rural Lands Protection Regulation 2010* (NSW), Schedule 3.

⁴² *Rural Lands Protection Amendment Act 2008* (NSW), Schedule 4.

⁴³ The clauses were originally scheduled to commence on 1 January 2010, but on 14 December 2009, the *Rural Lands Protection Amendment Act 2009* (NSW) amended the commencement date to "...a day or dates to be appointed by proclamation." This legislation was repealed by the LLS Act.

⁴⁴ Terry Ryan, *Report on The Review of the NSW Livestock Health and Pest Authority (LHPA) Model*, February 2012.

⁴⁵ The Hon Katrina Hodgkinson MP, *Local Land Services Bill 2013*, Second Reading Speech, 28 May 2013.

Table 2.2 Key findings of the Ryan Report

#	Finding
1	The prime responsibility for biosecurity lies with those who are most directly affected, either as risk creators or risk bearers, namely farmers and other landholders in agricultural and rural areas.
2	The LHPAs are established historically in legislation to deliver certain front line functions, including some important biosecurity functions, on behalf of landholders, farming industries and the community. While the current dispersed governance arrangement of LHPAs has strengths in relation to regional intelligence and local coordination of service delivery, it has also frequently led to lack of clarity and differences of perspective between the Authorities, landholders and the NSW Government (Department of Primary Industries) on their respective responsibilities and priorities, which inhibits timely and consistent delivery of important front line functions.
3	There is also evidence of significant systemic weaknesses in corporate governance and accountability of individual LHPAs to State Management Council and, in turn, to the NSW Government and ratepayers, and there is room for greater administrative efficiency.
4	The staff of the LHPA, employed through the CEO of the State Management Council, are the cornerstone of the current LHPA model in delivering animal health and pest animal biosecurity operations, and are responsible for Travelling Stock Reserve (TSR) management. The LHPAs deliver crucial services in ensuring the effectiveness of the animal health strategy for NSW, including maintenance of essential registers and compliance operations.
5	To ensure the LHPA model efficiently delivers core frontline functions in line with its legislated responsibilities, and contributes to the objectives of the State Plan, it is essential that the LHPA develop a policy with the NSW Government (DPI) in relation to the adoption and implementation of state-wide biosecurity priorities and operations, and engagement mechanisms for emergency and preparedness campaigns. This direction should be informed by regional-level intelligence.
6	There is potential for a broader biosecurity role for the LHPA model that includes plant pests and diseases, and weeds.
7	Particular parcels of the TSR system may deliver value, such as nature conservation and recreation, to the broader NSW community and some grazing opportunities for a small section of the LHPA ratepayer base. However, there is no longer a robust case for landholders to continue to manage reserved public lands to support these values.
8	A new LHPA model could contribute to the 2021 State Plan by: <ul style="list-style-type: none"> ▼ helping develop biosecurity policy and coordinating the delivery of frontline animal and plant biosecurity services ▼ actively responding to all biosecurity and general emergencies coordinated by DPI ▼ participating with other agencies in joint compliance and advisory functions on pest animals, pest insects, diseases and weeds.
9	In order to refocus and broaden the role of the LHPA model it is necessary to break with historical thinking and remodel the governance arrangements. This will require a staged approach.

Source: Terry Ryan, *Report on the Review of the NSW Livestock Health and Pest Authority (LHPA) Model*, A review commissioned by the Minister for Primary Industries, February 2012, pp 7-8.

3 IPART's approach to the review

The process we followed to develop the funding framework was as follows:

1. Research and analyse cost recovery in general, and assess the cost recovery frameworks used by service providers similar to the LLS to determine whether an existing framework provides a model for the LLS funding framework.
2. Decide which objectives the LLS funding framework should meet, and the key principles its design should reflect, taking account of our research and analysis and stakeholder comments.
3. Develop a cost recovery framework that meets these objectives and principles and is tailored to LLS's needs, taking stakeholder comments into account.
4. Review the LHPA's current rating system, and form our advice on the specific rating issues we were asked to address.
5. Develop an audit methodology for assessing the extent to which LLS boards comply with the framework.

The sections below discuss the findings and outcomes of the first 2 stages of our process. The remaining stages are discussed in following chapters.

3.1 Key findings of our research and analysis

To develop a broad understanding of best-practice objectives and principles for cost recovery, and assess the strengths and weaknesses of the cost recovery frameworks used by service providers similar to LLS, we examined:

- ▼ the Productivity Commission's (PC) 2001 report on Cost Recovery by Government Agencies⁴⁶
- ▼ the Commonwealth of Australia's cost recovery guidelines based on the PC's report⁴⁷
- ▼ the Organisation for Economic Co-operation and Development's report on user charging for government services.⁴⁸

⁴⁶ Productivity Commission, *Cost recovery by Government Agencies*, Report no.15, AusInfo, Canberra, August 2001, (from now referenced as PC (2001)).

⁴⁷ Commonwealth of Australia, *Australian Government Cost Recovery Guidelines*, Canberra, 2005.

⁴⁸ Organisation for Economic Co-operation and Development, *Best Practice Guidelines for User Charging for Government Services*, PUMA Policy Brief No.3, March 1998.

We also examined and assessed a range of cost recovery frameworks for specific organisations, including:

- ▼ Biosecurity NSW (NSW Department of Primary Industries)
- ▼ Department of Treasury and Finance (Victoria)
- ▼ Primary Industries and Regions (South Australia)
- ▼ Department of Agriculture, Fisheries and Forestry (Queensland)
- ▼ Biosecurity New Zealand, and
- ▼ Agriculture and Agri-Food Canada.

Overall, we found that the PC's report provides the most comprehensive discussion and guidance on cost recovery by Australian government agencies, and should guide the development of the LLS funding framework. We also found the funding framework for Biosecurity NSW includes important concepts and features, which should be incorporated into the LLS framework. A comprehensive overview of our analysis and findings is included in Attachment B. We consider that our findings from the Draft Report continue to be valid.

The next sections and chapters explain how we have been guided by the PC's Report in developing the framework.

IPART findings:

- 1 The funding framework for Local Land Services (LLS) should be consistent with the principles developed by the Productivity Commission, and incorporate features of the Biosecurity NSW approach.
- 2 Property rights⁴⁹ are important when considering which cost recovery strategy, impactor pays or beneficiary pays, should be used. The existence of "property rights" means that a landholder who fails to achieve a certain standard may generate costs for other landholders. In general, LLS should recover the cost from the landholder creating the need for the activity before considering those who may benefit. This idea is consistent with the principles identified in Finding 1.
- 3 When those who benefit are charged, consideration should be given to:
 - recovering the full costs of a service from those directly benefiting from the service when their benefits exceed the costs of providing the service, even though there may be other indirect beneficiaries⁵⁰
 - the opportunity for facilitating additional private funding when public funding is applied.⁵¹

⁴⁹ Property rights both create rights and impose obligations upon landholders. Landholders have a right to enjoy their property. However, in some circumstances, landholders are obliged to do, or refrain from doing, things that may have implications for other landholders or the community.

⁵⁰ Sufficiency concept.

⁵¹ Additionality concept.

3.2 Objectives the LLS funding framework should meet

In line with the PC's report, the key objectives of the LLS funding framework should be to improve the efficiency of LLS's service delivery and funding arrangements.⁵²

3.2.1 Efficiency in service delivery

The main objective of cost recovery – and of cost-reflective pricing – is to improve the allocation of resources in an economy, thus contributing to allocative efficiency. In the context of cost recovery, efficiency is achieved through the allocation of resources to the most valuable uses for society as a whole.

Application of cost reflective pricing to the provision of services by government leads to improved decisions on:

- ▼ what services are provided
- ▼ to whom they are provided
- ▼ by whom they are provided, and
- ▼ how they are provided.

Cost-reflective pricing enables consumers and producers to make informed decisions on the services demanded and supplied. This also reduces the potential for government to provide services that cost more than the value consumers and society place on them (or more than the benefits they create).

3.2.2 Equity in funding arrangements

Cost recovery may improve equity in funding government services, specifically horizontal and vertical equity. Horizontal equity refers to treating people in similar situations in similar ways. Therefore, whoever benefits from government-provided services, or has created the need for government intervention (such as regulation), pays the associated costs.

Vertical equity refers to those with greater means contributing proportionately more than those with lesser means. For example, this could be achieved by charging different prices to different people for the same service. There are more efficient tools available in public policy to meet this objective, for instance, explicit taxes and transfers.

Vertical equity is not an objective of cost recovery and is not considered further in this review.

⁵² PC (2001), p XXIX.

IPART finding

- 4 The LLS funding framework should be designed to meet 2 key objectives:
 - Improve allocative efficiency in service delivery.
 - Improve horizontal equity in funding.

3.3 Principles the LLS funding framework should reflect

We consider the LLS funding framework should reflect the following principles:

- ▼ full cost recovery, except where there are specific reasons why this is not desirable
- ▼ administrative efficiency
- ▼ compliance with legislation and government policy
- ▼ transparency, and
- ▼ consistency in the application of the framework.

In practice not all of these principles will align. For example, the cost recovery framework may determine that a particular stakeholder should be charged consistent with efficient provision of the service, but this may not align with a collection mechanism that is administratively efficient. Therefore, at times it may be necessary to make trade-offs between the principles, in both the design and application of the framework. An appropriate trade-off should be informed by the cost recovery hierarchy.

The North West LHPA commented there might be an adverse trade-off between consistency in the underlying principles and the flexibility of how the framework is to be applied. It is concerned that consistency will be used to over-ride flexible approaches at the local board level.⁵³

The funding framework requires a common rationale be applied across all LLS boards to the funding of their operations. This will encourage efficient use of resources and avoid distorted outcomes between regions. However, the framework provides for differences between regions, for example different regions will be faced with different biosecurity threats and will have different cost structures. The Board of Chairs and the Minister may impose constraints to the guidelines provided by the high level framework developed by IPART. Any such action is outside of the scope of IPART's recommendations.

⁵³ North West LHPA submission to Draft Report, p 2.

3.3.1 Full cost recovery

In principle, LLS should set charges on a **full cost recovery** basis to recover the costs incurred in bringing products or services to market,⁵⁴ consistent with general government policies across Australia. However, there may be instances where it is desirable to recover at less than full cost.

The PC's view is that partial cost recovery is, in general, not appropriate – either the costs are recovered in full or funded from general taxation. The PC states that “deviating from this rule would involve making subjective decisions about the degree of public and private benefit involved.”⁵⁵

However, in its recent review into rural research and development corporations,⁵⁶ the PC considers co-funding arrangements and recommends they be based on additionality,⁵⁷ which must by definition allow for private and public benefits.

Less than full cost recovery **may** be justified where, for example, a service will provide a positive net benefit to society and:

- ▼ the benefits received by those who can be charged is less than the costs of providing the service
- ▼ there are benefits to unrelated third parties (sometimes referred to as ‘positive externalities’)
- ▼ it is not efficient to charge those third parties, and

Cost should not be recovered in service charges where:

- ▼ costs incurred are not related or integral to the provision of products or services
- ▼ the activity is for the general business of government (eg, policy development).

Minimal cross-subsidisation

Cross-subsidisation should be avoided where possible, as it distorts the price signal sent to producers and consumers of government provided services and undermines the efficiency objective.⁵⁸

⁵⁴ PC (2001), p XLII.

⁵⁵ PC (2001), p XLIV.

⁵⁶ Productivity Commission, *Rural Research and Development Corporations*, Report No. 52, Final Inquiry Report, Canberra, February 2011, pp 121-131.

⁵⁷ Additionality here means that people should not be paid to do things they were going to do anyway (or were already doing) but the government may wish to contribute to have people undertake an activity where the net benefit to society exceeds those people's private benefit.

⁵⁸ Department of Treasury and Finance (Victoria), *2013 Cost Recovery Guidelines*, Melbourne, p 8.

To comply with this principle, decisions on cost recovery should be made on an individual activity or service basis rather than on an agency wide basis. This approach will reduce the potential for inefficient and non-transparent cross-subsidisation. However, there will be instances where an activity contributes to more than one outcome.

In its submission to the Draft Report, the NSW Irrigators' Council reiterated its objection to cross-subsidisation.⁵⁹ However, other stakeholders, Australian Land Management Group⁶⁰ B. Tomalin⁶¹ and the Board of Chairs LLS⁶² argue the funding framework should not create silos but rather there should be flexibility. This is not consistent with the aim of establishing Local Land Services NSW, improving governance and transparency.

Where an activity contributes to multiple outcomes or a single outcome requires multiple activities, the framework provides for an apportionment of responsibility and cost sharing. Table 4.2 distinguishes between different services, their private and public good characteristics and highlights the associated charging considerations.

For example, ratepayer funds for plant pest incursions could be combined with grant funds for biodiversity (for protection of native flora) to obtain benefits to private landholders and society, greater than if either program is run on its own. This is consistent with the 'additionality' principle discussed in Section 5.4.2.

The PC recognises that some degree of cross-subsidisation is unavoidable when an activity or service is funded using a rate or levy, rather than a fee for service.⁶³

3.3.2 Administrative efficiency

Funding and collection mechanisms should be simple and cost effective to administer. The cost of undertaking an activity and the administrative cost of the funding and collection mechanism should not outweigh the benefit of undertaking an activity. Where the administrative costs of an activity are greater than the net benefit of undertaking the activity, then an alternative cost recovery approach should be considered, or cost recovery should be reassessed.

By 'net benefit of an activity' we mean the benefits to an individual or group are greater than the cost of the LLS activity provided to generate these benefits.

⁵⁹ NSW Irrigators' Council submission to Draft Report, p 3.

⁶⁰ Australian Land Management Group submission to Draft Report, p 1.

⁶¹ B. Tomalin (individual) submission to Draft Report, p 1.

⁶² Local Land Services Board of Chairs' submission to Draft Report, 2 December 2013, p 2.

⁶³ PC (2001), pp XLIV-XLV.

3.3.3 Compliance with legislation and government policy

Cost recovery arrangements for services should take national and state policy settings and government objectives into account. When considering cost recovery for a service, it is important that other arrangements are considered to ensure the service is in line with broader objectives and does not duplicate existing efforts.

Recognition of existing arrangements

The Australian Macadamia Society (AMS), and NSW Cane Growers Association with the NSW Sugar Milling Co-operative are concerned that existing funding arrangements should be recognised when setting charges. For example, the AMS⁶⁴ and NSW Cane Growers,⁶⁵ respectively, state:

- we have a plant biosecurity levy and that can be set at whatever rate is necessary to fund our contribution towards incursion management
- the industry had, for many decades, undertaken its own organised and structured approach to what we now call biosecurity and crop protection through crop protection boards and other mechanisms.

A party should not have to pay twice for the same service. Therefore, any analysis of an existing or proposed service that does not consider (local and national) existing institutional arrangements could violate this principle. We address recognition of actions to mitigate risk in our discussion on exemptions (see Section 8.3).

However, duplication would have to be clearly demonstrated – it is possible for a service to be related to, but not duplicating existing arrangements. For example, funding by industry directed towards the national plant and animal deeds or other national priorities does not exclude industry from also funding local commitments that have a different emphasis. In 2012, the Animal Health Cost Recovery Review Reference Group (South Australia) noted that funds collected for national levies are not provided to States for post-border surveillance and emergency preparedness programs.⁶⁶

3.3.4 Transparency

Cost recovery arrangements, including how costs are allocated between relevant parties should be clear and easily understood.

⁶⁴ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 12:3-5.

⁶⁵ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 17:41-44.

⁶⁶ http://www.pir.sa.gov.au/__data/assets/pdf_file/0004/173263/Communique_-_Animal_Health_Cost_Recovery_Review_-_No.2_-_May_2012.pdf, p 2.

Appropriate consultation should occur with affected parties, to ensure any service provided meets its objectives in the most efficient manner, and the reasons for cost recovery are understood by those that will be charged. For example, consultation should explain the rationale for any charge and obtain useful information on designing an efficient cost recovery mechanism.⁶⁷

Reporting on how funds are used and the outcomes achieved from the suite of activities provided is also likely to assist stakeholder acceptance.

We consider the Board of Chairs LLS proposal to 'integrate the funds it receives from rates with multiple income streams'⁶⁸ is contrary to this principle.

Cost shifting

A number of submissions and comments to IPART express concerns about cost shifting.⁶⁹ Cost shifting refers to the unjustified allocation of costs to parties that do not create the need or receive a benefit from a service, but are required to pay the cost of its provision. The AMS at the public roundtable,⁷⁰ stated:

...a significant concern of ours in this process is that there will be cost shifting from the government to industry and more broadly the community.

The Ryan Report (2012) commented:

...cost shifting is not necessarily deleterious if the costs are directly attributable to the requirements of an industry or group or ratepayers, as they are costs imposed upon the rest of society that can be internalised to the industry or group of ratepayers.⁷¹

A change in cost allocation does not necessarily indicate a cost shift. A cost recovery framework should transparently show the reasons for the cost being attributed to a particular group over another. **Where costs are shifted without reason, the principle of transparency would be violated.**

However, it should not be assumed the current mix of funding for services is appropriate. We have not analysed current charging arrangements for each service – this is a task for the LLS boards. The allocation of costs may change when exposed to a cost recovery framework.⁷²

⁶⁷ PC (2001), p XLV, discussed a view put to it by industry participants that a stronger say was required by those being asked to pay, that is a 'user pays, user says' argument. The Productivity Commission acknowledges the risk of undue influence or agency capture, but considered that a degree of industry consultation is desirable to help drive agency efficiency.

⁶⁸ Local Land Services Board of Chairs' submission to Draft Report, 2 December 2013, p 2.

⁶⁹ In section 5.2, we discuss this issue further and in particular some submitters' view that the role of the taxpayer as funder of last resort may result in cost shifting.

⁷⁰ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 57:3-5.

⁷¹ Terry Ryan, *Report on the Review of the NSW Livestock Health and Pest Authority (LHPA) Model*, A review commissioned by the Minister for Primary Industries, February 2012, p 11.

⁷² We do not mention new services because we assume as new services are proposed they would be considered in light of the framework, rather than having a legacy funding approach applied.

In chapter 10, we discuss the preparation and publishing of annual compliance statements that allow for analysis and consultation to occur transparently. Additionally, the application of the funding framework is subject to periodic audit. We further discuss how cost recovery impact statements can be used during the development of LLS boards' strategic plans.

3.3.5 Consistency

The funding framework should be applied consistently across all LLS boards. However, consistent application of the framework does not mean that outcomes will necessarily be the same across LLS boards. For example, due to variations in climate and landscape, propensity for disease outbreaks and other factors, it is possible that services provided, who should pay and the appropriate funding approach may vary.

What should be **consistent** across LLS boards is the **application** of the **economic principles** within the framework to identify who should pay, their relative responsibility for the service and the best way for those identified to fund the provision of the service.

IPART finding

5 LLS funding framework should be consistent with the principles of:

- full cost recovery
- administrative efficiency
- compliance with legislation and government policy
- transparency
- consistency in the application of the framework.

3.4 Other stakeholder comments

In general, stakeholders have expressed support for the proposed principles.

The NSW Irrigators' Council broadly agrees with our principles, but is concerned that more detail could be provided on consultation between boards and stakeholders.⁷³ Other stakeholders have not changed their position from earlier comments, for example, NSW Farmers maintains its view the proposed principles are generally in line with its own principles.⁷⁴

Consultation is emphasised in the transparency principle (see Section 3.3.4) and it is a component of Step 3 of the framework (see Section 5.6).

⁷³ NSW Irrigators Council submission to Draft Report, October 2013, p 4.

⁷⁴ NSW Farmers' Association submission to Draft Report, October 2013, p 3. The original comment was in its submission to the Issues Paper, July 2013, p 7.

Some stakeholders expressed the view that biosecurity is an Australian Government (eg, border protection) issue and hence should be funded accordingly, not paid for by individual landholders.⁷⁵ This view does not consider the various layers of responsibility that exist. The Australian Government provides funding for biosecurity, but also requires States and Industry to contribute a base level of funding or provide risk mitigation activities. This approach recognises a shared role and is consistent with the Nairn review into Australian Quarantine⁷⁶ and Beale review⁷⁷.

NSW Farmers suggested an additional principle - robustness.⁷⁸ In general, robustness refers to the LLS's ability to raise sufficient funds to carry out its identified functions. We consider this principle is captured in the principle of full cost recovery.

At the Penrith Public Forum,⁷⁹ NSW Farmers expressed concern that the demand for some functions, such as responding to biosecurity threats, will be volatile. An issue is how the funding framework should take account of that volatility, to ensure sufficient funds are available in years when the demand exceeds available funds (eg, when locust plagues are particularly bad). This will require setting annual charges (eg, adopting an annuity approach) that will meet the anticipated cost of a service over the long term.⁸⁰

The Serrated Tussock Working Party (ACT & NSW) (STWP) contends we rely too heavily on the PC's report and questions its application to LLS. In particular, recovering costs for outcomes with public good characteristics when stakeholder cooperative action is preferred to having an external agency impose its activities and associated costs. STWP considers this scenario will be common to many LLS services.⁸¹

The framework provides for situations described by the STWP. In such situations 100% taxpayer funding may not be the most efficient result.

In addition, some matters may be confined to a particular area or region and therefore are more easily allocated to the appropriate parties.⁸²

⁷⁵ See Submissions to Draft Report by T Kirk (individual) p 1 and T Hackett (individual) p 3.

⁷⁶ Nairn, M.E, Allen, P.G, Inglis, A.R and Tanner, C., *Australian Quarantine: a shared responsibility*, Department of Primary Industries and Energy, Canberra, 1996, pp 200-205.

⁷⁷ Beale, R., Inglis, A., Trebeck, D. and Faibrother, J. *One Biosecurity – A Working Partnership*, the independent review of Australia's quarantine and biosecurity arrangements report to the Australian Government, September 2008, pp 25-26.

⁷⁸ NSW Farmers' Association submission to Issues Paper, July 2013, pp 4-5.

⁷⁹ NSW Farmers' Association, Penrith Public Forum, 8 July 2013, Transcript, pp 21-22.

⁸⁰ For example, in the past when the pest insect levy has not been sufficient to cover the costs of combating locust plagues, the NSW government has paid for this service in the year costs were incurred, and recovered the additional costs via the levy in the subsequent years.

⁸¹ STWP submission to Draft Report, October 2013, pp 3-5.

⁸² Marshall, G.R, *Economics of Cost Sharing for Agri-Environmental Conservation*, 42nd Annual Conference of the Australian Agricultural and Resource Economics Society, University of New England, Armidale, January 1998, pp 10-11.

The PC approach adopted in the funding framework is consistent with that applied in other states. For example, Fisheries Victoria has adopted the features of the funding hierarchy described in the PC report⁸³ in its review of cost recovery for commercial wild catch fisheries and aquaculture.

⁸³ See, <http://www.depi.vic.gov.au/fishing-and-hunting/commercial-fishing/fisheries-cost-recovery>, accessed 7 January 2014.

4 Funding framework for Local Land Services NSW

Once we identified the objectives and principles for the LLS funding framework, our next step was to develop the framework itself. This framework is consistent with the Productivity Commission's (PC) cost recovery guidelines⁸⁴ and incorporates features of the Biosecurity NSW approach,⁸⁵ in line with IPART findings 1-3 (discussed in Section 3.1). We also took account of the objectives and principles listed in IPART's findings 4 and 5 (discussed in Sections 3.2 and 3.3).

The framework recognises that LLS will undertake 2 types of activities – 'regulatory' and 'non-regulatory'. These activities may serve a common purpose or have separate purposes and may occur within a program or separately. To understand who should pay, a hierarchy of potential funders should be applied to all activities.

Regulatory activities provided by LLS relate to the monitoring, managing and enforcement of legislative requirements imposed on owners and occupiers. This is necessary because legislation affects landholders' property rights – for example, by restricting what they can do or requiring them to do certain things on their land.

Non-regulatory activities provided by LLS are additional services that do not directly relate to the monitoring, managing and enforcement of legislative requirements imposed on owners and occupiers – for example, advisory services for agricultural production and selling products or publications.

The sections below provide an overview of the framework and then discuss the first 2 steps of the framework in more detail. The remaining 4 steps are discussed in detail in Chapters 5, 6 and 10.

⁸⁴ Productivity Commission 2001, *Cost Recovery by Government Agencies*, Report no.15 AusInfo, August 2001.

⁸⁵ NSW Government, *NSW Biosecurity Strategy 2013-2021*, May 2013.

4.1 Overview of framework

The funding framework consists of a series of steps to guide the process and decision-making required to review, design and implement LLS' cost recovery arrangements. It is intended that LLS boards (or the LLS Board of Chairs) apply the funding framework following the development of their strategic plans and before putting a new cost recovery mechanism in place, or amending an existing mechanism. (See Chapter 9 for more information on when and how the framework is implemented.)

Step 1 – Is action necessary?

This step involves gaining an understanding of the problem (and the intended outcomes) and confirming that it is appropriate and necessary for the LLS to address it. The 'market failure test' is applied at this step.

Step 2 – What is the proposed solution?

This step involves specifying the activity (or program of activities) required to address the problem, including its intended outcome and required resources. A key objective of this step is to ensure the level of the activity is the minimum necessary to achieve the intended outcome and meet the needs of the community. Identifying whether an activity is regulatory or non-regulatory at this stage assists with selecting the costing approach and may provide an early indication of who should pay.

Step 3 – Who should pay and how much should they pay?

This step is to determine who should fund the activity and how to allocate costs. It involves working through the following hierarchy of potential funder categories:

1. impactor(s) or risk creator(s) – including land managed by government
2. beneficiaries:
 - a) direct beneficiaries, then
 - b) indirect beneficiaries (in a co-funding arrangement)
3. taxpayers, as funder of last resort, where risk creators or beneficiaries have not been identified and a public land management agency does not enter the hierarchy as an impactor/risk creator or beneficiary.

This hierarchy reflects the view that an impactor pays approach is preferable where government activities relate to regulation of the use of property rights.⁸⁶ However, it is likely that the beneficiary pays approach is more relevant for non-regulatory activities as these activities are aimed at creating value that did not exist before rather than imposing restrictions on landholder's actions. Nevertheless, all activities should be assessed through the common hierarchy to confirm which cost recovery strategy is appropriate.⁸⁷

In Step 3, the objective is to identify the appropriate funder(s) within the hierarchy that it is feasible, efficient and effective⁸⁸ to charge for the activity. This step also includes costing the activity and undertaking a cost-benefit analysis in consultation with stakeholders. For core regulatory activities, a fully distributed costing approach should be used. For additional, non-regulatory activities, an avoidable or marginal costing approach may be used. These costing approaches are discussed in Section 5.6.

Step 4 – How should they be charged?

This step is to decide which funding option to use, for example, fee, general rate, special purpose rate or taxpayer funding.

Step 5 – How should the charge be collected?

Step 5 is to decide how the selected funding option should be collected. This step involves considering whether it is appropriate for LLS to collect its own fees, rates or levies, or whether collection by another entity (such as local government) may be more efficient.

Step 6 – Has efficient cost recovery pricing been applied?

This step is to assess the extent to which efficient cost recovery pricing has been applied.

Table 4.1 summarises the key steps of the framework.

⁸⁶ Aretino, B., Holland, P., Matysek, A. and Peterson, D., 2001, *Cost Sharing for Biodiversity Conservation: A Conceptual Framework*, Productivity Commission Staff Research Paper, AusInfo, Canberra, p 44 (from now onwards referred to as Aretino *et al* (2001)). The views expressed in staff papers are those of the staff involved and do not necessarily reflect those of the Productivity Commission. Further, this view on impactors is also appropriate for risk creators, a term associated with biosecurity.

⁸⁷ We discuss impactor /risk creator pays and beneficiary pays in section 2.2.

⁸⁸ For example, charging them would not create perverse incentives or affect LLS' ability to achieve its objectives.

Table 4.1 Summary of funding framework for LLS

Phase	Step
Review	7. Understand the problem, and confirm that LLS should take action: <ul style="list-style-type: none"> – Link to statutory functions and strategic plan outcomes. – Conduct market failure test. 8. Specify the activity required to address the problem.
Design	9. Determine who should fund and how to allocate costs: <ul style="list-style-type: none"> – Select appropriate funder using hierarchy. – Cost the activity. – Allocate costs to selected funder(s). – Undertake cost-benefit analysis in consultation with stakeholders. 10. Decide on the funding approach (fee or rate) to use.
Implementation	11. Decide how the fee or rate will be collected. 12. Assess the extent to which efficient cost recovery pricing has been applied.

Source: IPART.

We consider that this framework meets the objectives and principles discussed in Chapter 3. The framework is consistent with the PC's guidelines for cost recovery.⁸⁹ We also consider it is generally consistent with stakeholders' views.

4.2 Step 1: Understand the problem and confirm that LLS should address it

The first step of the funding framework is to understand the nature of the problem, and confirm that it is appropriate and necessary for LLS to address it.

4.2.1 Confirm LLS needs to address the problem

LLS needs to identify the market failure that is causing the problem and confirm that it is necessary for it to address the problem, which should be linked to a specific statutory function or strategic plan outcome.

The LLS Board of Chairs and each LLS board are required to prepare a strategic plan that outlines its objectives, the outcomes to be achieved and the delivery of these outcomes.⁹⁰ In preparing its strategic plan, the LLS boards must have regard to the State strategic plan for local land services, among other things.

⁸⁹ Productivity Commission 2001, *Cost Recovery by Government agencies*, Report no.15, AusInfo, Canberra.

⁹⁰ See *Local Land Services Act 2013* (NSW), ss 36-44 for State strategic plan, and ss 45-54 for local strategic plans.

As a general rule, there will only be a need for LLS action if the information generated in this step of the framework shows the problem's magnitude and consequences are significant enough to warrant action **and** there is a market failure. If this is the case, LLS boards should follow Steps 2 to 5. If it is not, they should reconsider taking action.

It is important to ensure regulatory or non-regulatory activities are necessary. Imposing cost recovery on top of ineffective arrangements will compound their distortionary effect.

4.2.2 Understand the problem

To understand the problem, LLS boards should:

- ▼ accurately describe its nature
- ▼ undertake a risk analysis to understand its magnitude
- ▼ identify the parties (individuals or groups, commercial or non-commercial) associated with the problem
- ▼ describe the expected outcome.

To classify the parties identified as impactors or risk creators, boards should ask:

'Who has caused this problem, or the need to address it?'

To classify the parties identified as beneficiaries, they should ask:

'Who has requested the problem be addressed, or will benefit from it being addressed?'

As discussed in Chapter 2, LLS' activities aimed at potential impactors/risk creators or beneficiaries include:⁹¹

- ▼ Private parties, such as individuals or businesses (including landholders).
- ▼ Collectives, including industry or community organisations or distinct groups of landholders (including public land managers).
- ▼ The community, which can be either:
 - the entire LLS rate paying community or all landholders within the LLS boundary (broader than ratepayers)
 - the NSW (or Australian) community – via taxation, where they benefit from or create the need for actions or where alternative charging options are not practical or cost effective.

⁹¹ The Ryan Report identifies 3 groups for which the functions of the LHPAs are delivered on behalf of; these include landholders, farming industries and the community. The Ryan Report also discusses a sequence of assessment beginning at a narrow individual level and broadening to the taxpayer, as the problem expands.

However, the actual parties to be charged will be determined based on analysis undertaken in Step 3.

4.2.3 Identify the market failure causing the problem

Government action to address a problem should only be taken if the market is unlikely to do so due to a market failure. Therefore, as part of Step 1 of the funding framework, LLS boards should link the problem to the market failure that will be addressed.

As the NSW Government's Guide to Better Regulation notes, 'market failure' has a very precise meaning in economics.⁹² It does not simply mean dissatisfaction with market outcomes. It refers to a situation when a market, left to itself, does not allocate resources efficiently.

Where market failures exist, there is a potential role for government to improve outcomes for the community, the environment, businesses and the economy. Governments may intervene to change the behaviour of businesses or individuals to address market failure or to achieve social and environmental benefits that would otherwise not be delivered. Government intervention is not warranted in every instance of market failure; in some cases the private sector can find alternative solutions.⁹³ Further, government intervention requires that there must be a practical means of intervention and intervention that results in a net benefit to society.

There are several main types of market failure – the most relevant to this review are briefly described in Box 4.1.

⁹² Better Regulation Office, *Guide to Better Regulation*, NSW Government, November 2009.

⁹³ Better Regulation Office, *Guide to Better Regulation*, NSW Government, November 2009, p 29.

Box 4.1 Forms of market failure most relevant to this review

Public Goods

Public goods exist where provision of a good (product, service, resource) for one person means it is available to all people at no extra cost and not possible to exclude those unwilling to pay. Public goods said to be '**non-excludable**' and '**non-rival**' (see under Public Goods below). This creates a problem with free-riding. Because the good is non-excludable, everyone can use it once provided. This makes it impossible to recoup the costs of provision by extracting payment from users.

The definition of a public good should not be confused with phrases such as 'good for the public', 'public interest' or 'publicly produced goods'. There are very few pure public goods.

Externalities

Externalities occur when an activity undertaken by an individual has side-effects on others that are not taken into consideration by the first individual. Externalities can be either positive (external benefit) or negative (external cost). Their existence can result in too much or too little of goods and services being produced and consumed than is economically efficient. For example, where the cost of producing a good does not include its full costs, say in relation to environmental damage, then a negative externality is said to exist. Resulting in the good being over-produced (and under-priced) relative to efficient level of production, if all costs were internalised.

The government may try to address negative externalities through regulation that mandates corrective measures; establishing property rights to create a market; charging for pollution generating behaviour; and persuasion (eg, advertising campaigns).

Source: Better Regulation Office, *Guide to Better Regulation*, Appendix A, Pannell, D., *Thinking like an economist 11: Externalities and market failure*, No. 35, January 2005 and IPART.

In its submission to the Draft Report, the Australian Land Management Group (ALMG) supports the concept of market failure and considers it should be more prominent in our report.⁹⁴ However, the ALMG also raised concerns that application of the use of market failure test may fail to account for:

- ▼ interdependencies in outcomes, for example embedding environmental outcomes with the goal of improved productivity (which is important for the additionality principle we propose), and
- ▼ economies of scope and scale.⁹⁵

⁹⁴ Australian Land Management Group submission to Draft Report, October 2013, pp 1-2.

⁹⁵ The submission refers to economies of association, we interpret this to mean scope where the LLS board may obtain multiple outcomes from the provision of a single activity.

These concerns, along with whether the framework can account for the mix of public and private benefits and the integrated delivery of services (and resulting outcomes), are also mentioned by other stakeholders.⁹⁶

The types of market failure we consider most relevant to this review are public goods and externalities.

Another potential market failure is information asymmetry, where one party has access to information not available to others. This may lead to a party making uninformed decisions. In such situations, parties to a transaction may seek assurance from independent sources to offset uncertainty. Where no independent assurance is available the price will reflect the level of uncertainty. For instance, where a party is buying livestock they may only purchase where independent advice is available or adjust their offer price accordingly.

The funding framework can be applied to assess outcomes that have a mixture of public and private benefits. The research that informed the development of the framework is based on cost sharing for biodiversity and rural research and development where there is a combination of public and private benefits. This research informed the development of the sub-hierarchy within beneficiary pays.⁹⁷ We discuss how mixed benefits can be considered in Section 5.3.

Public goods

The characteristics of market failure related to public goods are:

- ▼ non-rivalry in benefits, meaning the use of a good by one person does not impede another person from using the same good
- ▼ non-excludability in use, meaning that it is not possible to preclude another people from accessing the good. If people can enjoy the good without paying, it will be difficult to recover costs from users (charge for it).

A pure public good has both characteristics of non-rivalry and non-excludability. These characteristics may mean that it is more efficient for government to provide a good if it wishes to maximise net benefits to society. Governments may, and usually do, provide goods with significant public good characteristics.

⁹⁶ Other stakeholders that mentioned the issue of integrated service delivery include B. Tomalin (submission to Draft Report, October 2013, p 1) and B. Wilde (public roundtable, p 56:29-42).

⁹⁷ The concept of additional actions from Aretino *et al* (2001), p 23, or 'additionality' from PC (2011), Box 2 p XX, is expressly incorporated into the framework to take into account mixed benefits.

The term '**public goods**' is often confused with the concept of public (or private) benefits. It is also incorrectly used interchangeably with terms such as, 'publicly provided good' or the notion of collective ethical action 'for the public good'. Some examples of how the term public goods can be misunderstood include:

It is a public good, therefore the public is the beneficiary and should pay or the beneficiaries are private, therefore it cannot be a public good problem.⁹⁸

We have separated public goods into 2 categories, 'pure' and 'selective' to distinguish between benefits to the widest possible group and to specific groups.⁹⁹ An example of a selective public good is applied research that may be subject to the free-rider problem between producers. An industry levy could be used to address this problem to ensure beneficial research is undertaken and those that benefit from it contribute to its cost.¹⁰⁰ This example is discussed in the PC's review of rural research and development corporations.¹⁰¹

Examples of (pure) public goods are less common than selective public goods, mixed public goods (often described as club goods and common-pool goods¹⁰²), and private goods. This distinction between the types of public good problems highlights the need to clarify the market failure related to public goods.

Further steps are required to determine whether government should provide a public good. These include ensuring that:

- ▼ there is a practical means of intervention
- ▼ the potential efficiency gains, net of the costs of intervention, are positive and of a similar order of magnitude to competing uses of government funds.

NSW Farmers¹⁰³ support further clarification around public and private goods and benefits. Table 4.2 describes various types of public goods and externalities and includes examples and charging considerations. It also incorporates comments by ALMG.¹⁰⁴ The conclusions in this table are indicative only and actual outcomes may vary depending on the specific situation.

⁹⁸ Department of Environment and Primary Industries (Victoria), *The Case for Cost Recovery*, (circa 2010), <http://www.dpi.vic.gov.au/agriculture/pests-diseases-and-weeds/pest-insects/queensland-fruit-fly/review-of-fruit-fly-in-victoria/funding-of-a-queensland-fruit-fly-qff-management-program-in-victoria/3-the-case-for-cost-recovery> (no longer active), p 4, accessed 17 June 2013.

⁹⁹ In the NSW Biosecurity Strategy 2013-2021, the decision tree in Appendix A refers to Industry Goods. We consider 'selective' public goods are analogous to that term.

¹⁰⁰ There are limitations to this argument, especially where benefits are spread thinly across industries or accrue mainly to the wider community.

¹⁰¹ Productivity Commission, *Rural Research and Development Corporations*, Report No.52, Final Inquiry Report, Canberra, 2011, pp XVII-XXIII - (See Box 2 and Box 4).

¹⁰² Common-pool goods are rivalrous but non-excludable, eg, fish stocks in the open ocean. A potential equivalent in terms of LLS boards is the use of travelling stock reserves.

¹⁰³ NSW Farmers' Association submission to Draft Report, October 2013, pp 4-5.

¹⁰⁴ ALMG submission to Draft Report, October 2013, p 2 dot point 2 of additional comments regarding one-on-one or group training courses.

Table 4.2 Types of public and private goods with charging considerations

Description	Examples of programs or services performed				Charging consideration	Public / Private benefit
	LHPA	CMA	DPI Extension	Emergency response		
<p>'Pure' public goods Are non-rivalrous in consumption meaning any party can use the good without affecting another party's enjoyment and non-excludable which means it is not possible or efficient to prevent access to the good once it is provided.</p>	Maintain corridors of native vegetation in Travelling Stock Reserves for wildlife movement.	Catchment Action Plan; service point for government programs; community resilience programs.	Basic extension eg, noxious and environmental weed control handbook; improve linkages with researchers.	Preparation – arrangement / plans to deal with emergency (eg, Emergency Management Plan – Biosecurity Sub Plan; establishing MoUs with government.)	The non-rivalrous and non-excludable nature of public goods means they are not easily provided by the market. A strong case exists for taxpayer funding where a net benefit is provided to the community.	Public.
<p>'Selective' public goods Have the characteristics of a public good but mainly benefits a narrow group of users.</p>	Animal health – zoonosis, record maintenance and reporting of disease; Livestock identification (emergency response zoonotic).	Integrated land management program; salinity reduction; weed management advice and control program.	Applied extension – employs results from applied research directed at specific problems (eg, new crop varieties).	Prevention – identification of hazard and (control) measures to reduce risk.	These types of public goods lend themselves to be funded by the identifiable beneficiaries through compulsory rates. Funding may also come from the public sector where there are significant external benefits to society.	Private with a degree of public benefit.
<p>Club goods Goods/services that can be used by anyone within a group without affecting anyone else's use but can be excluded to non-club members.</p>	Livestock identification (information, market access); pest & weed control; active surveillance – monitoring	NA	Development extension – adopting research results in a commercial environment eg, crop variety advice;	Response – providing immediate relief to affected parties such as agricultural damage assessment; and recovery.	May be provided and funded by collectives of beneficiaries (eg, industry organisation). The public sector may provide club goods, and charge the members of the 'club' through rates .	Private.

Description	Examples of programs or services performed				Charging consideration	Public / Private benefit
	LHPA	CMA	DPI Extension	Emergency response		
	endemic disease in livestock and plants.		reproductive management; market access advice.			
<p>Private goods Are rivalrous in consumption and excludable which means another party is prevented from their use.</p>	Animal health – non-zoonosis; animal husbandry; livestock identification (product differentiation).	Farm plans.	Specific financial and technical advice.	Assist in co-ordinating relocation and feeding of livestock.	Costs should be recovered from those that benefit from private goods (user pays).	Private.
<p>Positive externalities Some goods provide unrelated third parties to a transaction with benefits that are not paid for. The market is likely to under-provide this type of activity.</p>	NA	Support community Natural Resource Management (NRM) infrastructure.	Some basic and applied extension.	Preparation and prevention activities more likely to result in externalities.	There may be a case for co-funding to encourage beneficial externalities, but should be considered in light of additional benefits beyond the by-product of private actions.	Public good (pure/selective).
<p>Negative externalities Governments may need to regulate certain activities to reduce the risk of harm that may occur to consumers, the community or the environment.</p>	Plant and animal health regulation; chemical residue regulation.	Native vegetation regulation; threatened species regulation.	NA	Breaches of stock movements in an emergency.	On economic efficiency grounds the administrative costs should be internalised into the cost structure of the regulated industry – as an impactor/risk creator . Practical considerations usually mean businesses are charged, but ultimately costs are shared along the supply chain.	Public bad (pure/selective).

Notes:

1. Table 4.2 does not take into account the potential application of the sufficiency principle. This principle is most applicable for 'selective' public goods, where it may be efficient for taxpayers to free-ride on the spillover generated.
2. **Merit goods** (eg, education and the arts) are not considered as relevant for this review. **Common Pool goods** are rivalrous in use but non-excludable in consumption eg, open water fisheries, but are not considered here as they are less likely for the LLS situation. Notwithstanding the previous statement, Travelling Stock Reserves are an example of a good that potentially suffer from problems associated with common pool goods, commonly known as 'the tragedy of the commons' (nobody has incentive to look after common property). A potential remedy to this problem is the allocation of property rights, for example, through the issuance of permits to use the good. A **Public bad** has similar characteristics to a Public good, but its consequences are detrimental to another party.
3. Livestock identification is an example of an activity that could cut across many categories depending on the outcome sought from the provision of an identification system. This multiplicity of outcomes is why it is important to consider the activity provided rather than a generic function. The example is adapted from Hobbs *et al* (2009).
4. Zoonosis is an infectious disease that is transmitted between species from animals to humans [DPI Victoria, accessed 26/2/2014]. Non-zoonotic diseases affect animal health and may lead to loss of production.
5. Basic, applied and developmental classification of extension activities sourced from Lloyd (1986). This classification is useful as it provides an indication of the information being communicated through an extension activity.
6. We have classified emergency response activities at a high-level. A specific activity within a particular group (eg, prevention) may have characteristics that mean it is classified elsewhere. The outcome sought from an emergency response activity is the key guide since an emergency may be either from a natural disaster or biosecurity event; we have not attempted to classify them. For example, the October 2013 H7 outbreak compared to an outbreak of H5N1 that is likely to have significant spillover beyond the industry.

Source: IPART; Department of Treasury and Finance (Victoria), 2013, *Cost Recovery Guidelines*, Melbourne, Table 3.1, pp 14-15; NSW Government, Local Land Services – Functions and Service Delivery see, <http://engage.haveyoursay.nsw.gov.au/document/show/880>; Alan G. Lloyd, *Rural economics study*, A Report to the Minister for Agriculture and Rural Affairs by Professor Alan G. Lloyd, Victoria July 1986 (Lloyd (1986)), pp 140-141; Hobbs, J.E, Kerr, W.A., and Yeung, M.A, Growing Forward - *Public and Private Goods: The Canadian National livestock and Poultry Traceability Program*, Report for Agriculture and Agri-Food Canada, August 2009 (Hobbs *et al* (2009)).

Public and private benefits

‘The public’ is the aggregation of all private individuals (eg, business owners, private individuals, taxpayers, consumers). Therefore, private benefits exist to the narrowly defined individual or group of individuals being considered and public benefits accrue to everyone else (ie, the public).¹⁰⁵

Public benefits can be considered as wider community benefits, as long as it is understood the wider community includes everyone other than the individual (or narrow group) beneficiary.

Some people use a narrower definition of ‘the public’. For example, the public “is generally taken to mean a group of non-commercial beneficiaries forming either part, or all, of ‘the public’”.¹⁰⁶ This narrower view fits with the idea that government should focus on generating public benefits (eg, health, environment) not private benefits. However, we consider this view may be counterproductive if the idea behind spending public money is to maximise the return on the investment, ie, to leverage off private contributions, which may also achieve these other non-market benefits.

4.2.4 Worked examples of Step 1 of the funding framework

Table 4.3 contains 3 worked examples for Step 1. These examples are continued through all 6 steps and together can be used to understand how the proposed funding framework would apply.

Note these are only examples of how specific issues can be assessed in Step 1; answers may differ depending on regional and local circumstances.

¹⁰⁵ See, Pannell, D., *Thinking like an economist 5: Public goods and public benefits in NRM*, #22, 2004, for this broader view of public/private benefits.

¹⁰⁶ Department of Environment & Primary Industries (Victoria), *The Case for Cost Recovery*, (circa 2010), p 4.

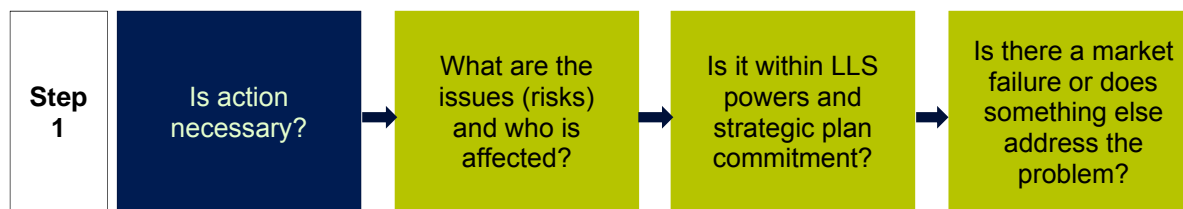


Table 4.3 Examples - Step 1: Is action necessary?

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
Identified problem	Private horticulturists are not investing in beneficial research as: <ul style="list-style-type: none"> the cost of the research exceeds the private benefits gained by any one landholder the outcomes of the research, once available, may be used by others without contributing to the cost 	A disease outbreak occurs on a landholding posing a threat to livestock on adjoining properties but not a public health risk nor threat to native animals.	Wild dogs are found in national park, on forestry land and private landholdings attacking livestock and native fauna.
What are the issues & who is affected?	The opportunity for productivity improvement by landholders is lost	The disease could spread affecting the health of livestock on other properties and the industry could be banned from export markets.	<ul style="list-style-type: none"> Loss of farm productivity Reduced biodiversity
Is it within LLS powers & strategic plan commitments?	Yes <ul style="list-style-type: none"> Relevant to LLS functions under LLS Act s4 Potentially linked to objective of increasing agricultural production in 2014 Local Strategic Plan. 	Yes. <ul style="list-style-type: none"> Relevant to LLS functions under LLS Act s4 Potentially linked to animal disease management, control and eradication objective in 2014 Local Strategic Plan. 	Yes. <ul style="list-style-type: none"> Relevant to LLS functions under LLS Act s4 Potentially linked to animal pest management, control and eradication objective in 2014 Local Strategic Plan.
Is there a market failure or does something else address the issue?	Yes, there is a market failure. Selective public good: <ul style="list-style-type: none"> Unable to restrict the benefits of the research to those who contributed to its cost May be provided by a private firm in combination with an industry group pooling its resources. 	Yes, there is a market failure. Negative externality: <ul style="list-style-type: none"> Requires coordinated action from LLS to take preventative action for the benefit of the entire industry The landholder with the diseased livestock may be discouraged from reporting the disease if they were to be charged the full costs of the preventative action. 	Yes, there is a market failure. Negative externality: <ul style="list-style-type: none"> Requires action from LLS co-ordinating the response of national parks, forestry and private landholders. LLS action benefits the community from reduction in pest animals and increased biodiversity and for private landholders from reduced stock losses.

Source: IPART analysis.

4.3 Step 2: Specify the activity required to address the problem

Once the nature of the problem is understood and the need for LLS boards to address it has been confirmed, the next step of the framework is to specify the activity required to overcome the problem (and hence rectify the market failure) and achieve the LLS board's outcomes. This involves clearly describing the activity including, for example, the intended outcome, the resources required and where these resources will be used.

If the intervention comprises more than one activity, LLS boards should generally assess each activity separately using the framework. This is important for Step 3 of the framework, which involves identifying the impactor/risk creator or beneficiary of the activity. Assessing diverse activities together makes it more difficult to accurately identify this individual or group. It also makes it more likely that cross-subsidisation will occur. Cross-subsidisation weakens the case for cost recovery.

However, where the nature and intended outcomes of the activities have sufficient similarities or overlap – eg, the same resources will be employed in the same areas for the same intended outcome – they may be able to be grouped and assessed at the same time. Research and monitoring may be examples of activities with similar characteristics. Research and control activities are less likely to have similar characteristics.

As part of this step, the LLS boards should also ensure the level of the existing or proposed activity is the minimum necessary to achieve the intended outcome and meet the needs of the community.¹⁰⁷ This is important to ensure the most efficient activity is applied to the problem and no unnecessary costs are imposed on those required to pay. Establishing the minimum required level may involve:

- ▼ consultation with the community
- ▼ benchmarking against similar activities in other areas
- ▼ market testing to allow third party suppliers to provide the activity.

¹⁰⁷ A useful tool that may assist LLS boards to choose among a variety of policy tools, ie activities to affect desired outcomes is the *Public: Private benefits framework developed by Pannell*. Pannell, D., *Public benefits, private benefits, and the choice of policy tool for land-use change: Summary*, 2008, see <http://dpannell.fnas.uwa.edu.au/ppf.htm>.

Stakeholder comments

The ALMG considers the framework should focus on intended outcomes and not on activities because LLS activities are integrated and serve interdependent outcomes.¹⁰⁸ Stakeholders argue that a focus on activities may promote funding silos, which is contrary to the purpose of an integrated entity.¹⁰⁹

Under Step 1 of the framework the problem is defined and intended outcomes are nominated. Step 2 devises a program of activities that flow from the outcomes. Some activities will be directed at more than one outcome, eg, confer both private and public benefits. In recognition of this, some activities and hence outcomes will be paid for by a combination of private and taxpayer funding (see Section 5.4.2). In other cases fees for service and specific purpose rates charges will link to a specific outcome. While this may be seen as creating a funding silo it is necessary for transparency and accountability of LLS.

In its promotional material supporting the formation of LLS the Government posed the following questions:¹¹⁰

- Why should citrus growers pay LHPA rates for wild dog and sheep lice control when they want more resources for fruit fly control?
- Why should North Coast dairy producers pay for plague locust control when they need more resources for tick control?

The STWP supports a greater emphasis on public funding than may be the case with application of the guidelines:¹¹¹

If good practice is followed, Local Land Services functions will most often be based on information, assistance, and incentives and rewards, rather than on regulation and commercial services.

Similarly, the ALMG emphasises motivating rather than mandating.¹¹²

The framework does not discriminate against these approaches. However, the government has seen it necessary to mandate actions particularly where the interests of the individual may conflict with the broader community and the consequences of inaction are significant (eg, combating biosecurity threats).

Therefore, we consider the framework accommodates the issues raised by stakeholders.

¹⁰⁸ ALMG submission to Draft Report, October 2013, p 2.

¹⁰⁹ B. Tomalin (individual) submission to Draft Report, October 2013, p 1.

¹¹⁰ NSW Government, Local Land Services: Productive Primary Industries, Connected Catchments. Accessed on 25 February 2014. Link: http://www.dpi.nsw.gov.au/__data/assets/pdf_file/0005/444803/minister-primary-industries-presentation.pdf.

¹¹¹ Serrated Tussock Working Party for the NSW and the ACT submission to IPART Draft Report, 15 October 2013, p 1.

¹¹² Australian Land Management Group, Innovation in Land Management, September 2013, p 1.

4.3.1 Link the activity to a specific statutory obligation or strategic plan outcomes

LLS boards should link the activity to a specific statutory requirement or objective in their strategic plans. This is consistent with the principle of ‘compliance with legislation and government policy’, discussed in Chapter 3. It is likely to be more relevant for non-regulatory activities to ensure they are in line with broader objectives and do not duplicate efforts already being undertaken.

The issue of duplication of effort was raised by the Australian Macadamia Society¹¹³ at the public roundtable and in submissions from the NSW Cane Growers/NSW Sugar Milling Co-operative¹¹⁴ and NSW Irrigators’ Council.¹¹⁵ We agree with stakeholders that where a landholder is taking verifiable steps to mitigate risk, it would make sense to not duplicate effort. This issue is considered in more detail in Section 8.3 where exemptions are discussed.

Additionally, all LLS boards are required under section 48 of the LLS Act to consult widely on their strategic plans. Many parties that have contributed to this review have highlighted the importance of consultation. The Chair of the LLS Board of Chairs acknowledged this at the public roundtable, stating, “it comes back down to accountability, transparency and good community and stakeholder consultation”.¹¹⁶

Therefore, we consider Steps 1 and 2 of the framework adequately address the need for consultation. This consultation is likely to ensure the outcomes sought by stakeholders and required of LLS will be achieved.

4.3.2 Identify whether the existing or proposed activity is regulatory or non-regulatory¹¹⁷

Regulatory activities are necessary because of legislation that restricts or regulates landholders’ property rights – for example, by placing enforceable obligations on them to take certain actions, such as controlling pests on their land, animal disease prevention, complying with pesticide control orders and the clearing of native vegetation. Regulatory activities, in the context of this review, generally relate to monitoring, managing and enforcing compliance with these obligations.

¹¹³ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 12:9-15.

¹¹⁴ Joint NSW Cane Growers and NSW Sugar Milling Co-operative Ltd submission to Draft Report, October 2013, p 2.

¹¹⁵ NSW Irrigators’ Council submission to Draft Report, October 2013, p 4.

¹¹⁶ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 56:20-22.

¹¹⁷ Various submissions to Issues Paper, July 2013 (NSW Farmers, p 7 and B. Tomalin, p 5) considered LLS activities could be split between statutory/regulatory activities and other activities and this distinction should be made clear; this view is in accordance with the approach undertaken by the PC (2001).

Non-regulatory activities are all other activities, including those LLS is required to undertake to fulfil its statutory functions, and those it chooses to undertake to meet the objectives of its strategic plans. Examples of these non-regulatory activities include developing research partnerships and extension services such as the PROfarm.¹¹⁸

In general, if the activity is regulatory and it is related to property rights that regulate a party's actions, the identified parties are likely to be impactors or risk creators. Similarly, if it is non-regulatory, these parties are likely to be beneficiaries as the activity seeks to create value where none existed before. The type of activity (regulatory or non-regulatory) is also related to which costing approach is relevant. This is discussed at Section 5.7.

Stakeholder comments

There are conflicting views on the value of classifying activities as regulatory or non-regulatory. NSW Farmers support this classification but the STWP considers it unhelpful.¹¹⁹ The ALMG notes that care should be taken to ensure the distinction does not preclude synergistic use of both type of activities.¹²⁰

In the Draft Report we split the framework into these categories based on our research (ie, PC approach) and comments from stakeholders.

In this Final Report we have maintained a distinction of regulatory and non-regulatory, but have chosen not to have separate frameworks.

We also note that the framework is able to accommodate a program of activities, such as a combination of regulatory and non-regulatory activities, which is intended to produce multiple outcomes (eg, farm productivity, natural resource management and biosecurity).

We consider that while activities should ideally be assessed separately, similar activities can be considered collectively under the framework without loss of efficacy. Assessment by activity is recommended by the PC¹²¹ and also a review into Fisheries Victoria's operations.¹²² The LLS may have a portfolio of activities that are aimed at different groups and the only way to consider which group(s) should pay for activities may be to assess them separately. The framework allows for aggregation later when LLS boards calculate fees. The process of aggregation effectively determines cost-sharing between LLS' various

¹¹⁸ PROfarm is the training program developed by NSW Department of Primary Industries (NSW DPI) to meet the needs of farmers, primary industries, agribusiness and the community. Link: <http://www.dpi.nsw.gov.au/agriculture/profarm/about>

¹¹⁹ See submissions to Draft Report (October 2013) by NSW Farmers p 4 and STWP p 7.

¹²⁰ ALMG submission to Draft Report, October 2013, p 2.

¹²¹ PC (2001), pp 157-158 (recommendation 7.2).

¹²² Department of Primary Industries, *Commercial Wild Catch Fisheries and Aquaculture Cost Recovery Review*, Economics and Social Research Branch prepared for Fisheries Victoria, 2012, p 34.

stakeholders, based on whichever activities are finally provided to deliver a LLS board's outcomes.

Recommendations

- 1 LLS boards should adopt the 6-step cost recovery framework summarised in Table 4.1.
- 2 Each LLS board should use the cost recovery framework to assess its operations at the activity level. These activities are determined by the strategic plans developed by the LLS Board of Chairs and LLS boards. The LLS Board of Chairs can also apply the cost recovery framework at the strategic level to assess if there are economies of scale between the LLS boards.

4.3.3 Worked examples of Step 2 of the funding framework.

Table 4.4 continues the examples from Step 1, providing example answers to the questions posed in Step 2 of the funding framework. Note these are only examples of how specific issues can be assessed in Step 2; answers may differ depending on regional and local circumstances.

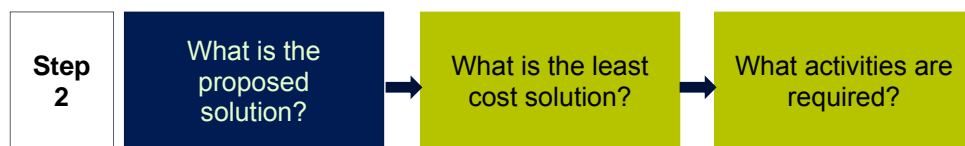


Table 4.4 Examples - Step 2: What is the proposed solution?

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
Identified problem (restated for convenience)	Private horticulturists are not investing in beneficial research as: <ul style="list-style-type: none"> ▼ the cost of the research exceeds the private benefits gained by any one landholder ▼ the outcomes of the research, once available, may be used by others without contributing to the cost 	A disease outbreak occurs on a landholding posing a threat to livestock on adjoining properties but not a public health risk nor threat to native animals.	Wild dogs are found in national park, on forestry land and private landholdings attacking livestock and native fauna.
What is the least cost solution?	Coordinated research made available to all in affected industry.	Intervention on the infected property to eliminate the disease	Eliminate, to the extent practical, wild dog population through baiting program.
What activities are required?	<ul style="list-style-type: none"> ▼ Define scope of possible research program ▼ Cost the proposed research program ▼ Liaise with industry on demand for program & refine scope. It may be a service that industry is already providing or already well serviced by private sector providers. ▼ If decide to proceed, undertake market testing to compare in-house vs market provided service. 	<ul style="list-style-type: none"> ▼ Removal & disposal of diseased livestock ▼ Testing of livestock on adjoining properties ▼ Publicising disease outbreak to encourage reporting of other possible cases. 	<ul style="list-style-type: none"> ▼ Scope extent of problem ▼ Develop a co-ordinated plan with national parks, forestry and private landholders for baiting and on-going monitoring of problem.

Source: IPART analysis.

5 Step 3: Determine who should fund the activity and how to allocate costs

As Chapter 4 discussed, the funding framework consists of a 6-step process. Steps 1 and 2 begin the process by having LLS boards consider whether there is a need for action (ie, an activity) to address a problem **and** to devise a course of action to achieve the desired outcome. The next step is to consider who should pay for the activity and how to allocate costs. This chapter provides an overview of Step 3 in the framework.

5.1 Overview of Step 3

The objective of Step 3 is to determine who should fund the activity and to decide what share of the cost they should pay. This step involves 4 key components:

- ▼ selecting the funder(s) by identifying who is the most feasible, efficient and cost effective party to charge and applying the appropriate cost recovery approach (impactor/risk creator or beneficiary pays)
- ▼ allocating the cost of the activity to the selected funder(s)
- ▼ costing the activity, and
- ▼ undertaking cost-benefit analysis in consultation with stakeholders.

The outcome of the application of cost recovery and cost allocation approaches may differ depending on whether the activity is a regulatory activity or non-regulatory activity. For example:

- ▼ in the case of **regulatory activities**, we expect the **impactor or risk creator** will more likely be identified as the party to pay under the cost hierarchy
- ▼ in the case of **non-regulatory activities**, we expect the **beneficiary** will more likely be identified as the party to pay under the cost hierarchy.

5.2 Hierarchy of potential funders of LLS board activities

The funder(s) of LLS boards activities should be determined using the following hierarchy of potential funder categories:

1. impactors or risk creators – including land managed by government agencies
2. beneficiaries:

- a) direct beneficiaries, then
 - b) indirect beneficiaries (in a co-funding arrangement)
3. taxpayers, as funder of last resort, where risk creators or beneficiaries have not been clearly identified, or it is inefficient to charge them.

An impactor/risk creator or a beneficiary may be either a private party or a government agency. The hierarchy does not distinguish between them for assessing whether they are risk creators or beneficiaries.

The framework should be applied in the order presented above. That is, where an impactor or risk creator can be identified, they should be selected first, and the proportion of costs they should pay, if any, should be determined. If there are no impactors or risk creators, beneficiaries should be selected, and the proportion of costs they should pay, if any, should be determined.

This hierarchical approach ensures that the selected funder is the party closest to, and most able to influence a problem. It is also consistent with the literature that suggests a sequential assessment is appropriate where the regulation is intended to minimise impacts on other parties.^{123,124}

Impactors / risk creators

Where property rights are established, failure to comply with related obligations may impose an external cost on another party, such as another landowner, business or the community.¹²⁵

Therefore, it is appropriate for LLS boards to recover the costs associated with encouraging, managing, monitoring and enforcing compliance from parties that impose an external cost or create a risk that results in external costs. It is also more likely that the impactor/risk creator will be able to adjust their actions to mitigate the risk they have created.

Beneficiaries

However, where a benefit is created by LLS board activity, it is appropriate for those who capture that benefit to contribute to the cost of the activity. In this case it is also unlikely that an impactor/risk creator exists. The beneficiary pays approach is generally applicable where the activity provides a benefit where no benefit existed before.

¹²³ Aretino, B., Holland, P., Matysek, A. and Peterson, D., *Cost Sharing for Biodiversity Conservation: A Conceptual Framework*, Productivity Commission Staff Research Paper, AusInfo, 2001, p 44.

¹²⁴ PC (2001), pp 33-34.

¹²⁵ Property rights determine who owns and controls a resource (such as land) and how it is used. These rights are created, restricted and regulated by legislation and common law.

Taxpayers

Taxpayers may be considered as a funder of last resort where risk creators or beneficiaries have not been clearly identified; or where it is not administratively efficient to charge. However, this is only appropriate if the intervention leads to a net social benefit of at least similar size to other uses of these funds (this is discussed further in Section 5.6). A public land management agency may enter the hierarchy as an impactor/risk creator or beneficiary.

Stakeholder comments

Some stakeholders have expressed support for the hierarchy of potential funders in submissions¹²⁶ and at the public roundtable.¹²⁷ However, the NSW Farmers' Association (NSW Farmers) expressed concern that the recommendation of government as funder of last resort within the hierarchy potentially alleviates some of the duties of the government and their funding commitments to LLS.^{128,129} The Uralla Council¹³⁰ is concerned with the Board of Chairs' endorsement of recommendation 7, that government funding be available to the LLS as a funder of last resort. The council considers this recommendation is cost shifting from Government to the landholder.

This matter is further discussed in Section 5.5, where the funder of last resort concept is explained.

Additionally, some stakeholders are concerned whether it is possible to efficiently and effectively identify impactors or risk creators.¹³¹ This concern may have arisen from a misunderstanding of the distinction between impactors and risk creators, which we define in the glossary of this report.

Impactors may or may not be identifiable for issues related to biosecurity or natural resource management. However, a risk creator is more likely to be identifiable because the activity they are engaged in, eg, as primary producers or as landowners, makes them:

- ▼ susceptible to a problem that potentially requires LLS boards to act
- ▼ exacerbate the problem through inaction, requiring LLS boards to act.

¹²⁶ See submissions to Draft Report (October 2013) by North West LHPA, p 3, and Cumberland LHPA, p 1.

¹²⁷ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, (J. Burnett) pp 10:47-11:1; (B. Wilde) p 13:19-21, (J. Macarthur-Stanham) p 24:45-47.

¹²⁸ NSW Farmers' Association submission to Draft Report, October 2013, p 6.

¹²⁹ The Local Government Association shared similar concerns, see, IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 16:18-26.

¹³⁰ Uralla Council submission to Local Land Services Board of Chairs submission, December 2013, pp 1-4. Submissions by T. O'Connor (individual), p 1, and Namoi Councils, pp 2-4, to the submission by Local Land Services Board of Chairs also support this view.

¹³¹ This issue was raised by the NSW Irrigators' Council in its submission to the Draft Report, October 2013, p 5, and the SWTP at the public roundtable, p 9:8-10, amongst others.

This distinction is important, for example, a single primary producer who is not vigilant in their care of animals may potentially spread disease to other producers. However, the spread of the disease occurs because more than one producer is keeping susceptible animals. LLS boards may then wish to charge either type of risk creator (the single primary producer or all producers keeping susceptible animals) depending on the circumstances.

A LLS board may rate all producers as they are susceptible to the same issues and individual impactors are difficult to identify and charge. Also, collective action is demanded and required. However, an LLS board could potentially charge an impactor if they are identified later, for example through more intensive inspections.

The cost recovery strategy of impactor pays (and the analogous risk creator pays) is the basis for actions such as pollution taxes. We have also found a number of examples of the risk creators pays approach related to biosecurity.¹³²

The hierarchy of potential funders allows for both cost recovery strategies to be considered, so where impactors or risk creators are not identifiable or it is not efficient to charge them, beneficiaries are considered next. Direct beneficiaries should be considered before calling on indirect beneficiaries. We consider this sequential assessment to be suitable as it initially considers those closer to the issue who are better able to do something about it.

Who should pay for a government service?

NSW Farmers also questioned whether producers or consumers should pay the costs of government services that are imposed for the benefit of the community.¹³³ It noted that primary producers are “price takers” and their costs are not necessarily passed on to consumers.¹³⁴

While individual primary producers are price takers, this is not necessarily the case for the agricultural industry as a whole. Individual production decisions are influenced by a change in the cost of inputs to production, given the prevailing prices for goods. However, the price will adjust as changes to the cost of production affect the industry’s supply and any subsequent changes in consumer demand. Therefore, consumers do pay eventually as changes to industry output work through the system and affect the price, which reflects the change in the conditions of doing business.

This is explained further in Box 5.1, with an illustrative case study.

¹³² See, Frontier Economics, *Mechanisms for Funding Biosecurity Measures*, A report prepared for the Department of Primary Industries, Victoria, November 2008, p 12, Department of Environment & Primary Industries (Victoria), *Case for Cost Recovery*, (circa 2010), p 14 and NSW Government, *NSW Biosecurity Strategy 2013-2021*, p 30.

¹³³ IPART, *Review of a rating framework for Local Land Services – Roundtable – 28 October 2013*, (A. Gidley-Baird) p 23:12-17.

¹³⁴ NSW Farmers’ Association submission to Draft Report, October 2013, p 5.

Box 5.1 Who should pay for a government service?

When governments provide a regulated service, they need to determine who should bear the cost. The Productivity Commission notes that charging producers rather than a diverse group of consumers is often more efficient and cost effective where the costs of regulated activities differ between producers. However despite charging producers consumers are likely to share at least some of the cost of providing the service. This is largely determined by the **responsiveness** of demand and supply to changes in price (including the cost recovery charge), which ultimately determines how much the producer can pass onto consumers.

The Department of Treasury and Finance (Victoria) makes a similar point in its cost recovery guidelines. Regulated services are often needed to offset negative external effects, notably environmental degradation. This means that by charging for these services the costs become internalised^a and ultimately **shared** between responsible parties.

Case Study – 2013 NSW H7 Avian Influenza

The culling of over 400,000 chickens in December 2013 is expected to result in the price of eggs increasing; similar to the effect on banana prices due to the 2006 cyclone. This market dynamic illustrates how changes to production, unexpected or determined as a result of changes to cost, transmit through to prices. The price of the final product is paid by consumers. The resulting higher price, in this instance, is (partly or in full) captured by the remaining producers in the industry.

^a Cost internalisation is the incorporation of negative external effects, notably environmental depletion and degradation, into the budgets of households and enterprises by means of economic instruments, including fiscal measures and other (dis)incentives. OECD, *Glossary of statistical terms*, November 2001.

Source: Productivity Commission (2001), *Cost Recovery for Government Agencies*, pp 31-33; Department of Treasury and Finance, *Cost Recovery Guidelines*, Melbourne, 2013, p 13; Michael Condon, *Egg Shortage looms after bird flu*, ABC Rural – NSW Country Hour, 4 December 2013, <http://www.abc.net.au/news/2013-12-03/nsw-egg-production-down-due-to-bird-flu/5134346>, [accessed 5 December 2013].

5.3 Determine who should fund LLS board activities – impactor/risk creator pays

There are 4 main components to determining who should fund LLS board activities using the impactors/risk creators pay approach:

- ▼ selecting the appropriate funder(s)
- ▼ costing the activity
- ▼ undertaking cost-benefit analysis and consultation, and
- ▼ allocating costs to the selected funder(s).

5.3.1 Selecting the appropriate funder(s)

Starting with the list of parties associated with the problem identified in Step 1, LLS boards will identify the appropriate party to charge – that is, the party that is feasible, efficient and cost-effective to charge. They should begin by considering a narrow definition of the party, (eg, individual landholder) and then more broadly defined groups (such as all landholders in the LLS boundary or NSW community) as necessary. Which party is appropriate depends on the size of the identified problem. If the problem is contained to an individual landholder’s property, it is unlikely that a broader group should pay. As the problem expands (eg, if it spills over to more properties or a wider area), the breadth of the group that should pay will also expand.¹³⁵ This approach is similar to how the Ryan Report discussed a hierarchy for assessing biosecurity intervention.¹³⁶

Where a public land management agency is identified as an impactor or risk creator of an activity it is required to fund the activity in proportion to the impact or risk it creates. The framework does not distinguish on the basis of who holds the land (that is, private or public ownership); it operates on a ‘nil tenure’ approach.¹³⁷

Each LLS board will work through the hierarchy of potential funders beginning with the narrowest defined group until the suitable funder(s) is identified. They should work through the list, answering the following questions:

- ▼ Can they be clearly identified and is it feasible to charge this candidate?

The purpose of this question is to understand who LLS should consider from the potential list of candidates to charge.

The Natural Resources Commission¹³⁸ and another stakeholder¹³⁹ highlighted that identifiable risk creators may be outside the rate base of LLS boards. An example is a problem of spreading weeds that were legally sold as garden plants. It is clear in this example the LLS boards would be unable to charge all risk creators (eg, all landholders with gardens).

¹³⁵ For example, the most narrowly defined would be a specific individual landholder or a collection of similar landholders. The most widely defined groups would be all landholders within the LLS boundary or the NSW community.

¹³⁶ Terry Ryan, *Report on the Review of the NSW Livestock Health and Pest Authority (LHPA) Model*, A review commissioned by the Minister for Primary Industries, February 2012, pp 25-26. We will refer to Ryan’s hierarchy as a sequence from now on to ensure there is clarity around our use of the term hierarchy. We only consider hierarchy to apply to cost recovery approaches.

¹³⁷ A nil tenure approach to public land management is supported by the Natural Resources Commission, see IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 14:36-37.

¹³⁸ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 13:17-24.

¹³⁹ T. Hackett (individual) submission to Draft Report, October 2013, p 2.

Where it is not feasible to charge impactors or risk creators, the hierarchy of the framework leads LLS boards to then consider allocating costs to the beneficiaries of taking action. We discuss how beneficiaries are considered in Section 5.4.

▼ Would it be efficient to charge this candidate?

This involves considering whether there is any reason why the candidate should not be charged. There may be cases where recovering costs from an individual may lead to outcomes that are contrary to the desired behaviour. Efficiency also relates to creating incentives that align the person being charged with the desired outcome.

For example, it may not be sensible to charge an individual for the cost of cleaning up an outbreak of a disease on their own property. This would create what is known as a 'perverse incentive' for land holders to report issues/outbreaks on their property (knowing they will bear the full cost). In such a case, it may be more efficient to charge a group of similar individuals that create the risk of an outbreak of disease.

▼ Would it be administratively efficient to charge this candidate?

This involves considering whether a fee (for individuals) or a levy (for group) mechanism exists that would collect enough to fund the activity beyond the collection costs. If not, charging this candidate would lead to an inefficient outcome and other candidates should be considered.

The NSW Irrigators' Council does not agree with this point as "this method does not reflect the principle of fee-for-service".¹⁴⁰

However, if the collection costs of a fee-for-service exceed the money needed to fund the activity, then it is not economic to pursue this option. Other options should be considered, including moving from charging an individual to charging a group who has a link to the problem.

If it is not administratively efficient to charge the impactors the hierarchy dictates that the beneficiaries pay. As a last resort the taxpayer may pay the cost of providing the service(s).

Depending on the issue being addressed, ratepayers at different levels in the hierarchy have varying abilities to influence the activities required of LLS.¹⁴¹ LLS boards should not allocate costs to the taxpayer without assessing why the taxpayer is the efficient alternative funding source.

¹⁴⁰ NSW Irrigators' Council submission to Draft Report, October 2013, p 5.

¹⁴¹ This view of internalising, for example, spillovers is found in, Marshall, G.R, *Economics of Cost Sharing for Agri-Environmental Conservation*, 42nd Annual Conference of the Australian Agricultural and Resource Economics Society, University of New England, Armidale, January 1998, p 11, quoting Hussey, D., 'An economic perspective, in Price, R. (ed.), *Sustainable Management of Natural Resources: Who Benefits and Who Should Pay?*, Occasional Paper No. 01/96, Land and Water Resources and Development Corporation, Canberra, 1996, pp 8-12.

5.3.2 Allocating costs to the selected funder(s)

When using the impactor/risk creators pay approach, LLS boards need to calculate the approximate cost of the activity and then allocate this cost to the selected funder(s) in proportion to their contribution to the impact or risk created. They should be able to use the information gathered in Steps 1 and 2 to understand the problem and specify the activity required to address it. For example, this information might include the human and other resources required for the activity, the land area or the number of properties covered by the activity.

If the selected funder is a single individual, industry or community, 100% of the cost will be allocated to them. However, if the selected funder, for example, is a diverse group – such as all livestock farmers in the LLS region, or all landholders (public and private) to control for wild dogs – the cost will need to be allocated proportionately. This involves identifying a way of estimating each group member’s contribution that is proportional to the activity.

We consider the most appropriate allocation metric is likely to be identified if LLS boards have developed a good understanding of the problem in Step 1 and specified the activity in enough detail in Step 2.

Other issues that arise from applying the impactor/risk creator cost recovery approach include:

- ▼ Legacy costs – it may not be (technically or practically) possible to apply the impactor/risk creator pays approach to problems that result from past activities.¹⁴²
- ▼ Diffuse source costs – it may not be possible to determine which activities, by whom and in what proportion are responsible for the problem that imposes a cost. Charging impactors may be difficult because it is not always possible to determine the appropriate charge when the available information is imprecise or non-existent. Further, even if impactors are identifiable it may not be cost-effective to charge them.

Where impactors or risk creators cannot be identified, or it is inefficient or not cost effective to charge them for the regulatory activity, beneficiaries (direct and indirect) could be asked to pay for a regulatory activity instead, as per the hierarchy of funders in Section 5.2.

¹⁴² See Aretino *et al* (2001) p 28 for a discussion on degradation resulting from past activities.

5.4 Determine who should fund LLS board activities – beneficiary pays¹⁴³

Following the hierarchy of potential funders, the next option is to consider beneficiary pays. The same main components apply to determining who should fund LLS board activities using the beneficiary pays approach:

- ▼ selecting the appropriate funder(s)
- ▼ costing the activity
- ▼ undertaking cost-benefit analysis and consultation, and
- ▼ allocating costs to the selected funder(s).

5.4.1 Selecting the appropriate funder(s)

As for the impactor/risk creator pays approach, LLS boards develop a list of potential funders for the activity being considered. This involves determining which potential funder(s) is a direct beneficiary, and which potential funder(s) is an indirect beneficiary.

Each LLS board should work through the list of potential funders beginning with the most narrowly defined group before considering wider groups until the funder(s) is selected. They should work through the list answering the following questions:

- ▼ Is it feasible to charge this candidate? Can they be clearly identified?
- ▼ For direct beneficiaries, do they capture sufficient benefits to justify charging them?

Specifically, do they capture enough benefits to outweigh the cost of the activity? If the beneficiaries are a group of individuals, a coordination mechanism may be needed for the group to capture a net benefit – for example, to prevent some group members from free-riding. If this is the case, LLS may be able to step in and coordinate the activity for a fee from the group. Where the benefits to this group outweigh the cost of the activity, other (indirect) beneficiaries are not required to pay.

- ▼ For indirect beneficiaries, do they capture additional benefits to justify charging them also?

Do they capture enough benefits to outweigh the cost of the activity attributable to them? Would a co-funding arrangement induce the direct and indirect beneficiaries to pay for the activity up to the value of net benefits they capture?

- ▼ Would it be administratively efficient to charge this candidate?

¹⁴³ Considering beneficiaries is redundant if impactors/risk creators have been identified and it is efficient and cost-effective to charge them.

Does a fee (for individuals) or a levy (for a group) mechanism exist that would collect enough to fund the activity beyond the collection costs? If not, charging this candidate would lead to an inefficient outcome and other candidates should be considered.

5.4.2 Allocating costs to the selected funder(s)

LLS boards should start the process of allocating costs to the selected funder(s) by calculating the approximate cost of the activity using information from Steps 1 and 2.

Beneficiaries could be an individual landholder or business, or they could be a group of landholders that use/benefit from a service. The total cost is allocated to the individual or group, with a per-use cost charged to each user. Subsequently it is then up to that individual or group to determine whether they will continue to demand this service based on whether they think the benefits outweigh the costs (net benefit).

However, where the selected funders include more than one beneficiary, a diverse group of beneficiaries, or a combination of direct and indirect beneficiaries, allocating the cost is considerably more complex. The obvious approach is to allocate the cost to each funder in proportion to the benefits they capture. However, there is unlikely to be clear information on each party's share of benefits. This problem could be addressed by directly negotiating with the beneficiaries to understand their benefits and assess what they are willing to pay. However, there may be an incentive for them to hide the benefits they capture (to free-ride), which may increase the administrative costs of obtaining the information.

To efficiently allocate costs across multiple beneficiaries, LLS should be guided by 2 important principles - the sufficiency and additionality principles. In addition, they should choose from 3 approaches to value benefits to help them allocate costs. Approaches for valuing benefits are discussed in Section 5.8.

The sufficiency principle

The sufficiency principle applies where the selected funders include direct beneficiaries that can capture sufficient benefits to justify charging them for the activity (ie, the benefits outweigh the cost of the service). In this situation, it is efficient to allocate the entire cost to these direct beneficiaries - even where indirect beneficiaries also obtain some benefit. This is because where the direct beneficiaries capture benefits that outweigh the cost of the activity, they are likely to be willing to pay the entire cost.

Where the direct beneficiary is a group that can only capture sufficient benefit to pay for the activity through coordinated action, LLS could assist the group using a mechanism to align the individual members' incentives (for a fee). Lack of coordination can encourage free riding behaviour that restricts beneficial actions taking place. LLS' role in this instance is to bring the group together. This would be a more efficient option than charging indirect beneficiaries who also capture benefits.

The additionality principle

The additionality principle applies where the direct beneficiary is unable to capture enough of the benefits to outweigh the cost.¹⁴⁴ In this situation, it may be worth considering allocating part of the cost to the direct beneficiary (up to the point equal to its benefit), and the residual to the indirect beneficiary (assuming they can capture benefits equal to or greater than this amount).

Government may consider paying on behalf of the indirect beneficiaries, where this group is diffuse and it would be difficult to charge them efficiently, eg, the wider community. However, taxpayer funding is likely to require negotiation with the NSW Government or the Australian Government. The avenue for 'negotiation' is through grant programs or other approaches such as tenders.

If the cost of an activity cannot be allocated in line with the additionality principle, the LLS board should reconsider undertaking the activity unless there is a reason for taxpayers to fund it.

Box 5.2 provides a hypothetical example that illustrates how the sufficiency and additionality principles work together where the wider community is identified as the indirect beneficiaries and government funding is sought.

¹⁴⁴ The direct beneficiary incurs the cost of the activity charged by a LLS board and any forgone opportunity of an alternative activity. However, the opportunity cost of the alternative activity is a consideration for the direct beneficiary.

Box 5.2 Example of the sufficiency and additionality principles

An LLS board is considering an activity that will provide direct benefits to a specific group of private landholders, and indirect benefits to the NSW community by contributing to LLS region's natural resource management (NRM) targets and strategies. The full cost of the activity is \$2 million.

If the direct beneficiaries consider they can capture \$2 million+ in benefits, they should be willing to fund the activity. In line with the sufficiency principle, the full cost should be allocated to this group. It would not be efficient to consider a co-funding arrangement with the NSW community, ie, the indirect beneficiaries.

But if the direct beneficiaries consider they can capture only \$1.5 million in benefits, they are unlikely to fund the activity if the whole cost is allocated to them. Therefore, the next option is to consider whether government would be willing to contribute to the cost, on behalf of the NSW community.

If government decides it is worth pursuing the activity for the NRM benefits, it should contribute only to the extent necessary to induce the direct beneficiaries to invest in the activity – that is, \$0.5 million. If it contributed more, the community would subsidise the benefits to the direct beneficiaries. This is consistent with the additionality principle because, under this funding arrangement, the activity represents additional action – that is, one that would not have gone ahead if the direct beneficiaries had been allocated the full cost.

5.5 Determine who should fund LLS board activities - where the taxpayers pay

Where it has been assessed that it is not possible or it is inefficient to charge the impactor/risk creator or beneficiary, or a public land management agency is not identified as an impactor or beneficiary then the taxpayer, as a last resort, may pay for the activity on behalf of the NSW community.

For the taxpayer to pay there must be a practical method of intervention and the intervention must result in a net benefit to society following a cost-benefit analysis.

The framework correctly applied should not result in an outcome where **any** group avoids its funding responsibilities. The case should be made that the immediate group is unable to internalise the benefits before considering who else could also fund the outcome.

If at this stage of the process it has been determined that it would not be efficient or effective for any other funder to pay for the activity then the taxpayer, through the State Budget, would be the efficient funder of the activity (funder of last resort). However, this does not mean the activity will be funded (and hence provided); the taxpayer through government may decide to self-insure or fund other public goods instead of undertaking the activity.

To ensure government, on behalf of the taxpayer, maximises net social benefits to society, its resources should be used efficiently. Taxpayer resources should not be diverted to fund activities where private benefits already exceed costs and funders would be willing to pay. The sequential assessment of activities as shown in the hierarchy achieves this end.

Stakeholder comments

NSW Farmers is concerned (see Section 3.3.4) that having the government at the bottom of the hierarchy as funder of last resort will promote a greater reliance on ratepayer funding even for activities that are properly the role of the government. Further, the ALMG submits this recommendation is contrary to application of the concept of market failure.¹⁴⁵

The submissions by Uralla Council, Namoi Councils and Tom O'Connor raise similar concerns suggesting:¹⁴⁶

- ▼ rate income as a proportion of total income will increase by the expansion of the rate base (reducing the minimum rateable land area from 10ha to 2 ha) and having the government as funder of last resort
- ▼ the Government's failure to indicate its funding commitment to LLS beyond the initial 4-year period, raises the possibility that ratepayers will be expected to pay more in future
- ▼ LLS will have limited ability to collect funds from other state government agencies
- ▼ the Draft Report subscribes to cost shifting (see page 26 of Draft Report).

The councils' submissions propose an alternative funding model, with the community service obligation (CSO) estimated and published to begin with, and the balance of LLS board funding to be recovered from impactors or beneficiaries. The Uralla council submits that the CSO should become an ongoing future commitment and indexed for inflation.¹⁴⁷

¹⁴⁵ ALMG submission to Draft Report, October 2013, p 2.

¹⁴⁶ Uralla Council submission to LLS BoC submission, December 2013, pp 1-5; Namoi Councils submission to LLS BoC submission, December 2013, pp 1-3; T. O'Connor (individual) submission to LLS BoC submission, December 2013, p 1.

¹⁴⁷ Uralla Council submission to LLS BoC submission, December 2013, p 3.

Our response is:

- ▼ Expanding the rate base is intended to better capture and send price signals to risk creators (ie, reduce cross subsidies) and not increase overall LLS revenue.
- ▼ The Government has guaranteed funding for the next 4 years as part its commitment to establishing LLS. It is therefore current government policy to fund LLS on this basis.¹⁴⁸
- ▼ We do not propose direct rating of public land management agencies. These agencies could fund LLS boards to undertake activities or provide in-kind contributions. These agencies should contribute (one way or the other) to action as it relates to their risk creating behaviour.
- ▼ The application of the guidelines may result in a different allocation of costs to what occurs currently. The operation of the guidelines is intended to produce efficient outcomes by ensuring that those who create the need or benefits from an activity fund it. If in the application of the guidelines, the wrong party is currently funding an activity then this will be corrected. The guidelines are not designed to shift costs that should be funded by government to ratepayers.

The proposed sequential structure, including the taxpayer as funder of last resort, ensures equitable outcomes. The taxpayer contribution needs to be transparently calculated and published. This can occur within the proposed guidelines.

Recommendation

- 3 LLS boards should follow a hierarchy to identify who should pay the cost of a program or an activity (ie, regulatory and/or non-regulatory):
 - At the top of the hierarchy are those causing an adverse impact or creating a risk including government land management agencies. The cost of the activity should be allocated to the impactor(s) or risk creator(s) in proportion to their contribution to the impact or risk created, where it is efficient and cost effective to charge them.
 - Second in the hierarchy are beneficiaries, also including government land management agencies, where it is efficient and cost effective to charge them, subject to the following:
 - Where the direct beneficiary captures sufficient benefits to meet the costs of the activity, indirect beneficiaries should not pay.
 - Where the direct beneficiary is unable to capture sufficient benefits to meet the total cost of the activity, the direct beneficiary should pay up to the point where benefits equal costs and the indirect beneficiary should pay the residual to meet the cost of the activity for the additional benefits, where it is efficient for them to do so.

¹⁴⁸ The Hon Katrina Hodgkinson, MP, Minister for Primary Industries, The Land, 22 August 2013, p22.

- Third on the hierarchy are taxpayers, as funders of last resort, where risk creators or beneficiaries have not been identified, or although identified it is inefficient to charge them.

5.5.2 Worked examples of Step 3(a) of the funding framework.

Table 5.1 continues the examples from Step 2, providing example answers to the questions posed in Step 3a of the funding framework. Note these are only examples of how specific issues can be assessed in Step 3a; answers may differ depending on regional and local circumstances.

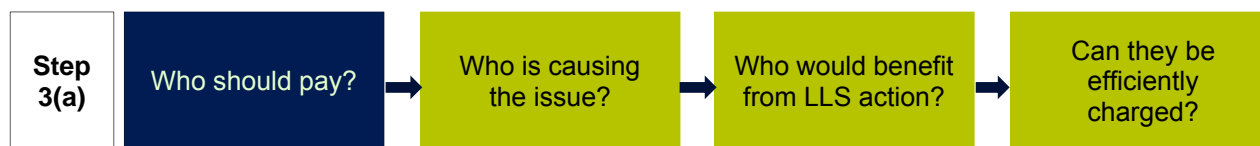


Table 5.1 Examples - Step 3a: Who should pay?

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
Identified problem (restated for convenience)	Private horticulturists are not investing in beneficial research as: <ul style="list-style-type: none"> ▼ the cost of the research exceeds the private benefits gained by any one landholder ▼ the outcomes of the research, once available, may be used by others without contributing to the cost. 	A disease outbreak occurs on a landholding posing a threat to livestock on adjoining properties but not a public health risk nor threat to native animals.	Wild dogs are found in national park, on forestry land and private landholdings attacking livestock and native fauna.
Who is causing the issue?	No impactors or risk creators identified.	Landholder with diseased stock is primary impactor. <ul style="list-style-type: none"> ▼ To charge this landholder may discourage reporting of disease. ▼ All landholders carrying this livestock increase risk of disease spreading. 	All landholdings are potential harbourers of wild dogs and dogs will move from one property to another. Difficult to assign specific responsibility to individual landholders.
Who would benefit from LLS action?	All growers of specified crops.	Livestock producers.	Private landholders and the general community.
Can they be efficiently charged?	Beneficiaries can be identified & efficiently billed.	In effect, risk creators and beneficiaries are identical. They can be efficiently billed.	Risk creators (private and public landholders) are at the top of the hierarchy. They can be identified and efficiently billed.

Source: IPART analysis.

5.6 Costing the activity

LLS boards should use different approaches to costing an activity depending on whether the activity is regulatory or non-regulatory:¹⁴⁹

- ▼ For regulatory activities and services requested by landholders, LLS boards should use a fully distributed cost approach. Fully distributed cost is typically used by agencies that recover costs for a large proportion of their activities.¹⁵⁰ The Productivity Commission's view is that a regulatory agency should recover the full cost of administering regulation.¹⁵¹
- ▼ For non-regulatory activities, LLS boards should choose between fully distributed, marginal or avoidable costing approaches.¹⁵² The most appropriate approach will depend on the nature of the activity, and whether LLS faces competition (or potential competition) in its provision. These approaches are appropriate as non-regulatory activities tend to be information provision, such as advice on natural resource management and extension services.

NSW Farmers discussed costing approaches in its submissions to the Issues Paper and Draft Report. It raised the issue of whether average or marginal costs would be charged for LLS services.¹⁵³

This part of the funding framework involves deciding which approach is appropriate to cost the activity or activities identified in Step 2. Costing the activity is also required for the cost-benefit analysis. Ultimately, the cost of the activity is allocated to a particular individual(s) or group(s), as assessed in Step 3, and is then charged as a fee or rate/levy as discussed in Step 4 of the framework.¹⁵⁴

NSW Farmers also sought clarity on the relationship between costing an activity (fixed costs or marginal cost) and charging for an activity (fixed and variable charges).¹⁵⁵ We consider these steps are indirectly linked, but separate.

¹⁴⁹ PC (2001), p 155, the PC considers the application of cost recovery separately for regulatory and non-regulatory agencies (which in the review are referred to information agencies, eg, ABS).

¹⁵⁰ PC (2001), p 161.

¹⁵¹ PC (2001), p 173.

¹⁵² The assumption behind marginal cost for activities such as information provision is that a basic information set has been defined. Basic information usually has significant public good characteristics and is general in nature, which makes it difficult to charge for, and forms the basis for taxpayer funding. However, activities that require some effort additional to the collection of the basic information set should be charged for as they begin to provide more value to a private individual or group than to a diffuse group of users.

¹⁵³ NSW Farmers' Association submission to Issues Paper, July 2013, pp 6-7.

¹⁵⁴ Where the cost of the activity is borne in part or in full by a public land manager or the taxpayer, LLS boards may receive in-kind contributions or monetary funding depending on the activity.

¹⁵⁵ NSW Farmers' Association submission to Draft Report, October 2013, p 7.

The cost of the activity is related to the type of activity. The structure of charges is related to who the cost of the activity is allocated to and the demand they make to influence the activity's provision. We note that the cost recovery guidelines of the PC and the Australian Government also treat costing the activity and the charging structure separately. As the Department of Primary Industries (Victoria), in its review for Fisheries Victoria, argues:¹⁵⁶

...the cost allocation process should guide whether a charge is a fee or a levy, and its mix of variable and fixed charges.

In Section 4.1, we noted that determining whether an activity is regulatory or non-regulatory will have a bearing on how the activity is costed. This view is consistent with guidance provided in the Productivity Commission's (PC) cost recovery review.

However, all sources we have found suggest that certain costs should not be recovered. These costs include the cost of general policy development and costs associated with provision of advice to the Minister.

Costing regulatory activities

For regulatory activities, which are required functions of the LLS board, the board should use a **fully distributed cost** approach to determine the total cost to be recovered. LLS boards are required to administer certain regulatory activities. These activities are core functions – that is, if these activities were not required by legislation it is unlikely the LLS boards would exist. Given this, it is appropriate to recover the direct costs of the activity (eg, labour and on-costs and materials), as well as the portion of indirect (ie, overheads) and capital costs.¹⁵⁷

Indirect costs are usually allocated using a pro-rata approach. The pro-rata approach may use proportions such as:

- ▼ staff involved in the activity to total staff
- ▼ budget allocated to the activity to total budget.

A more sophisticated approach to allocate indirect costs is to use an Activity Based Costing method. This method links an organisation's outputs to activities to produce these outputs, which are in turn linked to costs.¹⁵⁸

¹⁵⁶ Department of Primary Industries (Victoria), *Commercial Wild Catch Fisheries and Aquaculture Cost Recovery Review*, prepared for Fisheries Victoria, October 2012, p 37.

¹⁵⁷ Capital costs include depreciation and a return on the funds tied up in the capital used to provide the activity. The funds tied up in the activity could have been used for other purposes and thus have an opportunity cost.

¹⁵⁸ Department of Treasury and Finance, 2013 *Cost Recovery Guidelines*, Melbourne, p 26.

The framework¹⁵⁹ ensures the functions of government are not cost recovered.¹⁶⁰ However, the PC considers that as a general principle, the administration costs of regulation should be recovered.¹⁶¹ Therefore, in theory, the cost of making the legislation that gives rise to a regulatory activity should be recovered.

LLS boards have functions under legislation but they do not create or amend legislation. The purpose of this review is to consider how LLS boards should fund activities they provide. The costs of any legislation relating to LLS should be borne by government.

Costing non-regulatory activities

For non-regulatory activities, where some functions are required and others are discretionary, LLS boards should use a different approach. Where non-regulatory activities are not government funded functions, it is necessary to recover those costs that are attributable to the activity. Depending on the activity, the following approaches may apply:¹⁶²

- ▼ **Marginal cost.** This is where the LLS board has to increase its output by an additional unit for an activity already being undertaken. In this case, LLS boards should recover short-run marginal costs. Marginal cost includes salaries, on-costs and other direct operating expenses. Overheads and capital costs are excluded because they are unaffected by the level of activity in the short-run.
- ▼ **Avoidable cost.** This approach refers to the costs that would be avoided if a particular activity was no longer undertaken. This approach is particularly relevant where a LLS board activity faces actual or potential competition from the private sector. Avoidable cost includes salaries and on-cost, operating expenses and a portion of the overheads and capital costs that would be avoided should the activity no longer be provided.

¹⁵⁹ Consistent with the Productivity Commission's operational principles for cost recovery, see PC (2001), p XXIX.

¹⁶⁰ By the functions of government, for example, we mean policy development and ministerial services.

¹⁶¹ PC (2001), p 159, (Recommendation 7.3) and p 175 (recommendation 7.9).

¹⁶² Commonwealth Competitive Neutrality Complaints Office (CCNCO), *Cost Allocation and Pricing*, CCNCO Research paper, Productivity Commission, Canberra, October 1998, pp 9-11.

The avoidable costing option, beyond fully distributed or marginal cost, is important because where LLS boards' activities have actual or potential competition, cost recovery charges should be consistent with the NSW Treasury's competitive neutrality policy.¹⁶³ The policy states that:¹⁶⁴

...the view of the NSW Treasury is that competitive neutrality will be achieved if the prices charged at least cover avoidable costs and are consistent with approaches followed by private sector competitors.

The direct costs of an activity, whichever costing approach is used, should always be recovered. According to the Commonwealth Competitive Neutrality Complaints Office (CCNCO), direct costs include GST. We do not explicitly state that GST should be included. However, where an activity could be or is provided in a contestable market, GST should be included. For an activity such as enforcement, which is generally not provided in a contestable market, the cost of this activity should not include GST.

Table 5.2 summarises the treatment of various categories of costs under each costing approach. Table 5.2 is consistent with guidance from the CCNCO, which provides the basis for costing approaches adopted by the Commonwealth¹⁶⁵ and States.¹⁶⁶

Table 5.2 Treatment of costs under the different costing approaches

Costing category	Is the cost included in the cost base?		
	FDC	SRMC	Avoidable cost
Direct costs	Yes	Yes	Yes
Executive costs	Yes	No	No
Rent	Yes	No	Often, not always
Other overhead costs	Yes	No	To the extent avoided
Capital costs exclusive of the activity	Yes	No	Yes
Joint capital costs	Yes	No	To the extent avoided

Note: Direct costs (includes direct labour, material costs and GST) which is consistent with the discussion in Section 5.6 of salaries and on-costs and operating costs. GST should be charged where a contestable market exists for the activity. 'FDC' means fully distributed cost. 'SRMC' means short-run marginal cost.

Source: Commonwealth Competitive Neutrality Complaints Office (CCNCO), *Cost Allocation and Pricing*, CCNCO Research paper, Productivity Commission, Canberra, October 1998, p 11.

¹⁶³ New South Wales Treasury, *Policy Statement on the Application of Competitive Neutrality – Policy & Guidelines Paper*, TPP 02-1.

¹⁶⁴ *Ibid.*, p 16.

¹⁶⁵ Commonwealth of Australia, *Australian Government Cost Recovery Guidelines*, Canberra, 2005, p 49 (see footnote 4).

¹⁶⁶ New South Wales Treasury, *Policy Statement on the Application of Competitive Neutrality – Policy & Guidelines Paper*, TPP 02-1, p 16 (see footnote 2) and Department of Primary Industries (Victoria), *Commercial Wild Catch Fisheries and Aquaculture Cost Recovery Review*, prepared for Fisheries Victoria, October 2012, p 25.

We consider that a combination of costing approaches is appropriate for LLS boards' activities because they will provide a combination of regulatory and non-regulatory activities.¹⁶⁷

Efficient costs

Those proposing an activity should ensure that cost estimates are based, wherever possible, on the efficient costs,¹⁶⁸ not actual costs.¹⁶⁹

Recommendation

- 4 LLS Boards should adopt the following costing approaches for activities:
 - Fully distributed cost for core activities (ie, direct, indirect and capital costs).
 - Marginal cost for discretionary non-regulatory activities that are additional to government funded activities (ie, direct costs).
 - However, where an additional activity competes with the private sector, as a minimum the avoidable costs should be recovered – ie, all costs that would be avoided should the activity not be provided (ie, direct, and avoidable indirect and capital costs).

5.7 Undertaking cost-benefit analysis and consultation

LLS boards could undertake cost-benefit analysis and consultation at various phases of the framework (including prior to Step 3). However, at a minimum, they should do so prior to Step 4.

The Natural Resource Commission suggested that a preliminary cost benefit analysis be done at Step 3 with a full-blown cost-benefit analysis undertaken at Step 4 along with an activity level cost-benefit analysis.¹⁷⁰ We agree this is possible. However, we consider that a full cost-benefit analysis at Step 3 will ensure the best option is chosen.

¹⁶⁷ LHPAs ensured that landholders complied with regulatory requirements, CMAs provided a combination of government and landholder funded non-regulatory activities (they also undertook regulatory activities but this comprised a small portion of total activities) and DPI's extension activities were a combination of government and landholder funded non-regulatory activities.

¹⁶⁸ This was noted by the NSW Farmers' Association in its submission to the Draft Report, October 2013, p 4.

¹⁶⁹ Commonwealth of Australia, *Australian Government Cost Recovery Guidelines*, Canberra, 2005, p 45.

¹⁷⁰ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 15:22-25.

Undertaking a cost-benefit analysis at Step 3 of the framework:

- ▼ allows for comparison of activities or different programs (a collection of activities), and
- ▼ involves LLS boards identifying who should fund an activity at the same time - this requires activities to be assessed separately depending on the cost recovery strategy (impactor/risk creator or beneficiary pays).

Cost-benefit analysis

The aim of cost-benefit analysis at this stage of the framework is to ensure the activity is efficient and results in a net benefit to society. The activity may be considered against other potential activities, designed to achieve the LLS board's desired outcomes against the current situation or on its own if no other solution is considered.

The comprehensiveness of cost-benefit analysis undertaken should be proportional to the impact the cost recovery approach will have on those that will be charged. Where the cost recovery approach will not have a significant impact on those being charged (eg, either because the amount of the charge is low or is similar to what they are currently being charged for the activity), a basic cost-benefit analysis should be sufficient. Where the activity has a significant impact on those being charged, a more detailed and comprehensive cost-benefit analysis will be required.

Guidelines on such detailed cost-benefit analysis are available from NSW Treasury and the Commonwealth Office of Best Practice Regulation.¹⁷¹ In addition:

- ▼ A register of approved consultants is available to agencies seeking professional assistance - the Department of Finance and Services has established prequalification schemes which assist agencies.¹⁷²
- ▼ LLS may consider setting up an expert panel with the required skills to apply the framework and undertake a cost-benefit analysis.¹⁷³ This final point appears to be something LLS is considering already.¹⁷⁴
- ▼ DPI/DITRIS should undertake the cost-benefit analysis where legislative change may be required.

¹⁷¹ See, http://www.treasury.nsw.gov.au/__data/assets/pdf_file/0016/7414/tpp07-5.pdf and <http://www.dpmc.gov.au/deregulation/obpr/cost-benefit-analysis.cfm>.

¹⁷² See, <http://www.procurepoint.nsw.gov.au/prequalification-schemes/about-prequalification-schemes>, accessed 8 January 2014.

¹⁷³ The LHPA SMC suggested an expert panel in its submission to the Issues Paper, October 2013, p 17.

¹⁷⁴ See comment by Chair of LLS Board of Chairs, IPART, Review of a rating framework for Local Land Services - Roundtable - 28 October 2013, p 45:12-21.

If the cost-benefit analysis shows the **activity does not result in a net benefit to society**, it will lead to a reduction in efficiency and should not be undertaken. The only exception is where the activity meets some other (eg, social welfare) objective. In this case, the efficiency requirement is not paramount. However, the activity should always be designed and delivered to meet the intended objective in the most cost-effective way.

Consultation

The level of consultation undertaken should also be consistent with the degree to which the proposed cost recovery will affect those being charged. Where it will not have a significant impact on those being charged, LLS boards should consult with the parties directly involved. If it will have a significant impact, LLS boards should widen the consultation effort to include all relevant stakeholders, not just those that may be directly affected.

Consultation is important because changes are more likely to be accepted if the affected parties have a sense of ownership in the change. Further, the affected parties are likely to have useful information relating to the proposed change. However, care should be taken to ensure the parties consulted do not have an inappropriate level of influence over the LLS board's decision-making, particularly their cost estimation and allocation, as this may result in the activity not meeting its objectives, or the costs not being allocated efficiently.

5.8 Approaches for valuing benefits

In allocating costs among beneficiaries, LLS boards will need to value the net benefit of the activity for different parties. We consider the following 3 approaches could be used to assess benefits to direct and indirect beneficiaries:¹⁷⁵

- ▼ **Detailed assessment**, which quantifies the expected net benefit each identified beneficiary is likely to capture from the activity using detailed analysis. With this approach, the share of costs allocated to each party should be proportionate to the benefits the analysis suggests they will receive.
- ▼ **An auction (or tender)**, which aims to draw out bids from interested parties to develop a cost sharing arrangement. With this approach, the costs allocated to each party reflect what the bids indicate they are willing to pay. We understand some Catchment Management Authorities previously used an auction approach to obtain voluntary contributions to conservation activities above the minimum required.¹⁷⁶

¹⁷⁵ Aretino *et al* (2001), pp 33-40.

¹⁷⁶ For example, the Lachlan CMA used a market based instrument for its Soil Carbon Pilot Project, <http://www.lachlan.cma.nsw.gov.au/ourprojects/pages/soilcarbonpilot.aspx>.

- ▼ A **‘rule of thumb’** approach, which approximates the benefit to each party. This may involve a basic cost-benefit analysis and possibly a sliding scale to allocate each party a fixed proportion of the costs, depending on the level of benefit the analysis indicates they are likely to receive.
 - This approach could be achieved through a task force, as suggested by the Chair of LLS Board of Chairs at the public roundtable.¹⁷⁷ For example, the LLS Board of Chairs could coordinate a cost allocation process in which LLS boards provide input and the task force makes a recommendation. However, for this approach to be effective, the LLS Board of Chairs would need appropriate resources.

In general, the more detailed the benefit valuing approach, the more time consuming and expensive it will be.¹⁷⁸ Therefore, similar to the cost-benefit analysis and consultation discussed in Section 5.6, the approach taken needs to be proportionate with size of the net benefits expected.

The detailed assessment and auction approaches are likely to lead to more efficient outcomes. Therefore, they should be used in preference to a ‘rule of thumb’ approach whenever the activity’s cost and expected benefit are high enough to justify the higher administrative costs they involve. However, where these approaches are not cost-effective we consider a sliding scale to allocate costs would provide an adequate ‘rule of thumb’ until better processes and information are available.

Each LLS board (or Board of Chairs) should use the scale in Table 5.3 to consider funding arrangements for activities where it is appropriate to share the cost between a private party or group and the community; this occurs when the beneficiary pays approach is used. This sliding scale approach should only be used where it would not be cost-effective to value the relevant benefits to each party in detail.

We have adapted this sliding scale from the emergency plant and animal biosecurity deeds.¹⁷⁹

¹⁷⁷ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 45:17-18.

¹⁷⁸ Aretino *et al* (2001), p 33.

¹⁷⁹ Emergency Animal Disease Response Agreement (the EADRA): <http://www.animalhealthaustralia.com.au/programs/emergency-animal-disease-preparedness/ead-response-agreement/> and Emergency Plant Pest Response Deed (the EPPRD): <http://www.planthealthaustralia.com.au/biosecurity/emergency-plant-pest-response-deed/>.

Table 5.3 Sliding scale approach for sharing the cost of non-regulatory activities between public and private funders

Benefits	Public	Private (Industry or Landholder)
Largely Public	100%	0%
Public > Private	80%	20%
Public ≈ Private	50%	50%
Public < Private	20%	80%
Largely Private	0%	100%

Note: The Industry and Landholder groupings are mutually exclusive.

Source: IPART, adapted from the EADRA and the EPPRD (see footnote 179).

Each LLS board should use the same sliding scale (Table 5.2), but the benefits of each activity are likely to vary to reflect local circumstances. For example, the control of a pest in one LLS area may benefit private landholders but control of a pest in another LLS area may benefit native animals and hence is undertaken for the public.

A basic cost-benefit analysis and consultation with the parties is needed to understand the extent to which each party benefits before using the sliding scale to allocate costs. We consider the most likely outcome of this kind of cost sharing arrangement is a levy on private parties and a contribution from government (subject to net benefits for society and where the benefits are not largely private).

We also note that:

- ▼ given this approach will be used for relatively low cost activities, it is unlikely the benefits will be shared between government and more than one other broad group – that is, either an industry or landholder group
- ▼ the scale includes a 100% share from industry or landholder funders, as there is no reason why the scale should be asymmetrical.

We have not received any objection to the use of the sliding scale as a method of last resort. One stakeholder commented that it would not be widely applicable.¹⁸⁰ The STWP notes this approach would commonly apply to natural resource management decisions.¹⁸¹

Recommendation

- 5 A sliding scale approach should be considered as a method of last resort for determining cost shares of non-regulatory activities where it is administratively inefficient to identify specific cost allocations.

¹⁸⁰ NSW Irrigators' Council submission to Draft Report, October 2013, p 5.

¹⁸¹ STWP submission to Draft Report, October 2013, p 7.

5.8.1 Worked examples of Step 3(b) of the funding framework

Table 5.4 continues the examples from Step 3a, providing example answers to the questions posed in Step 3b of the funding framework. Note these are only examples of how specific issues can be assessed in Step 3b; answers may differ depending on regional and local circumstances.

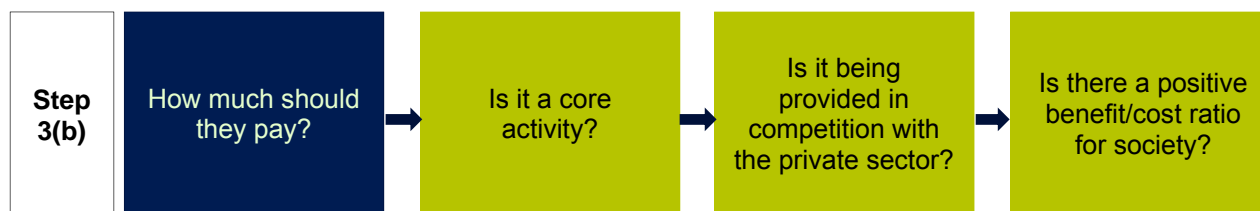


Table 5.4 Examples - Step 3b: How much should they pay?

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
Identified problem (restated for convenience)	Private horticulturists are not investing in beneficial research as: <ul style="list-style-type: none"> ▼ the cost of the research exceeds the private benefits gained by any one landholder ▼ the outcomes of the research, once available, may be used by others without contributing to the cost. 	A disease outbreak occurs on a landholding posing a threat to livestock on adjoining properties but not a public health risk nor threat to native animals.	Wild dogs are found in national park, on forestry land and private landholdings attacking livestock and native fauna.
Is it a core activity?	Assume in this case the service being provided is an adjunct to existing agricultural advice. Charge at incremental cost.	Yes, recover fully distributed cost. Information on livestock disease is a core requirement but a specific disease outbreak is additional information.	Yes, recover fully distributed cost.
Is it being provided in competition with the private sector?	If yes, calculate charges at least at avoidable costs. If not, charge at marginal cost.	No, fully distributed cost remains the cost base. Publicising the outbreak through various channels to be charged at marginal cost.	No, fully distributed cost remains the cost base
Is there a positive benefit/cost ratio for society?	To be calculated in accordance with Treasury guidelines <ul style="list-style-type: none"> ▼ If no re-assess LLS involvement ▼ If yes continue to the next step. 	To be calculated in accordance with Treasury guidelines. <ul style="list-style-type: none"> ▼ If no re-assess LLS involvement ▼ If yes continue to the next step. 	To be calculated in accordance with Treasury guidelines <ul style="list-style-type: none"> ▼ If no re-assess LLS involvement ▼ If yes continue to the next step.

Source: IPART analysis.

6 Steps 4 and 5: Selecting the funding mechanism and declaring on the collection mechanism

After determining the most appropriate party or parties to fund the activity, and the cost share each party should pay, the fourth step of the funding framework is to select the mechanism to recover or fund this cost. The sections below provide an overview of this step.

Step 5 of the funding framework is mainly concerned with the collection of rates and levies. The collection of fees should occur either at the point of sale or through invoicing as determined by each LLS board.

6.1 Overview of Steps 4 and 5

In Step 4, LLS boards will need to select the funding mechanism for the activities provided. LLS boards should consider the options in the following order:

1. **Fee-for-service.** This funding option provides the clearest and most effective price signal, and therefore should be the default option for LLS.
2. **Rate or levy.** This option may be appropriate in a range of circumstances, including where:
 - the activity targets or benefits a general group (such as an industry),
 - it is difficult to identify specific impactors/risk creators or beneficiaries, or
 - it is more effective or efficient than charging individual people or firms.
3. **Government funding.** This should option be available to LLS where a public land management agency is identified as the primary impactor or beneficiary or where impactors/beneficiaries cannot be identified or it is inefficient to target actual impactors /beneficiaries with a fee, rate or levy.

In Step 5, where a rate or levy has been selected as the funding mechanism, LLS boards will need to decide how to collect this rate or levy. We consider it likely that the most efficient approach will be for LLS to develop its own centralised billing system. However, for some levies (such as the current Hunter catchment levy) it may still be efficient for local authorities to collect on behalf of the LLS.

6.2 Selecting the appropriate funding mechanism

Once LLS boards have costed the activity, they need to select the most appropriate funding mechanism to recover the cost. The options include:

- ▼ fee-for service
- ▼ general rate or special levy
- ▼ government funding.

6.2.1 Fees-for-service

We consider that fee-for-service should be the default funding mechanism for LLS. This is consistent with the Productivity Commission's (PC's) view that a direct fee-for-service is preferable to a rate or levy in principle.¹⁸² This is because it provides as close as possible a link between the activity and the charge. In general, the stronger the link between a good or service and its charge, the stronger the pricing signal and the more efficient the outcome will be.

However, the PC also notes that while a fee provides a clear price signal it may not be the most efficient way to recover the costs of a service. For example, it may be more expensive than a levy to administer.¹⁸³ In addition, as stakeholders pointed out,¹⁸⁴ there are circumstances where it would be:

- ▼ ineffective to charge a fee (eg, where it would create a perverse incentive), or
- ▼ not feasible to charge a fee (such as when the party selected to fund the activity is a group).

In general, fees are likely to be most appropriate where there are clear private benefits to an identifiable party (such as an individual commercial or non-commercial landholder).

The LHPA charged a fee-for-service¹⁸⁵ for numerous goods on a cost recovery basis. These included include products for controlling declared pests, some of which are available from other providers (eg, baits) and others are not (eg, 1080 poison). In 2011/12 fee for service items¹⁸⁶ accounted for 26% of total LHPA revenue.¹⁸⁷

¹⁸² PC (2001), pp 175-176.

¹⁸³ Ibid.

¹⁸⁴ For example, LHPA submission to Issues Paper, July 2013, p 15.

¹⁸⁵ PC (2001), p XXIII.

¹⁸⁶ We assume that "other income" in the LHPA 2011-12 Annual Report, p 22, aligns with fee for service.

¹⁸⁷ LHPA, Annual Report 2011/12, p 22.

6.2.2 Rates and levies

If a fee-for-service is ruled out because it is not efficient, effective or feasible, the next funding mechanism LLS boards should consider is a rate or levy.

We consider it may be more appropriate to use a rate or levy than a fee in the following circumstances:

- ▼ The activity is of a general industry nature rather than of immediate application to one identifiable entity (or person).
- ▼ It is difficult or impossible to identify the users of a particular service or the extent of their use.
- ▼ Although the users can be identified, charging a direct fee would impede the objectives of the activity, for example, by creating a perverse incentive.¹⁸⁸
- ▼ Administrative complexity means that it is simpler and cheaper to recover regulatory costs for a defined industry through a single industry levy rather than by collecting a large number of smaller fees.¹⁸⁹

As with all cost recovery arrangements, levies should account for administration costs, transaction costs and compliance costs. In some cases, these costs may mean that even an industry levy is impractical or too expensive. In such cases, taxpayer funding may be preferable.¹⁹⁰

6.2.3 Government funding

We consider that government funding through a public land management agency (including in-kind contributions) should be available to LLS boards where the agency is identified as the primary impactor or beneficiary of the activity. Government may also be a funder of last resort, where it is inefficient or inappropriate to target actual impactors or beneficiaries with a fee, rate or levy.

LHPAs received no government funding, whereas CMAs were almost exclusively funded by government (State and Commonwealth). We understand there is an indicative budget for LLS until 2017/18, which provides estimates of the various government and non-government funding sources, including rates. Further, we understand that the NSW Government will fund approximately 50 DPI extension staff that will become part of LLS. The Minister for Primary Industries has requested a stay on office locations for the first 2 years of operation.¹⁹¹

¹⁸⁸ PC (2001), p XXIV.

¹⁸⁹ Ibid, p 176.

¹⁹⁰ Ibid, p 177.

¹⁹¹ Local Land Services, *Top 20 Frequently Asked Questions Local Land Services*, May 2013, p 3.

We note that stakeholders were strongly in favour of government pre-committing funding to the LLS.¹⁹² They were also concerned that government would shift costs onto rate payers.¹⁹³

We consider that public land management agencies should contribute to LLS. This is consistent with the cost recovery framework (see Section 5.3). However we consider that the LLS should negotiate with public land management agencies, especially in light of the recommendation to remove exemptions for government agencies (see Section 8.3). This should produce a more efficient outcome than charging these agencies rates on the same basis as private land holders, allowing agencies to make payments from their own budgets (funds or in kind).

Recommendation

- 6 Fee-for-service should be the default funding mechanism for LLS.
- 7 Rates and levies should be considered when a fee-for-service has been ruled out on the grounds that it is not feasible, efficient or effective.
- 8 Government funding should be available to the LLS as a funding mechanism where:
 - a public land management agency has been identified as the primary impactor or beneficiary of the activity, or
 - as the funder of last resort, where it is inefficient to target actual impactors or beneficiaries with a fee or levy.
- 9 LLS should negotiate with Commonwealth and State Government public land agencies, local government and Aboriginal Land Councils for contributions to fund the net costs they impose on LLS. The negotiations should have regard to any offsetting action taken by the relevant bodies. Funding arrangement should be formalised under an instrument such as a deed of agreement or a Memorandum of Understanding.

6.2.4 Worked examples of Step 4 of the funding framework

Table 6.1 continues the examples from Step 3b, providing example answers to the questions posed in Step 4 of the funding framework. Note these are only examples of how specific issues can be assessed in Step 4; answers may differ depending on regional and local circumstances.

¹⁹² Mr Cameron, Transcript of Public Hearing at Tamworth, 18 June 2013, p 70.

¹⁹³ Ms Paton-Blackwell, Transcript of Public Hearing at Wagga Wagga, 14 June 2013, p 16.

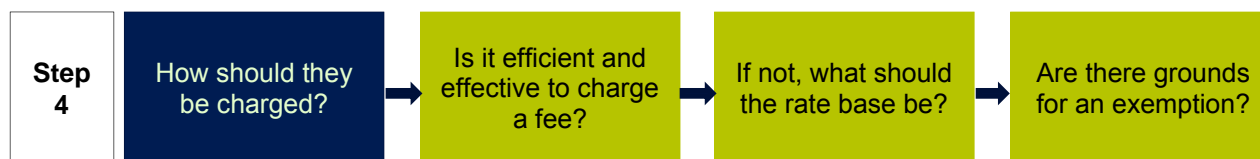


Table 6.1 Examples - Step 4: How should they be charged?

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
Identified problem (restated for convenience)	Private horticulturists are not investing in beneficial research as: <ul style="list-style-type: none"> ▼ the cost of the research exceeds the private benefits gained by any one landholder ▼ the outcomes of the research, once available, may be used by others without contributing to the cost. 	A disease outbreak occurs on a landholding posing a threat to livestock on adjoining properties but not a public health risk nor threat to native animals.	Wild dogs are found in national park, on forestry land and private landholdings attacking livestock and native fauna.
Is it efficient & effective to charge a fee-for-service?	No, unable to restrict the benefits to paying landholders.	No, creates a potential perverse outcome if landholder does not report to avoid a charge.	<ul style="list-style-type: none"> ▼ Yes for private landholders ▼ No for public landholders.
If not, what should be the rate base?	Levy set to recover avoidable costs of LLS from industry.	Notional carrying capacity.	Negotiated contribution from public landholders.
Are there grounds for an exemption?	No	No	Possibly, allowance could be made for actions already taken by parties to eliminate pest animals.

Source: IPART analysis.

6.3 Deciding on the collection mechanism

Where LLS boards decide to fund an activity through a rate or levy, they will need to decide how to collect this rate. There are 2 options – LLS could:

- ▼ Develop a centralised system to collect LLS rates on behalf of LLS boards. Under this option, LLS boards should be charged a fee for the collection service, and their collection costs should be reported transparently to encourage efficiencies. These collection costs should also be incorporated into LLS fees and rates.
- ▼ Contract with a service provider to collect fees and rates on behalf of LLS boards. Again, LLS boards should be charged a fee for the collection services which should be incorporated into their fees and rates.¹⁹⁴

While some stakeholders considered that collection by local government would be a more efficient option¹⁹⁵ most stakeholders supported the development of an LLS collection mechanism. In addition, Local Government NSW argued against using local government to collect LLS rates on the grounds that:¹⁹⁶

- ▼ ratepayers are likely to perceive any LLS rate/levy collected by a council as a local government levy, even if the rates notice indicates that it is an LLS charge
- ▼ making LLS responsible for both expenditure and revenue collection would create in-built controls on expenditure growth
- ▼ there would be considerable collection costs and complexity in using 152 councils to collect LLS rates.

In response to the Draft Report, the LLS Board of Chairs recommended that local authorities be used to collect rates from land holders on properties below 2ha.

Local authorities were overwhelmingly opposed to the proposition of being required to collect rates on behalf of LLS. However, some local authorities stated that they would be open to the possibility of collecting rates on behalf of the LLS for a negotiated fee (in principle).¹⁹⁷

Due to a shortage of data, we have not been able to analyse the costs of LHPA's collection mechanism or compare the relative efficiency of the options.

¹⁹⁴ LLSBOC submission to Draft Report, October 2013, p 3.

¹⁹⁵ Serrated Tussock Working Party submission to Issues Paper, July 2013, p 1.

¹⁹⁶ LGNSW submission to Issues Paper, July 2013, pp 5-6.

¹⁹⁷ For example, Young Shire Council submission to LLSBOC submission, December 2013, p 1.

It is the responsibility of LLS to arrange the collection of its own rates providing transparency and accountability to rate payers. Therefore, we consider that LLS should investigate and develop options for an efficient centralised collection mechanism, taking into account the existing LHPA collection system and compare such costs to contracting with a service provider. LLS boards could contract with local authorities who are willing to collect rates but this would be subject to payment of a commercial fee to the local authorities. The main issue to consider when determining the efficiency of fee collection mechanisms is the transaction costs – that is, the costs associated with collecting rates from landholders/occupiers. These may include:

- ▼ labour costs (\$/hour)
- ▼ legal costs associated with challenges to the LLS rate system
- ▼ cost of the materials (eg, printing) used to issue rate notices
- ▼ other costs (eg, postage).

Recommendation

- 10 LLS should develop an efficient, centralised billing system and charge each LLS board its share of the costs of the system. LLS should compare the costs of an in-house system to that of contracting with a service provider.

6.3.1 Worked examples of Step 5 of the funding framework

Table 6.2 continues the examples from Step 4, providing example answers to the questions posed in Step 5 of the funding framework. Note these are only examples of how specific issues can be assessed in Step 5; answers may differ depending on regional and local circumstances.

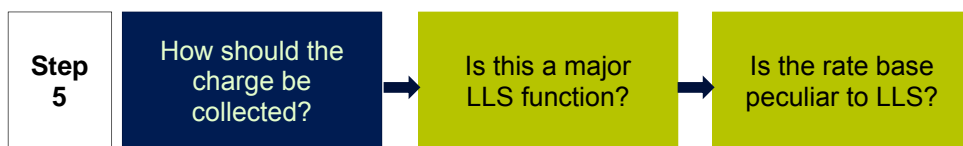


Table 6.2 Examples - Step 5: How should the charge be collected?

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
Identified problem (restated for convenience)	Private horticulturists are not investing in beneficial research as: <ul style="list-style-type: none"> ▼ the cost of the research exceeds the private benefits gained by any one landholder ▼ the outcomes of the research, once available, may be used by others without contributing to the cost 	A disease outbreak occurs on a landholding posing a threat to livestock on adjoining properties but not a public health risk nor threat to native animals.	Wild dogs are found in national park, on forestry land and private landholdings attacking livestock and native fauna.
Is this a major LLS function?	No, it was assumed in Step 3b that these are an adjunct to an existing advisory offering.	Yes, biosecurity is a key responsibility of LLS boards and substantial resources are devoted to this task.	Yes, natural resource management and improving farm productivity are key responsibilities
Is the rate base peculiar to LLS?	Yes, charges to be collected centrally by LLS or contracted fee collection agency.	Yes, charges to be collected centrally by LLS or contracted fee collection agency.	Yes, charges to be collected centrally by LLS or contracted fee collection agency.

Source: IPART analysis.

7 Use of rates and levies

In addition to recommending a broad funding framework for LLS, our Terms of Reference asked us to review the use of rates and levies. To develop our advice, we assessed the LHPA rating system, as prescribed by the *Rural Lands Protection Act 1998* (now repealed) (NSW) (RLP Act)¹⁹⁸ and *Rural Lands Protection Regulation 2010* (now repealed) (NSW) (RLP Regulation),¹⁹⁹ and the flood mitigation levy charged by the Hunter Central Rivers CMA. In particular, we considered:

- ▼ the minimum rateable land area for LLS rates
- ▼ rate types and rate structure
- ▼ each of the 4 existing specific purpose rates,²⁰⁰ and whether LLS should continue charging these rates
- ▼ the establishment of new LLS rates, such as a biosecurity levy or a natural resource management levy.

We note that the *Local Land Services Act 2013* (NSW) (LLS Act) repealed the previous legislative framework. Many of the previous provisions are carried forward in the new legislative framework.

To guide us in making our assessment and forming our advice, we established a set of assessment criteria, shown in Box 7.1. These criteria closely reflect the general principles for cost recovery discussed in Chapter 3, but are more relevant to assessing rating options. In developing these criteria, we had regard to:

- ▼ the Australian Government's Cost Recovery Guidelines²⁰¹
- ▼ the OECD's Best Practice Guidelines for User Charging for Government Services,²⁰² and
- ▼ the PC's Cost Recovery Guidelines for Government Departments.²⁰³

¹⁹⁸ Repealed by the LLS Act on 1 January 2014.

¹⁹⁹ Repealed by the LLS Act on 1 January 2014.

²⁰⁰ A 'specific purpose' rate or levy may refer to:

the animal health rate, the pest insect eradication rate, catchment contributions and any other special purpose rate under the *Local Land Services Act 2013* (NSW) and the meat industry levy under the *Meat Industry Act 1978* (NSW).

²⁰¹ Commonwealth of Australia, *Australian Government Cost Recovery Guidelines*, 2005.

²⁰² Organisation for Economic Co-operation and Development, *Best Practice Guidelines for User Charging for Government Services*, PUMA Policy Brief No. 3, March 1998.

²⁰³ PC (2001).

We assessed each rating option against these criteria, and considered stakeholders' comments and the PC's Cost Recovery Guidelines. The sections below provide an overview of our decisions and then discuss each decision in more detail. Chapter 8 discusses several further issues related to rates, including the most efficient rating base for LLS.

Box 7.1 Criteria for assessing rating options

LLS' rates and rating system should be:

- ▼ efficient, to minimise distortions in economic activity
 - ▼ targeted to an actual beneficiary or impactor group (ie, the appropriate funder(s) selected in Step 3)
 - ▼ simple and cost effective to administer
 - ▼ clear and easily understood
 - ▼ able to be consistently applied by all LLS boards.
-

7.1 Overview of recommendations on the use of rates and levies

LLS should retain the ability to charge a general rate and specific purpose rates, in line with the powers exercised by the LHPA.²⁰⁴ Each rate should comprise a fixed and a variable component, unless it is demonstrated that a purely fixed or variable rate would improve economic efficiency.²⁰⁵

The minimum rateable land area should be reduced from the current 10 hectares to 2 hectares (minimum of 0 hectares for intensive rates).²⁰⁶ This is to recognise that smaller properties contribute to biosecurity risk and benefit from natural resource management activities, and therefore should help fund LLS activities. It is also consistent with the funding framework for LLS and NSW Biosecurity Strategy 2013-2021.

The new minimum rateable land area should be introduced at the latest by 1 July 2016. This is sufficient time for LLS boards to engage with landholders affected by the change. The LLS Board of Chairs should assess this statutory minimum periodically and submit its recommendation to the Minister for Primary Industries for approval. Individual LLS boards should also retain the ability to set a minimum rateable land area above 2 hectares.

The 4 historical specific purpose rates – the animal health rate, the meat industry levy, the pest insect levy and the Hunter flood mitigation levy - should continue.

²⁰⁴ This structure is carried forward in the LLS Regulation, cl 5.

²⁰⁵ This may require legislative amendment: LLS Regulation, cl 6.

²⁰⁶ LLS Regulation, cl 4.

The threshold for paying the animal health rate and intensive animal health rate should be reduced from 50 to 30 stock units,²⁰⁷ in acknowledgment of the risks associated with small holdings of livestock.

LLS should be compensated the marginal cost of collecting rates (eg, the meat industry levy) on behalf of other government agencies.

LLS boards should have the flexibility to determine new specific purpose rates²⁰⁸ taking into account the criteria in Box 7.1 and discussion below.

An intensive animal health rate should be introduced based on notional carrying capacity. This recognises both the additional biosecurity risks posed by intensive industries and the possibility of intensive farming on small landholdings.

The funds collected under both the intensive and non-intensive animal health rates should be pooled to address animal biosecurity issues. They will be applied to address common threats, with the intensive rate set to recognise the proportionately greater risk created by intensive production.

LLS boards should also introduce an intensive horticultural rate, especially if a (general) plant biosecurity rate is introduced. An intensive horticultural rate should take into account the specific issues facing the intensive horticultural industry.

Table 7.1 Summary of recommended rates

Continuing Rates	Criteria	Rating Structure	Rate Base (variable component)
General rate	Rateable land (≥ 2 ha)	Fixed and variable components	Land area ^a
Animal health rate	Rateable land (≥ 2 ha) and 30 stock units	Fixed and variable components	NCC or land area
Meat industry levy	If liable to pay the animal health rate	Fixed and variable components	NCC or land area
Pest insect levy	Rateable land (≥ 2 ha)	Fixed and variable components	Land area
Hunter flood mitigation levy	All LG rate payers in the Hunter Central Rivers catchment	Fixed and variable components	Unimproved capital value of land
New Rates			
Intensive animal health rate	Rateable land (≥ 0 ha), 30 stock units & defined as intensive	Fixed and variable components	NCC or land area
Intensive horticulture rate	Rateable land (≥ 0 ha) & defined as intensive	Fixed and variable components	Land area

^a Except the Western region which has the option of using notional carrying capacity or land area as the basis for charging their general rate.

²⁰⁷ LLS Regulation, cl 14.

²⁰⁸ Including a general biosecurity rate and an environmental (natural resource management) rate.

7.2 LHPA rating system

The RLP Act empowered LHPA to charge 3 types of rates:²⁰⁹

- ▼ A general rate - all LHPAs were required to charge and this was paid by all rateable landholders.
- ▼ An animal health rate - a specific purpose rate that all LHPAs were required to charge and was paid by landholders in prescribed circumstances.
- ▼ Special purpose rates - LHPAs could charge other specific purpose rates for specified purposes.

Both general rates and specific purpose rates are consistent with our criteria for LLS rating options, provided they are designed and used to target the appropriate funder for the activity. For example, a general rate should be used when it is appropriate to fund core LLS activities that are applicable to all LLS ratepayers. A specific purpose rate should be used to fund activities that address a particular issue affecting either the entire LLS ratepayer base or a clearly defined subset.

Stakeholders expressed support for LLS retaining the ability to charge a general rate.²¹⁰ They also expressed strong support for LLS retaining the ability to create and charge specific purpose rates. The LHPA argued that this ability is essential to ensure LLS has the flexibility to respond to the changing needs of regional communities.²¹¹

Some stakeholders expressed concerns with current specific purpose rates, and how new specific purpose rates would be determined and approved.²¹² This issue is discussed in Section 7.6 below.

The LLS Board of Chairs considers that the LLS should have the capacity to integrate/pool funds it collects from multiple income streams to help it deliver a wide range of services.²¹³

We consider that there needs to be a clear price signal to allow risk creators to assess and change behaviour where necessary. In general, if the LLS were to pool funds this would risk significant cross subsidisation between risk creators and beneficiaries, distorting the price signal. It would be an inefficient outcome.

²⁰⁹ *RLP Act*, s 61. This structure is continued under the new legislative framework: LLS Regulation, cl 5.

²¹⁰ *Ibid.*

²¹¹ LHPA submission to Issues Paper, July 2013, pp 1-2, 8.

²¹² Ms Paton-Blackwell, Transcript for Public Hearing at Wagga Wagga, 14 June 2013, p 59.

²¹³ LLS Board of Chairs submission to the Draft Report, December 2013, p 2.

A major concern of stakeholders throughout this review has been transparency and governance with regard to the collection and expenditure of funds.²¹⁴ LLS boards need to account for funds collected and how they are applied. This accountability is best achieved through fee-for-service as the default charging mechanism. It provides the strongest link between a charge and an activity.

The absence of a link between funds collected and their application will dilute LLS boards' accountability to stakeholders and reduce the pressure on LLS boards to provide services at minimum cost. It will also limit benchmarking opportunities with similar service providers.

If new rates are to be introduced, we support specific purpose rates where practical. Over reliance on general rates removes the link between funds collected and their application.

We recognise that an activity may contribute to multiple outcomes and that priorities will vary over time. There are many multi-product enterprises in similar situations that make effective use of costing systems (eg, activity based costing) to separately account for their activities.

Recommendation

- 11 LLS boards should retain the ability to charge a general rate, and specific purpose rates (including the current animal health rate).

7.3 Coverage of general rates

Land services are a wide range of services, defined under the LLS Act as:²¹⁵

...programs and advisory services associated with agricultural production, biosecurity, natural resource management and emergency management, including programs and advisory services associated with the following:

- agricultural production
- biosecurity, including animal pest and disease and plant pest and disease prevention, management, control and eradication
- preparedness, response and recovery for animal pest and disease and plant pest and disease emergencies and other emergencies impacting on primary production or animal health and safety
- animal welfare
- chemical residue prevention, management and control
- natural resource management and planning
- travelling stock reserves and stock watering places

²¹⁴ For example: IPART, Review of a rating framework for Local Land Services - Roundtable - 28 October 2013, p 56.

²¹⁵ LLS Act, s 4.

- control and movement of stock
- related services and programs.

The LLS Act provides that the LLS “may do anything necessary, or supplemental or incidental, to the exercise of its functions”.²¹⁶

Some of these services will be specific to the land use practices of individual landholders and others specific to broader groupings of landholders (eg, dairy farmers). It would be administratively inefficient for LLS boards to develop specific purpose rates for all their activities, particularly as some activities will be directed at more than one outcome and may be directed at the entire rate base.

It is therefore likely that the general rate will be applied to fund the residual of activities not funded by specific purpose rates. Therefore it will be important to clearly define the coverage as well as key performance outcomes for the application of the general rate income.

7.4 LHPA rate structure

The RLP Act specified that LHPA rates must comprise a fixed amount and a variable amount.²¹⁷ The fixed amount applied to each holding of rateable land, while the variable amount was calculated based on the notional carrying capacity of each holding.

This rate structure is consistent with the criteria for rating in Box 7.1. The PC notes that a flat fee structure may have a greater impact on a small firm than a levy on turnover or sales.²¹⁸ Therefore, a rate structure with fixed and variable components allows an agency to target smaller properties by setting a high fixed amount, or target larger properties by setting a high variable amount.²¹⁹

In response to IPART’s Draft Report NSW Farmers asked:

Given the statements in chapter 6 about full cost recovery, does IPART have any position on the allocation of the capital or fixed costs versus marginal costs and how they might apply to a rating structure that include fixed and variable amounts?²²⁰

The decision to cost an activity at marginal, fully distributed or avoidable cost will determine the total costs attributed to the activity for recovery from ratepayers. The basis of cost attribution was discussed in Chapter 5.

²¹⁶ LLS Act, s 14(3).

²¹⁷ RLP Regulation, cl 7. This requirement is continued under the new legislative framework: LLS Regulation, cl 6.

²¹⁸ PC (2001) p XL.

²¹⁹ Ibid, p 170.

²²⁰ NSW Farmers submission to Draft Report, October 2013, p 7.

The price may include a fixed and variable component regardless of the basis of cost attribution. Ideally, the variable amount should be linked to the risk created or benefit received by identified impactors or beneficiaries to give a clear price signal and efficient outcome. However, there may be other considerations that need to be taken into account including the fixed costs of fee collection and volatility in the demand for services.

Recommendation

12 All LLS rates should comprise a fixed and a variable component.

7.5 Minimum rateable land area

Previously LHPA established landholders' liability to pay rates based on their land area. For example, all ratepayers with a land area of 10 hectares (ha) and above were liable to pay rates. LLS boards have the ability to set a minimum rateable land area above 10ha (eg, Western region LLS has a 40ha minimum).²²¹ Given LLS has a broader range of functions and objectives, we considered whether this minimum rateable land area should be maintained, or should be reduced to below 10ha.²²²

During our consultation process, most stakeholders were in favour of lowering the minimum rateable area to 2ha, arguing that small landholders posed a significant biosecurity risk.²²³ Many cited the 2007 equine influenza outbreak, where over 100,000 horses were found on small properties just west of the Sydney basin, many of which were not liable to pay LHPA rates.²²⁴

Those who were opposed to a reduction in minimum rateable area argued that the increased cost of administering rates to these properties (due to increased complaints) would be disproportional to the extra monies collected.²²⁵ This is consistent with the Bull Report's rationale for its recommendation in 2007 that the minimum rateable land area be increased to 10ha for all regions, with LHPA boards retaining the ability to set their own minimum area above 10ha. The report noted that complaints about the rating system tended to come from ratepayers with small properties (less than 10ha) who purchased their land for lifestyle reasons, and had no involvement in rural industries or livestock-related activities.²²⁶

²²¹ LLS website, *Rates FAQs*: <http://www.lls.nsw.gov.au/about/annual-rates/rates-faqs>

²²² RLP Regulation, Schedule 3. This is continued under the new legislative framework: LLS Regulation, cl 4.

²²³ For example, Mr C Sweeney, Transcript of public hearing at Wagga Wagga, 14 June 2013, pp 44-45.

²²⁴ LHPA submission to Issues Paper, July 2013, p 22. See also: NSW Farmers submission to Issues Paper, July 2013, p 12.

²²⁵ Mr Corboy, Transcript for Public Hearing at Wagga Wagga, 14 June 2013, p 67.

²²⁶ Bull Report, p 36.

However, the Beale Report on Australian biosecurity (2008) noted the risk posed by small properties and the need to involve them in the biosecurity continuum:

Awareness of biosecurity, let alone shared responsibility, is frequently lacking in the peri-urban environment. A number of recent biosecurity incidents have occurred in peri-urban areas including the first reported occurrence and subsequent spread of tomato leaf curl virus near Brisbane and periodic outbreaks of Hendra virus in Queensland. Involvement of small business, community groups and individuals in these areas is limited and represents a gap in the biosecurity continuum.²²⁷

In 2013, the NSW Government released its NSW Biosecurity Strategy²²⁸ which is designed to meet the increased need for a clear cohesive plan for the whole of NSW. This includes meeting the increasing need for biosecurity services in primary industries and managing new risks associated with smaller landowners with non-commercial livestock. The strategy states that landowners with small bush blocks or weekend getaways need to be seen as an important part of this strategy, making sure they and their neighbours are not unwitting pest protectors.²²⁹

The strategy also notes that the NSW Government has recently expanded Property Identification Code requirements to include a broader range of livestock.²³⁰ This recognises the risk to primary industry and human health posed by small properties,²³¹ and that pest animals (eg, wild dogs), weeds and diseases do not respect borders or fence lines.²³²

In IPART's Draft Report we recommended that the minimum rateable land area be reduced to 2ha with LLS boards having the flexibility to set a minimum above 2ha.

The Beale Report and the NSW Biosecurity Strategy clearly establish that small landholders contribute to the risks that LLS activities address. Therefore, they should help fund the cost of those activities. On this basis, we consider that the appropriate minimum rateable land should be reduced to 2ha with LLS boards retaining the current flexibility to set a higher minimum.

The reduction in the minimum rateable land area should be accompanied by a concerted effort to inform and educate them about why they are being rated. The Beale Report noted that there needs to be a greater effort to engage with small land holders.

²²⁷ Beale Report, p 73.

²²⁸ NSW Department of Primary Industries, NSW Biosecurity Strategy 2013 - 2021, 2013.

²²⁹ NSW Draft Biosecurity Strategy, Foreword, October 2012, p iii.

²³⁰ Species include sheep, cattle, goats, pigs, deer, bison, buffalo, camels, horses, donkeys, lama, alpaca or more than 100 poultry birds: NSW Draft Biosecurity Strategy Foreword, October 2012, p iii.

²³¹ NSW Biosecurity Strategy 2013-2021 (p 17) states that 60% of emerging infectious diseases in humans have originated in animals.

²³² NSW Biosecurity, Draft Biosecurity Strategy Foreword, October 2012, p iii.

Peri-urban areas represent a biosecurity risk that will remain a challenge to address, but one that justifies greater effort to tackle given the potential risk posed.²³³

By giving LLS boards to 1 July 2016 to introduce the new minimum rateable land area they will have time to engage and inform the affected landholders.

In response to our draft recommendation the LLS Board of Chairs recommended that the minimum rateable land area be removed and all risk creators in NSW be charged LLS rates (including properties below 2ha), with the exception of commercial and industrial land. It further recommended that properties below 2ha should be charged using unimproved capital value of land with these charges collected by local government. It proposed that a large proportion of the money collected from small landholders should be used to educate them in the first 2 years.²³⁴

In our view, adopting such a proposal would:

- ▼ discriminate between commercial/industrial land users and householders when it is not clear that this reflects their respective risk creation activities²³⁵
- ▼ potentially overlap with the rates charged and functions provided by local authorities
- ▼ remove the clear nexus between rates charges and services provided that is the foundation of the guidelines
- ▼ require agreement with 152 local authorities (that are largely opposed to collecting LLS rates)
- ▼ require local authorities to amend their billing systems and supplement resources devoted to responding to billing enquiries with consequent costs.

NSW taxpayers, in general, contribute from the State Budget to partial funding of the cost of LLS. The extension of LLS' funding base to properties below 2ha particularly where funds raised are not tied to a specific function of LLS or level of service, would introduce inefficiencies in cost recovery. Where LLS has a program of activity that extends across the whole of the NSW population (eg, general education on biosecurity) then such activity would be most efficiently funded out of general taxation.

We consider that the minimum rateable land area should be set at 2ha.

Recommendation

- 13** The minimum rateable land area should be reduced from the current 10 hectares to 2 hectares for all landholdings (except land used for intensive operations, which should be 0 hectares).

²³³ Beale Report, p 83.

²³⁴ LLS Board of Chairs submission to Draft Report, December 2013, p 3.

²³⁵ Orana Regional Organisation of Councils submission in response to LLS Board of Chairs submission, December 2013, p2.

- Individual LLS boards should retain the ability to set a minimum above the proposed state wide 2 hectare minimum.
- The reduction, where adopted by an LLS board, should occur by 1 July 2016, providing time for LLS boards to educate and inform small landholders.

7.6 Existing specific purpose rates

The Minister for Primary Industries asked us to provide advice on the appropriateness and efficiency of existing specific purpose rates in NSW, including:

- ▼ the animal health rate, formerly levied by LHPAs
- ▼ the meat industry levy, formerly collected by LHPAs on behalf of NSW Food Authority²³⁶
- ▼ the pest insect levy, formerly collected by LHPAs on behalf of the Department of Primary Industries
- ▼ the Hunter flood mitigation levy, formerly levied by the Hunter Central Rivers CMA.

We assessed each of these rates against the criteria in Box 7.1, giving consideration to stakeholder comments and the PC guidelines.

7.6.1 Animal health rate (AHR)

Currently, an animal health rate (AHR) is levied on the livestock industry.²³⁷ Clause 14 of the LLS Regulations provides:²³⁸

- ▼ Rateable land is exempt from any animal health rate for a year if the annual return indicates there are less than 50 stock units kept on the land.
- ▼ Horses are only included in this calculation if there are more than 5 kept on the land.

Poultry are not counted as stock when determining liability to pay the AHR.²³⁹ This means that a property with any number of poultry and less than 50 stock units worth of livestock would not be liable to pay the AHR. Poultry are discussed separately below.

²³⁶ Section 59A(1) of the *Meat Industry Act 1978* (NSW) states that “In respect of a year commencing on 1 January, a meat industry levy shall be payable to the Food Authority by every occupier of land liable to pay an animal health rate in respect of that year under the *Local Land Services Act 2013*.”

²³⁷ LHPA, *Annual Report 2011/12*, p 11.

²³⁸ LLS Regulation, cl 14.

²³⁹ LLS Regulation, cl 3(2).

LLS must have regard to additional matters in assessing the notional carrying capacity of rateable land used for intensive livestock production (relevant to calculating the variable component of an AHR).²⁴⁰ As stakeholders have expressed strong support for separate charging arrangements for intensive industries,²⁴¹ we have included a discussion of rates for intensive industries in Section 7.7.2.

In general, stakeholders support LLS continuing to charge an AHR.²⁴² However, some expressed concern about possible cross subsidisation of the AHR from non-livestock industries. For example, the Australian Macadamia Society stated that only those industries that create the risk and capture the benefit should be charged the AHR.²⁴³

Several stakeholders proposed changes to the AHR, to better target the appropriate risk creators and beneficiaries:

- ▼ NSW Farmers proposed that all properties should pay a base amount, while properties over 10 hectares should also pay a variable amount (based on their submitted livestock returns), and intensive livestock operations should pay a higher variable amount (to reflect their higher contribution to the total biosecurity risk). NSW Farmers also considers that intensive operations should be charged an intensive rate and that properties not running livestock could seek an exemption from the AHR.²⁴⁴
- ▼ The LHPA proposed that all properties with 30 stock units or more be required to pay the AHR (based on their submitted annual return), and that properties of between 2 and 40 hectares should pay a minimum AHR while properties above 40 hectares should pay a base amount and a variable amount (based on their notional carrying capacity).²⁴⁵ The LHPA also suggested that intensive operations be charged based on notional carrying capacity regardless of size to reflect their increased risk (see Section 7.7.2).
- ▼ The Cumberland LHPA proposed that the first 5 horses on a property should count toward the minimum stock units (currently 50) when assessing liability for the AHR.²⁴⁶

²⁴⁰ LLS Regulation, cl 17(6).

²⁴¹ For example, NSW Farmers submission to Issues Paper, July 2013, p 11.

²⁴² LHPA submission to Issues Paper, July 2013, p 20.

²⁴³ Australian Macadamia Society submission to Issues Paper, July 2013, p 7.

²⁴⁴ NSW Farmers submission to Issues Paper, July 2013, p 11.

²⁴⁵ LHPA submission to Issues Paper, July 2013, p 20.

²⁴⁶ Cumberland LHPA submission to Draft Report, October 2013, p 3.

We agree with the LHPA's proposal that it is appropriate to reduce the threshold for liability to pay the AHR from 50 to 30 stock units.²⁴⁷ Both Biosecurity NSW²⁴⁸ and the Beale Report²⁴⁹ have pointed out that smaller properties with relatively few animals contribute to the animal health risk. As discussed, the Beale Report noted the high cost of addressing the 2007 equine influenza outbreak, where over 100,000 horses were found on small properties just west of the Sydney basin. Many of these properties were not liable for the current AHR, as they carried less than 50 stock units. Yet, the direct cost of eradicating equine influenza from NSW and Queensland has been estimated at \$110 million.²⁵⁰

We also agree with the proposal by the Cumberland LHPA, that the first 5 horses count toward the minimum stock units (currently 50) when assessing liability for the AHR. This is in line with the cost recovery framework.

These changes will better target the actual risk creators and beneficiaries of LLS activities related to managing animal health risk and thus minimise the potential for cross-subsidisation. It is also consistent with our recommendation regarding minimum rateable land area for all LLS rates.

Some stakeholders noted the inequity of charging large broad acre cropping enterprises with few livestock (meeting the minimum 50 stock units) an AHR on the total carrying capacity of their property.²⁵¹ This issue was also noted by the Bull Report.²⁵² Stakeholders suggested that properties with broad acre cropping operations be identified through the annual return and charged on the proportion of their property that could support the actual number of livestock that they carry.²⁵³

The problem with this suggestion is that it would likely introduce another level of subjectivity into the assessment of the rate base and create incentives for ratepayers to game the system. This would be less efficient than dealing with these properties under a clearly defined exemption (full or partial) from the AHR.

We consider that this would be best dealt with under a broader exemptions policy (discussed in Section 8.3), rather than trying to adjust the rate base to suit exceptional circumstances. We consider that a partial exemption may be appropriate for landholders in this situation.

²⁴⁷ LLS Regulation, cl 14.

²⁴⁸ Department of Primary Industries, *NSW Biosecurity Strategy 2013-21*, May 2013, p 17.

²⁴⁹ Beale Report, pp 83-84.

²⁵⁰ Beale Report, p XV.

²⁵¹ IPART meeting with Cumberland LHPA and Sydney Metropolitan CMA, 17 July 2013.

²⁵² Bull Report, pp 21-22.

²⁵³ IPART meeting with Cumberland LHPA and Sydney Metropolitan CMA, 17 July 2013.

Poultry industry

There has been strong support amongst stakeholders for making the poultry industry liable for the AHR and the meat industry levy (MIL).²⁵⁴ NSW Farmers, however, supports an industry-wide exemption for poultry farmers. It argues that food safety, biosecurity and environmental requirements for poultry meat growers are covered under the Poultry Meat Industry Act 1986 (NSW).²⁵⁵

NSW Farmers also considers there should be a review of the allocation of notional carrying capacity to intensive industries. It argues that trying to apply a notional carrying capacity based on dry sheep equivalent to an intensive operation involving pigs or chickens may be an unreasonable process.²⁵⁶

The Bull Report recommended that intensive poultry industry be required to pay the AHR,²⁵⁷ stating that many chicken meat and egg production facilities in NSW require Boards to be the first response agency in the event of disease outbreak.²⁵⁸

The District Vet of the Cumberland LHPA noted that the LHPA was still required to engage with and address biosecurity issues (including disease outbreaks) associated with intensive poultry productions and that much of his time was spent dealing with intensive poultry productions. This is supported by a statement issued by the NSW Department of Primary Industries (in October 2013), concerning an outbreak of H7 Avian Influenza on 2 properties near Young. LHPA and DPI were involved in continued surveillance and tracing to determine the source and extent of the infection on both properties.²⁵⁹

At present, the intensive poultry industry imposes costs on the LHPA that are cross subsidised by non-poultry ratepayers. This is inconsistent with the cost recovery framework and the exemptions criteria which we outline in Section 8.3.

We consider that if LLS is required to service poultry meat growers and address poultry biosecurity issues, the poultry meat industry should contribute to LLS costs via the AHR (including intensive poultry productions, see Section 7.7.2).²⁶⁰

²⁵⁴ For example, LHPA submission to Issues Paper, July 2013, p 22 and Australian Macadamia Society submission to Issues Paper, July 2013, p 2.

²⁵⁵ NSW Farmers submission to the Draft Report, October 2013, p 8.

²⁵⁶ NSW Farmers submission to the Draft Report, October 2013, p 9.

²⁵⁷ Bull Report, p 7.

²⁵⁸ Bull Report, p 38.

²⁵⁹ Department of Primary Industries, *Avian Influenza outbreak – surveillance and tracing*, October 2013, p 1.

²⁶⁰ This may require legislative amendment: LLS Regulation, cl 3(2).

This should remove any cross subsidisation of the poultry meat industry by other livestock producers. It will also make poultry producers liable to pay the MIL, further reducing cross subsidisation. This will provide a clear price signal to poultry meat producers on the cost of biosecurity services directed to their industry. In setting charges, LLS should have regard to the requirements placed on poultry meat producers under the *Poultry Meat Industry Act 1986* (NSW).

Recommendations

- 14 LLS boards should continue charging the animal health rate, and should widen the group liable to pay this rate to include all landholders with a rateable land area and 30 or more stock units.
- 15 The allowance given to properties with 5 or less horses when determining liability for the animal health rate should be removed.
- 16 LLS boards should consider establishing a partial exemption on the animal health rate for broad acre cropping landholdings with few livestock under a broader exemptions policy.
- 17 Poultry should be included in the count of stock units when determining liability for the animal health rate.

7.6.2 Meat industry levy (MIL)

In addition to collecting its own rates, LHPA also collected the meat industry levy (MIL), as prescribed by the *Meat Industry Act 1978* (NSW),²⁶¹ on behalf of the NSW Food Authority. This rate is levied on the livestock industry, and is separate from the AHR. However, it is currently payable by all persons liable to pay the AHR. The revenue from the MIL goes to the Food Authority and partly funds its activities.

The Food Authority calculated the amount parties liable are to pay under the MIL, and the LHPA included this amount in the rates notices it issued annually to AHR ratepayers. The Food Authority advised that LHPA charged it a commission of 7.6% (plus GST) for collection of the MIL. In 2012, this commission amounted to \$78,450 (plus GST of \$7,845).²⁶²

The current MIL is both targeted and efficient, seeking to cost recover part of the Food Authority's costs from the industry that impacts/benefits from its activities. LLS should charge a fee to recover the efficient costs it incurs collecting the MIL. In line with Step 4 of the funding framework, it is appropriate to cost this collection using a marginal costing approach (see Section 5.6).

²⁶¹ *Meat Industry Act 1978* (NSW), s 59J. LLS took over this function when the RLP Act was repealed.

²⁶² NSW Food Authority submission to Issues Paper, July 2013, p 3.

Recommendation

- 18 LLS should continue to collect the meat industry levy on behalf of the NSW Food Authority from rate payers liable to pay the animal health rate. Once it has established its rate collection mechanism, LLS should charge the NSW Food Authority a fee that reflects the marginal cost of collecting the meat industry levy.

7.6.3 Pest insect (plague locust) levy

LHPA collected the pest insect levy (PIL) from all LHPA ratepayers on behalf of the Department of Primary Industries (DPI). The funds from this levy are held by DPI. The Plague Locust Management Group (which includes representatives from DPI, LPHA and NSW Farmers) is responsible for managing plague locusts in accordance with the pest insect levy (PIL) budget. This budget is developed by DPI in consultation with LHPA and NSW Farmers, and approved by the Plague Locust Management Group.²⁶³

Some stakeholders object to being charged this levy because plague locusts are not an issue east of the Great Dividing Range.²⁶⁴ The North Coast LHPA stated that coastal ratepayers strongly object to paying this levy when locusts do not impact on their production. It suggests that the PIL (for locust outbreaks) should be expanded to include other pests such as Cattle Tick.²⁶⁵

These objections highlight that the PIL is imposed on landholders who neither require nor benefit from the levy. This represents significant cross-subsidisation of landholders west of the Great Dividing Range which is inconsistent with the principles for creating specific purpose levies outlined in Section 7.7.

We consider that current arrangements for imposing and collecting the PIL are not consistent with the cost recovery framework. Given that the PIL is collected on behalf of DPI we recommend that DPI target actual beneficiaries or impactors of the PIL.

We understand that the LHPA has never received a fee from DPI for its levy collection activities.²⁶⁶ As discussed in relation to the MIL (above), it is appropriate for LLS to charge DPI a collection fee that reflects the marginal cost associated with collecting the PIL.

²⁶³ Email from Tim Seers LHPA, *Questions regarding the plague locust levy*, 26 August 2013.

²⁶⁴ Mr Cameron, Transcript of public hearing at Tamworth, 18 June 2013, pp 59- 60.

²⁶⁵ North Coast LHPA submission to Draft Report, October 2013, p 2.

²⁶⁶ Ms Paton-Blackwell, Transcript of Public Hearing at Wagga Wagga, 14 June 2013, p 59.

Recommendation

- 19 If LLS continues to collect the pest insect levy on behalf of the Department of Primary Industries (DPI):
- DPI should limit the areas from which fees are collected to those LLS regions where there are either impactors or beneficiaries in accordance with the cost recovery framework, and
 - LLS should charge DPI a fee that reflects the marginal cost of collecting the pest insect levy, once it has established its rate collection mechanism.

7.6.4 Hunter flood mitigation levy

The Hunter flood mitigation levy was charged by the Hunter Central Rivers CMA. The levy was charged to all local government rate payers in the Hunter Central Rivers catchment area,²⁶⁷ based on the unimproved capital value of land.²⁶⁸

The Hunter flood mitigation levy was collected by the local councils in the region on behalf of Hunter Central Rivers CMA. This levy was costed to cover the payment of a collection fee to local government (5% of receipts)

Only a few stakeholders commented on this levy, with no objections to LLS continuing to charge it. One stakeholder²⁶⁹ described how the levy already targets beneficiaries of flood mitigation activities in the Hunter catchment area, consistent with the cost recovery framework. By charging rate payers on the basis of land value,²⁷⁰ the levy targets high value properties that receive greater benefit from flood mitigation measures.

On the basis of stakeholder support and our own assessment of the levy, we consider that the Hunter LLS board should continue to charge the Hunter flood mitigation levy. The levy should include the cost of the collection fee paid to local councils, provided this fee reflects the marginal cost of the councils' collection activity. Where applicable, other LLS boards should consider charging a similar levy rather than subsidise flood mitigation services from other charges.

Recommendation

- 20 The Hunter LLS board should continue to charge the Hunter flood mitigation levy as a specific purpose levy. Where applicable, other LLS boards should investigate charging a flood mitigation levy to eliminate cross subsidisation of flood mitigation services.

²⁶⁷ Ms Marshall, Transcript of Public Hearing at Tamworth, 18 June 2013, p 38.

²⁶⁸ LLS Regulation, cl 36.

²⁶⁹ Ms Marshall, Transcript of public hearing at Tamworth, 18 June 2013, p 39.

²⁷⁰ Catchment Management Authorities (Hunter Central Rivers) Regulation 2010 (NSW), cl 5.

7.7 Establishment of new specific purpose rates

We were asked to provide advice on a more efficient approach to establishing new specific purpose rates, such as a biosecurity levy and a natural resource management (NRM) levy.

7.7.1 Approach for establishing specific purpose rates

Most stakeholders did not comment directly on approaches to establishing specific purpose rates. However, many highlighted the importance of transparency and minimal cross-subsidisation between rates.²⁷¹ LHPA stressed the need to avoid cross-subsidisation to maintain rate-payer confidence.²⁷² It also argued that individual LLS boards need to be able to establish new levies to give them flexibility to respond to changing needs in their region and to changes in government policy.²⁷³

New specific purpose rates can be established by applying the funding framework. For instance, Step 2 of the framework requires LLS boards to assess each activity separately using the framework, to minimise the potential for cross-subsidisation between activities and funders. By working through Steps 3 and 4, LLS boards will identify the most feasible, efficient and effective way to fund an activity, and the most appropriate impactors/risk creators or beneficiaries to charge for this activity.

Taking into account both stakeholders concerns, and the PC's Guidelines for Cost Recovery, the design of specific purpose rates needs to:

- ▼ account for any trade-offs between how well the rate targets impactors or beneficiaries (which affects its economic efficiency) and how easy it is to administer (which affects its cost effectiveness)
- ▼ minimise cross-subsidisation (for example, specific purpose rates should only recover the cost of activities clearly related to that specific purpose)
- ▼ minimise and incorporate transaction costs (for example, collection costs).

The PC's guidelines indicate that trade-offs between economic efficiency and cost effectiveness may be inevitable in the design of rates. However, such trade-offs should be consciously made, with due consideration of the likely impacts.

²⁷¹ For example, see NSW Farmers Association submission to Issues Paper, July 2013, p 12 and Mr Murdoch, Transcript of Public Hearing at Wagga Wagga, 14 June 2013, p 39.

²⁷² LHPA submission to Issues Paper, July 2013, p 1.

²⁷³ Ibid.

The guidelines clearly state that cross-subsidisation should be avoided because it can introduce inefficiencies. However, some cross-subsidies may be acceptable where an industry rate is used to fund activities that benefit the industry as a whole (or its customers), or where charging individual entities a fee-for-service is impractical or inconsistent with policy objectives.²⁷⁴

The PC guidelines note that cost recovery arrangements should aim to minimise transaction costs (such as the cost of administering and collecting a levy),²⁷⁵ and should recover these costs.²⁷⁶

Overall, we consider that LLS boards should have the flexibility to introduce an NRM or environment levy. This should be done in line with the funding framework where it can be demonstrated (by the relevant LLS board) that the levy would not duplicate current State Government or local government charges/services and that there is community support for it.

Recommendation

21 Any new special purpose rate established by a LLS board should satisfy the common rating criteria of being:

- efficient
- targeted
- simple and cost effective to administer
- clear and easily understood.

7.7.2 Rates for intensive industries

There is significant support from stakeholders for separate charging arrangements for intensive livestock productions (eg, feed lots).²⁷⁷ This is to recognise the increased risk associated with intensive livestock productions and to improve transparency.

Stakeholders have also suggested that there should be a corresponding intensive horticultural rate for intensive horticultural productions (eg, hot houses).²⁷⁸

The LLS Board of Chairs suggests a matrix linking risk mitigating activities required of an enterprise with turnover of that enterprise to determine LLS charges.²⁷⁹ This introduces a new charge and a new basis of charging with additional transaction costs.

²⁷⁴ PC (2001), pp XLIV-XLV.

²⁷⁵ PC (2001), p 161.

²⁷⁶ PC (2001), p 177.

²⁷⁷ For example, NSW Farmers submission to Draft Report, October 2013, p 7.

²⁷⁸ Mr J Macarthur-Stanham, Round Table Transcript, 28 October 2013, p 25.

²⁷⁹ LLS Board of Chairs submission to Draft Report, December 2013, p 3.

An intensive rate is intended to cover the same risks that arise from a non-intensive enterprise but which are magnified by the level of intensity. This suggests that the charging base (for instance, notional carrying capacity) for the two types of enterprise should be identical and that the intensive industry rate should be a multiple of that applying to a non-intensive enterprise. The 'multiple' could relate to scale of enterprise (either notional stock carrying capacity or land area) and specific industry risk.

We do not support the use of turnover in the calculation of the charge as it:

- ▼ would require the collection of new data that may be difficult to verify, particularly where it relates to operations on part of a landholding
- ▼ may vary substantially from one year to the next based on market prices of the produce being rated, which may have no relationship to the efforts required of LLS to counter potential risks.

These issues are discussed further in Section 8.2 in relation to the most efficient rate base for LLS.

Intensive animal health rate

In the draft report we recommended that LLS boards continue to charge intensive productions in line with the LHPA's methodology. This includes differentiating the notional carrying capacity (NCC) of intensive productions from land not used for intensive livestock farming.²⁸⁰

NSW Farmers supports a separate rate for intensive industries (ie, separate from the non-intensive animal health rate (AHR)). This is to recognise that intensive productions have large numbers of stock on relatively small parcels of land.²⁸¹

We agree with NSW Farmers' suggestion and consider that LLS boards should charge an intensive AHR targeted at intensive livestock productions. Charging an intensive AHR will improve the transparency of charging and reporting, allowing landholders to separately assess the cost to their intensive livestock productions.

We also consider that such rates should apply to all intensive productions (eg, intensive poultry productions) including those below the 2ha minimum. This is to recognise the risk associated with small intensive operations

²⁸⁰ LLS Regulation, cls 3(1) and 17(6).

²⁸¹ NSW Farmers submission to the Draft Report, October 2013, p 7.

LLS boards should continue to use the current definition of intensive livestock productions and separately assess the NCC of intensive productions²⁸² to avoid double counting with the general AHR. An intensive animal health rate should comprise a fixed component (a set amount for each intensive operation) and variable component based on NCC. We acknowledge that there may be some difficulty in establishing a NCC for poultry. The LLS could either establish an equivalent carrying capacity and stock unit for poultry or it could charge a rate based on land area, similar to that recommended for the intensive horticultural rate (see discussion below).

While LLS boards should develop a separate intensive AHR, money collected under both rates should be pooled to address animal biosecurity issues. This does not promote cross subsidisation, in this instance, because animal health issues are common to intensive and non-intensive animal productions (ie, common issues and risks).

Intensive horticultural rate

Stakeholders suggested that a corresponding intensive horticultural rate should be established to address the risks associated with intensive horticultural productions.

While this is consistent with IPART's criteria for establishing specific purpose rates, stakeholders did not provide us with any detailed information about the risks associated with intensive horticultural productions. Therefore based on the limited information we have been provided we consider that LLS boards should consider introducing an intensive horticultural biosecurity rate, especially if a (general) plant biosecurity rate is introduced. The rate should take account of specific issues the intensive horticultural industry faces and how they may differ from animal biosecurity.

We also consider that this rate should comprise a fixed component (a set amount for each intensive enterprise) and a variable component based on land area, regardless of the minimum rateable land area (like an intensive animal health rate). For the purposes of any horticultural rates, the LLS should regard any part of a property that is used for intensive horticulture separately from the rest of the property. The LLS should charge a separate per hectare amount for intensive and non-intensive parts of a property (if a non-intensive horticulture rate exists). Land used for intensive horticultural productions should not be subject to a non-intensive horticultural rate just as land used for non-intensive horticultural productions should not be subject to an intensive horticultural rate.

The LLS should also clearly define what comprises intensive horticultural production.

²⁸² LLS Regulation, cls 3(1) and 17(6).

Recommendation

- 22 LLS boards should charge an intensive animal health rate (separate from the animal health rate) and an intensive horticultural rate with a minimum rateable land area of 0 hectares.
- 23 The intensive animal health rate and the intensive horticultural rate should each comprise a fixed and a variable component. The variable component for:
- the intensive animal health rate (for all industries except poultry) should be based upon notional stock carrying capacity
 - the intensive animal health rate for the poultry industry should be based on either notional carrying capacity or land area
 - the intensive horticultural rate should be based on land area.

7.7.3 Biosecurity levy

We have considered whether, and in what circumstances, it may be appropriate for LLS boards to establish a biosecurity levy payable by LLS rate payers. We have assumed that such a levy could be used to fund the cost of activities that aim to mitigate general biosecurity risks in a LLS region. We have also assumed that a (general) biosecurity levy would target all LLS ratepayers who are the beneficiaries or impactors of these activities.

In our view, such a levy may be appropriate and efficient, provided the funding framework is applied correctly to ensure the levy does not cross-subsidise activities that are more appropriately funded via the animal health rate (or vice versa). In particular, LLS boards would need to clearly define and distinguish the activities to be funded through each of these rates – for example, taking account of the problem each is intended to address, the intended outcomes, what resources are required and where these resources will be used (in line with Step 2 of the framework).

It may also be possible to incorporate the existing pest insect levy into a biosecurity levy. Payments to the Pest Insect Destruction Fund could be made from the monies collected by this levy, and remaining monies used to address other local (or regional) biosecurity issues.²⁸³ However, the rates notices issued by LLS would need to be transparent, noting that the biosecurity levy includes the pest insect levy.

²⁸³ We note that money that has been received by imposition of a specific purpose rate may not be used otherwise than for the purpose for what the rate was levied, unless the minister approves another purpose: LLS Regulation, cl 6(8).

7.7.4 Natural resource management or environmental levy

We also considered whether and in what circumstances it may be appropriate for LLS boards to establish an NRM or environmental levy. We assumed that such a levy would be used to fund some of the non-regulatory activities that were undertaken by CMAs (but not those required to meet their statutory requirements, such as developing Catchment Action Plans). We also assumed the levy would target all LLS ratepayers (as the beneficiaries of these activities).

We note that CMAs provided public funding towards NRM projects in line with the strategies and targets in their region's Catchment Action Plan. They leveraged investment, in aggregate, in these projects at a rate of \$2.20 of private investment (labour, materials and co-payments) for every dollar of public investment. This was achieved through direct negotiation with landholders, where private individuals applied for government investment in projects on their land. This allowed the CMAs and landholders to assess the benefit to the public and the private individual respectively, which ensured an efficient and targeted outcome for both parties.²⁸⁴

This approach is likely to be more efficient than charging a levy to fund these projects. If an NRM levy were introduced, it may reduce private investment in these projects.²⁸⁵ For example, if ratepayers were required to pay a levy to fund NRM activities in the region, they may be less willing to also co-fund NRM projects on their own land.

However, this may not be a concern for all regions. For example, representatives of the Sydney CMA²⁸⁶ noted that leveraging investment in NRM projects works differently in major centres like Sydney, where there are relatively few private landholders with rateable land. In such centres, CMAs leverage investment by working with volunteer organisations, who contribute to NRM projects on public land (primarily in the form of labour). The introduction of an NRM levy would not affect these organisations, and thus would not affect their willingness to continue contributing to projects on public land.

While some stakeholders were in favour of an NRM levy,²⁸⁷ the majority were concerned about what would happen if the NSW and Commonwealth Governments were to stop funding NRM services.²⁸⁸ A representative of the CMAs at the Tamworth public hearing noted that provision of NRM services was contingent on investor funding²⁸⁹, with the government representing the single largest investor in NRM services.

²⁸⁴ CMA, *Five Year Achievements Report*, October 2009, p 5.

²⁸⁵ CMA, *Annual Report 2011/12*, p 5.

²⁸⁶ IPART meeting with Cumberland LHPA and Sydney Metropolitan CMA, 17/7/2013 at 12pm.

²⁸⁷ IPART meeting with Cumberland LHPA and Sydney Metropolitan CMA, 17/7/2013 at 12pm.

See also: Transcript of public hearing at Wagga Wagga, 14 June 2013, p 67.

²⁸⁸ Mr Freestone, Transcript of public hearing at Tamworth, 18 June 2013, p 70.

²⁸⁹ Miss Brown, Transcript of public hearing at Tamworth, 18 June 2013, pp 70-71.

Local Government NSW (LGNSW) was particularly concerned that any rating undertaken by the LLS should not overlap with local government rates, especially if urban areas are included in the rate base. It noted that extending liability for LLS rates into urban areas (for example, by reducing the minimum rateable land to below 2 hectares) could potentially impact on current and future council rating.²⁹⁰

On balance, LLS boards should have the flexibility to introduce an NRM or environment levy subject to the minimum rateable land area of 2 hectares. Its introduction should satisfy the general criteria applying to rating (see Box 7.1).

7.8 Property Identification Code (PIC)

A PIC²⁹¹ is a unique identifier assigned to a property that keeps livestock.²⁹² It assists in the control of disease and the identification of the source of residue problems (eg chemicals).

The national livestock identification scheme (NLIS) relies on the effective operation of the PIC system for tracing meat and protecting domestic and export markets.

PICs are allocated and charged for by LLS. The penalty notice amount for not having a PIC is \$550.²⁹³

A PIC is required for a property with one or more cattle, sheep, goats, pigs, deer, bison, buffalo, camelids, equines (ie, horses and donkeys) and poultry.²⁹⁴

The PIC system is an important source of information for LLS both for biosecurity and the broader operation of its rating system.

Recommendation

- 24 The LLS should continue to fund the operation of the Property Identification Code system through charges that reflect the efficient cost of operating the scheme. Charges imposed should be shown on rates notices.

²⁹⁰ LGNSW submission to Issues Paper, July 2013, p 4.

²⁹¹ www.dpi.nsw.gov.au/agriculture/livestock/nlis/pic

²⁹² NSW Department of Primary Industries, *NLIS - Procedures for assigning property Identification Codes for Managing and Accessing Registers*, September 2007, p 5.

²⁹³ *Stock Diseases Regulation 2009* (NSW), cl 37.

²⁹⁴ <http://www.lls.nsw.gov.au/livestock/pics>

8 Most efficient rating base and other rating issues

In addition to the rating issues discussed in Chapter 7, our terms of reference asked us to provide advice on the most efficient rating base for LLS. The rating base refers to the 'per unit' basis on which the variable component of a rate is calculated. For example, for local government rates, the rating base is the unimproved capital value of the ratepayer's land.²⁹⁵ For the LHPA rates, the rating base was the notional carrying capacity (NCC) of the landholder's property.²⁹⁶ We also considered 2 additional issues related to rates – whether there should be any exemptions to liability to pay LLS rates, and how to have regard to the late submission or failure to submit LLS annual returns.

The sections below provide an overview of our recommendations on these issues, and then discuss our analysis of each issue in more detail.

8.1 Overview of recommendations on the most efficient rating base, exemptions and annual returns

Land area is the preferred base for calculating the variable component of LLS general purpose rates. It is neutral between different land uses and it effectively targets the risk creator and beneficiary of LLS' general services. In addition, it is transparent and easy to understand, especially for ratepayers with small landholdings. However, we are aware of issues associated with moving to a land area rate base for areas that have significant variation in land quality (ie, the Western region). Therefore, we have recommended that the Western LLS Board be given the option of using notional carrying capacity as the base for calculating the variable component of their general rate.

LLS boards should use notional carrying capacity for calculating the variable component of the animal health rate. Stakeholders indicated that notional carrying capacity is targeted at actual impactors and beneficiaries of animal health services.

²⁹⁵ *Local Government Act 1993* (NSW), s 498.

²⁹⁶ LLS Regulation, cl 6. Previously: RLP Regulation, cl 7.

LLS boards should be allowed to grant exemptions (including partial exemptions) to landholders only where this is consistent with the set of principles outlined in Box 8.1. Current exemptions should be removed from the LLS regulation, however they may be continued if they are consistent with these principles.²⁹⁷

In the event landholders do not submit annual returns on time, they should pay a penalty in addition to any rates they are liable to pay. In the absence of an annual return, liability to pay rates could be determined through the National Livestock Identification System (NLIS). This will avoid non-livestock carrying landholders subsidising the livestock industry. It will also recognise the importance of the information collected by annual returns as part of the wider biosecurity initiative, not just as a mechanism for determining liability for rates.

8.2 Most efficient rating base

In determining the most efficient and appropriate general rating base we identified 4 possible options:

- ▼ Per unit of product sold (eg, grain, livestock)
- ▼ Unimproved capital value of land
- ▼ Notional stock carrying capacity (NCC)
- ▼ Land area (per hectare).

We then assessed each of these options against our criteria (discussed in Chapter 7, and listed in Box 7.1). The results of our assessment are shown in Table 8.1.

The sections below discuss our findings.

Table 8.1 Summary of our assessment of rating base options

Assessment criteria	Per unit of product sold	Unimproved capital value of land	Notional Carrying Capacity	Land area (per ha)
Efficient	No	Yes	Yes	Yes
Targeted at actual beneficiaries and impactors	Targets buyers and/or sellers	Targets high value land	Targets high yield land	Targets large properties
Simple and cost effective to administer	Yes	Yes, may have timing delays	No	Yes
Clear and easily understood	Yes	No	No	Yes
Able to be consistently applied	Yes	Yes	No	Yes

Source: IPART analysis.

²⁹⁷ This may require legislative amendment. See LLS Regulation, cl 15.

8.2.1 Option 1: Per unit of product sold

A per unit charge is a levy on the sale of farm produce, such as per head of livestock sold, per tonne of grain sold, or any defined unit of crop sold by primary producers. Such a charge could be a very cost-effective, targeted and objective way of funding LLS activities. However, it fails our assessment (ie, is not efficient).

A rate calculated on per unit of product sold (output) would not be economically inefficient. It is likely to distort economic activity by creating a disincentive for farmers to become more efficient and/or expand production. This would impose a 'deadweight cost' on the economy – acting as a drag on economic activity and reduce jobs and incomes below potential. This cost must be balanced against the actual revenue raised by the levy. Charges that minimise deadweight costs – that is, those that are efficient – are preferable.²⁹⁸

8.2.2 Option 2: Unimproved capital value of land

Unimproved capital value of land (UCV) is currently the rating base for local government rates. The definition of **land value** used by local governments is found in the *Valuation of Land Act 1916* (NSW).²⁹⁹

We consider that using UCV as the basis for LLS rates could be economically efficient and able to be consistently applied. However, it would not target the actual risk creator or beneficiary. As the Bull Report noted, there is no correlation between the value of land and the landholder's contribution to the risk creation (impact) or benefits associated with LLS services.³⁰⁰ The lack of correlation would cloud its application and reduce its acceptance by ratepayers.

Stakeholders' concerns with this option are consistent with those stated in the Bull Report. These concerns include:³⁰¹

- ▼ creating inequities in the rating system caused by the wide variations in land values (even within restricted areas) for land with similar productive capacity
- ▼ linking the rating base to location including proximity to the coast and major centres.³⁰²

²⁹⁸ IPART, *Final Report - Review of State Taxation - Report to Treasurer*, October 2008, pp 51-52.

²⁹⁹ *Valuation of Land Act 1916*, (NSW), Section 6A(1).

³⁰⁰ Bull Report, p 26.

³⁰¹ LHPA submission to Issues Paper, July 2013, p 21.

³⁰² Ibid.

Where stakeholders did support the use of UCV as the rating base, they did so on the grounds that there would be efficiency gains from using local government to collect rates on behalf of the LLS.³⁰³ While using UCV would be more cost-effective to administer than NCC we consider that it would be less targeted at actual beneficiaries and impactors, introducing inequities and cross subsidisation (between impactors and beneficiaries) into the LLS rating system.

8.2.3 Option 3: Notional stock carrying capacity (NCC)

The LLS Regulation defines NCC³⁰⁴ (in relation to land within a district) as the number of stock that the authority for the district has assessed could be maintained on the land. The LLS Regulation requires the authority to assess the NCC of land every 5 years by reference to the number of stock units that could be maintained on the land in an average season under management practices that, in the authority's opinion, are usual for the district.³⁰⁵

The LLS Regulation³⁰⁶ contains specific guidance on how to determine NCC, as follows:

- ▼ a 40 kilogram wether sheep of any breed represents 1 stock unit, and a 400 kilogram steer of any breed represents 10 stock units³⁰⁷
- ▼ the assessment is to be made irrespective of whether the land is or is not used for any purpose at the date of assessment³⁰⁸
- ▼ the authority must make its assessment as if the raising of stock were the only use of land.³⁰⁹

For rateable land used for intensive livestock production, LLS must take into account:

- ▼ the nature of the holding or structure concerned³¹⁰
- ▼ any improvement and equipment used for the purposes of intensive livestock production on the land³¹¹
- ▼ the manner in which the holding has been worked³¹²
- ▼ any other matter it considers necessary.³¹³

³⁰³ Serrated Tussock Working Party submission to Issues Paper, July 2013, pp 7-8.

³⁰⁴ LLS Regulation, cl 3.

³⁰⁵ LLS Regulation, cl 17(3).

³⁰⁶ LLS Regulation, cl 17.

³⁰⁷ LLS Regulation, cl 17(2).

³⁰⁸ LLS Regulation, cl 17(4).

³⁰⁹ LLS Regulation, cl 17(5)(c).

³¹⁰ LLS Regulation, cl 17(6)(a).

³¹¹ LLS Regulation, cl 17(6)(b).

³¹² LLS Regulation, cl 17(6)(c).

³¹³ LLS Regulation, cl 17(6)(d).

As a rating base, NCC is economically efficient. However, it does not meet the other criteria. Importantly, it has limited ability to target actual impactors and beneficiaries for general LLS rates. In addition, it is not clearly and easily understood – particularly by landholders with smaller or non-farming properties.

Criterion: Targeted at actual impactors and beneficiaries

In their submissions, the LHPA and NSW Farmers³¹⁴ both argued that NCC is an indicative measure of the risk created or benefit received by landholders. Both also argued that there is a link between the productivity and biosecurity risk, in particular animal biosecurity.³¹⁵ NSW Farmers also argued that NCC was a good representation of actual stock densities and this makes it appropriate for animal biosecurity.³¹⁶

NSW Food Authority also supported NCC, although specifically for the MIL rather than a general rate. It argued that NCC is the closest available approximation of a property's primary production capacity and most closely aligns with risk creators and beneficiaries of activities to improve the state's meat food safety management system.³¹⁷

In contrast, the Australian Macadamia Society (AMS) argued strongly against using NCC, especially for general rating.³¹⁸ AMS questioned the relevance of NCC to horticultural industries, stating that it is currently applied to landholders without any consideration of their need for LHPA services, risk creation and the ability to capture the benefits (especially for the horticultural sector).³¹⁹

The Bull Report also found that land productivity did not directly correlate with the ability to harbour pest animals.³²⁰ It noted stakeholder concerns, in the context of the general rate, about situations where pest animals were commonly breeding in areas with lighter country and a lower NCC. During consultation for the Bull Report stakeholders generally agreed that a land area rate base would rectify this situation, making it a better indicator of a property's risk associated with pest animals than NCC.³²¹ The Bull Report recommended that land area be used as the basis for all rating.³²²

³¹⁴ NSW Farmers submission to Issues Paper, July 2013, p 11.

³¹⁵ LHPA submission to Issues Paper, July 2013, pp 2 and 19.

³¹⁶ NSW Farmers submission to Issues Paper, July 2013, p 11.

³¹⁷ Food Authority submission to Issues Paper, July 2013, p 5.

³¹⁸ Australian Macadamia Society submission to Issues Paper, July 2013, p 6.

³¹⁹ Ibid, p 8.

³²⁰ This is largely due to the lack of cover from predators.

³²¹ Bull Report, p 27.

³²² Bull Report, p 7.

We consider that NCC does not meet the criterion “targeted at actual impactors and beneficiaries” for general LLS rates. While it may be an indicative measure of the level of risk created or benefit received for certain LLS activities – such as those targeted at the livestock industry – it does not accurately reflect the risk associated with different land uses or all activities. In particular, we are persuaded by AMS’ arguments that NCC does not reflect the impact or benefit of land holders engaged in the horticultural industry. We are also persuaded by the Bull Report’s finding that risk associated with pest animals is not directly correlated with a property’s productive capacity.

Criterion: Clear and easily understood

Both the Bull³²³ and Ryan³²⁴ Reports found that the concept and assessment of NCC is poorly understood by landholders not engaged in traditional farming activities. Both reports criticised the LHPA’s use of NCC as a rating base, on the grounds that it was not transparent, and assessments of the NCC within LHPA regions were subjective.

The Bull Report found this was a serious shortcoming, in light of protests by ratepayers on small land holdings.³²⁵ The Bull Report recommended that land area be used instead of NCC as the rating base for all LHPA rates because it is more transparent and objective, and is readily understood by all members of the community.³²⁶

The Ryan Report acknowledged that NCC is well understood by long standing agricultural landowners, but it found that:

...for new landholders on lifestyle blocks, it was not understandable at all. Therefore there were many protests against using something that they did not fully understand and doubting the methodology for determining the notional carrying capacities.³²⁷

In its submission to our review, the LHPA also acknowledged that the vast majority of complaints about NCC have come from small landholders, stating that:

We recognise that there is some confusion over the notion of carrying capacity among rate payers. The overwhelming anecdotal perspective of LHPA managers is that the majority of complaints received about rates notices are from small landholders about using carrying capacity as a basis for rating.³²⁸

³²³ Bull Report, p 25,

³²⁴ Ryan Report, p 54.

³²⁵ Bull Report, p 20.

³²⁶ Bull Report, p 33.

³²⁷ Ryan Report, p 51.

³²⁸ LHPA submission to Issues Paper, p 19.

To overcome this confusion, the LHPA suggested that all properties be charged a base rate and anything over 40ha be also charged a variable rate based on NCC.³²⁹ The LHPA's proposed cut-off is designed to recognise that lifestyle properties can be as large as 40ha. This would also overcome the need to provide new assessments for all the properties between 2ha and 10ha that currently do not have an NCC.³³⁰

However, this is not an appropriate solution for a range of reasons. Most significantly, it would effectively reintroduce a minimum rate, which was removed as a result of the recommendation of the Bull Report.³³¹ Our analysis indicates it would potentially result in 66% of LLS ratepayers being on this minimum rate (2ha to 40ha).³³² Reintroducing a minimum rate would not send a clear price signal to properties 2ha to 40ha, and may create perverse incentives and produce an inefficient outcome.

NCC does not meet the criterion "clear and easily understood", particularly for small landholders. This is a serious shortcoming, given our recommendation to decrease the minimum rateable land area to 2ha. Our analysis indicates that if this recommendation is implemented in all regions, more than 100,000 small landholders will become liable for a general LLS rate. These new ratepayers will represent around half of the total number of LLS ratepayers in NSW, ranging from 28% to 84% in the Central West and Greater Sydney regions respectively. It is important that the rating base is easily understood by all ratepayers to ensure a more efficient outcome and greater acceptance by non-livestock producing land holders.³³³

Existing rate payers (ie, those with landholding greater than 10ha) will be better acquainted with the concept of NCC than potential new ratepayers (ie, those with landholding less than 10ha). Hence, we recommend that where a minimum rateable land area of 10ha or greater is retained, LLS boards have the option to use NCC as the general rate base.

8.2.4 Option 4: Land area (per hectare)

Using land area (per ha) rather than NCC as the general rating base for LLS activities would require LLS boards to determine a dollar amount per hectare (\$/ha) rather than per stock unit for the region. This implies occupiers of larger properties would have greater liability, irrespective of the productive capacity of the land measured by NCC.

³²⁹ LHPA submission to Issues Paper, p 20.

³³⁰ IPART meeting with Cumberland LHPA and Sydney Metropolitan CMA, 17 July 2013.

³³¹ Bull Report, p 8.

³³² IPART calculations based on data received from the LHPA. 155,348 properties 40ha or less divided by total properties of 234,391.

³³³ Ibid.

Land area best meets the assessment criteria. It is economically efficient and clear and easily understood.

It better targets risks that are borne by all LLS ratepayers (eg, harbouring pests). In addition, it would be clearer and more easily understood – particularly by landholders with smaller or non-farming properties. It would also be simpler and easier to administer, and more able to be consistently applied by all LLS boards.

Criterion: Targeted at actual impactors and beneficiaries

AMS argues that land area is the most equitable rating base, provided the rate funds activities and services where it has been clearly established at the regional level that there is a significant benefit and/or risk creation on the part of the landholders affected.³³⁴

The NSW Food Authority³³⁵ recognises that land area is an objective and verifiable rating base that can be compared across regions. However, it does not support its use in the context of the MIL, as this would remove the link between the variable amount payable on a property and its commercial production potential. Since the MIL funds activities required to regulate primary production of food, it argued that the rating base should align with the commercial production capacity of the property. We agree that the use of NCC for the MIL would be targeted at actual impactors and beneficiaries.

Both NSW Farmers³³⁶ and the LHPA³³⁷ argued that because land area does not account for the relative productivity of land within a region, it would be inequitable and inappropriate as a basis for rating. NSW Farmers also argued that land area does not account for stocking densities associated with different climate zones and soil types, and therefore may not account for exposure to risk or benefit of LLS animal biosecurity functions.³³⁸

The LHPA also expressed concern about the possibility of large rate rises for occupiers of land with a low NCC if land area was adopted as LLS' general rating base.³³⁹ On this point, we note that the Bull Report suggested that large rate rises could be rectified by using a differential rating system, which would allow LLS boards to charge a lower per unit rate for land of significantly poorer quality. The Bull Report notes that it was generally agreed by boards that a differential rate would not normally be applied to individual holdings, but rather

³³⁴ Australian Macadamia Society submission to Issues Paper, July 2013, p 7.

³³⁵ NSW Food Authority Submission to Issues Paper, July 2013, p 5.

³³⁶ NSW Farmers submission to Issues Paper, July 2013, p 11.

³³⁷ LHPA submission to Issues Paper, July 2013, p 20.

³³⁸ NSW Farmers submission to Issues Paper, July 2013, p 11.

³³⁹ LHPA submission to Issues Paper, July 2013, p 20.

to large tracts of land that had significantly different environmental conditions from the majority of the district.³⁴⁰

We also conducted modelling to simulate the effect of moving to a land area rate for LHPA ratepayers using up-to-date data provided by the LHPA. The data covered 98% of rateable land holdings,³⁴¹ split into the respective LLS regions. We assumed that total rates collected and minimum rateable land area for all regions remained unchanged (at 2013 levels). We also rationalised all variable rates to a single land area rate.

Our modelling showed that introduction of a differential rate or a high fixed component would significantly reduce variations in current landholders' bills. These results do not include new rate payers, on properties below 10ha. We consider that some of the burden on current rate payers could be shifted onto new ratepayers rather than seeing them as a windfall gain. The LLS should also consider phasing rate changes in (eg, over 5 years), especially where landholders will experience large increases in rates.

Criterion: Clear and easily understood, and other criteria

The Bull Report recommended that land area should be adopted as the rating base for LHPA rates because it is transparent and readily understood by all members of the community.³⁴² This applies particularly to small landholders who are not engaged in traditional farming or livestock activities. As discussed in Section 8.2.3 above, this is especially important in light of our recommendation to decrease the minimum rateable land area to 2ha.

Because of this transparency, using land area rather than NCC as the rating base for general rates is likely to result in fewer complaints from ratepayers, making it more cost-effective to administer. In addition, as land area data is readily available from the Land and Property Information,³⁴³ and the LHPA also maintains data on the size of each rateable property (10ha and above), it is likely to be simpler to administer than NCC. In particular, there will be no need for LLS boards to assess the NCC of the large number of properties that would become newly rateable if our recommendation to reduce the minimum rateable land to 2ha is implemented.

Further, because land area is an objective and verifiable measure, LLS boards can apply it consistently both within and across regions.

In the draft report, we recommended that if LLS boards set their minimum rateable land area 10ha or above, they should be allowed to use NCC as the base for the general rate.

³⁴⁰ Bull Report, p 27.

³⁴¹ The remaining 2% could not be easily placed into their relative LLS region.

³⁴² Bull Report, p 33.

³⁴³ LPI website, http://www.lpi.nsw.gov.au/valuation/nsw_land_values.

Mr I Donges, Chair of the LHPA, queried this draft recommendation, noting that the LHPA had suggested a threshold of 40ha. He stated that:

Our submission talked about 40 hectares because we felt there are so many of these smaller landholdings and it gets confusing to landholders who, say, have 20 or 30 hectares to try and understand the notional carrying capacity. We understand that is a problem. Therefore setting a single rate based on a land area under 40 hectares we felt was a simpler way to go, easier to administer, and got around some of our inherent problems at the moment.³⁴⁴

We recommended a threshold of 10ha because it is the current minimum rateable land area and provides historical precedent. The LLS Board of Chairs may wish to consider raising this threshold in the future.

The 10ha threshold was also queried by the North West LHPA, stating:

The current recommendations seem to arbitrarily recommend a land area as the rating base or NCC as an alternative rating base depending if the lowest area is 2 or 10 hectares. It is not apparent why there is an allowance for NCC in one case but not another for a sub-set of the landholders.³⁴⁵

We consider that the use of NCC for a subset of landholders within a region, as suggested by the North West LHPA, may cause significant inconsistencies in rating within the same region.

Our primary consideration in setting the 10ha threshold was the Western LLS region where landholdings are large and generally used for livestock. We recognise the concerns raised by the North West LHPA and in light of the analysis above recommend that all LLS boards be required to use land area as the rating base for any general or broad-based rate, with the exception of the Western region. The Western LLS board should retain the option of using either land area or notional carrying capacity for any general or broad-based rate.

Recommendations:

- 25 Land area should be used as the rating base for any general or broad-based rate (such as those that target all LLS ratepayers as the beneficiary). However the Western LLS board should retain the option of using notional carrying capacity as the rating base for any general or broad-based rate.
- 26 Notional Carrying Capacity should be used as the rating base for specific purpose rates that target the livestock industry as the risk creator or the beneficiary (such as the animal health rate and the meat industry levy).
- 27 LLS boards should be allowed to standardise their current rates to avoid different landholders paying different rates for the same service.

³⁴⁴ Mr I Donges, Transcript of Roundtable at IPART, 28 October 2013, p 58.

³⁴⁵ North West LHPA submission to Draft Report, p 4.

- 28 LLS boards should consider phasing in changes to rates (eg, over 5 years), if there are expected to be large increases in landholder rates. This may involve capping the maximum annual increase in rates.

8.3 Exemptions from LLS rates

The Regulations specify the land uses and occupants that are exempt from paying LLS rates. Exemptions currently apply to any part of a holding:³⁴⁶

- ▼ used as a motel or caravan park
- ▼ occupied by LLS
- ▼ occupied by a local authority and that is used for a purpose other than an agricultural enterprise
- ▼ used for the purposes of a cemetery, golf course, racecourse, showground or industrial area
- ▼ on which a rifle range or buildings ancillary to the conduct of such a range are located
- ▼ used for growing sugar cane.

We have considered whether these exemptions should continue to apply to LLS rates, and whether exemptions from these rates should be granted in the future.

8.3.1 Current exemptions

There was strong support amongst stakeholders for removing current exemptions, in particular for sugar cane growers.³⁴⁷ The Bull Report also recommended that the exemption for the sugar cane industry be removed.³⁴⁸ It noted that sugar cane growers have been afforded an advantage over most of the other crop growers who also have had their own pest control measures in place.³⁴⁹

The NSW Cane Growers Association along with the NSW Sugar Milling Co-op raised some important issues in support of their industry wide exemption. They argued that the industry conducts its own local land services and has the capacity to react and respond to issues specific to cane growers effectively and efficiently with an annual investment of \$1.6 million by NSW cane farmers and Mill owners each year. The NSW Cane Growers Association also voiced concern with the lack of specialist skills and the limited resources of the LLS for dealing with issues and delivering services that are already being provided by the sugar cane industry. It argued that an industry wide exemption should be maintained

³⁴⁶ LLS Regulation, cl 15. Previously: RLP Regulation, cl 17.

³⁴⁷ Eg, LHPA submission to Issues Paper, July 2013, p 22.

³⁴⁸ Bull Report, p 7.

³⁴⁹ Bull Report, p 38.

because it is more administratively efficient than requiring 378 identical submissions from each individual cane growing business.³⁵⁰

We consider that there is significant benefit in not crowding out industry initiatives in addressing biosecurity and other issues. We also recognise the administrative inefficiency that would be created by restricting exemptions to individuals only. However, without more detailed information on the services that will be provided by the LLS and those currently provided by the industry it is not possible to determine the overlap of services that will occur.

We consider that all current exemptions should be removed and only included again if they are consistent with the cost recovery framework and principles outlined in Box 8.1. When assessing exemptions the LLS should consider work being done by industry groups, volunteer groups and individuals to address biosecurity and other issues to ensure it does not “crowd out” initiatives that are currently being undertaken.

We also consider that exemptions should not be restricted to individuals. The LLS should be allowed to enter into a deed of agreement or a Memorandum of Understanding (MOU) between itself and industry or volunteer groups. A deed or MOU should formally outline service arrangements between the LLS and the relevant industry/volunteer group.

Recommendation

- 29 All current exemptions from LLS rates should be removed. Any new exemptions (partial or full) should be assessed under an LLS exemptions policy.
- In assessing exemptions, the LLS should consider work being done by industry groups, volunteer groups and individuals to address biosecurity and other issues. Service arrangements could be formalised under an instrument such as a deed of agreement or a Memorandum of Understanding between the LLS and industry and volunteer groups.

8.3.2 Future exemptions (full or partial)

Stakeholders were divided as to whether exemptions (including partial exemptions) from LLS rates should be allowed in the future. AMS³⁵¹ and the Serrated Tussock Working Party³⁵² were both in favour of exemptions. They both supported the principles for granting exemptions set out in our Issues Paper, and the idea of providing incentives for landholders who mitigate their risk.

³⁵⁰ NSW Cane Growers Association and NSW Sugar Milling Co-operative submission to Draft Report, p 1-2.

³⁵¹ AMS submission to Issues Paper, pp 7-8.

³⁵² Serrated Tussock Working Party submission to Issues Paper, pp 8-12.

The LHPA opposed exemptions, stating that administration of the rating system would become inefficient and open to gaming. It argued that if exemptions were to be allowed, the reasons and criteria for granting them should be tightly defined. The LHPA also noted that if the minimum rateable land area is reduced to 2ha there would be approximately 290,000 rateable holdings in NSW.³⁵³ An increase in the number of rateable holdings could also increase administrative inefficiency in assessing applications for exemptions.

NSW Farmers argued that while exemptions would impact both the efficiency and transparency of the system there may be some justifiable reasons why exemptions should be provided. For example, for the poultry meat industry or in the case of drought where exemptions may be provided on the basis of reduced services or hardships.³⁵⁴

At IPART's Roundtable Mr K Lee noted the problems that were caused by allowing exemptions from the GST when it was introduced. He argued that exemptions in the LLS rating system would create administrative inefficiencies.

My history is as a tax accountant, so I lived through 1 July 2000, the biggest tax change we have ever seen with GST, and the sun came up the next day which was amazing for some people. However, that system is not as good as it could be, simply because it has exemptions built into it. It is much harder for that system to be administered. Much more effort in terms of compliance is wasted on working out what is exempt and what is not, rather than looking for avoidance and the like.³⁵⁵

We consider that while exemptions will create additional administrative effort they will introduce efficiencies by providing an incentive to those best placed to mitigate risks (see Figure 8.1). This may also recognise landholders who currently mitigate/pose less risk, such as large broad acre enterprises discussed in Section 7.6.1. LLS boards should only provide exemptions in circumstances where it can be clearly demonstrated that a landholder has mitigated their risk in line with the cost recovery framework and the criteria in Box 8.1 (below).

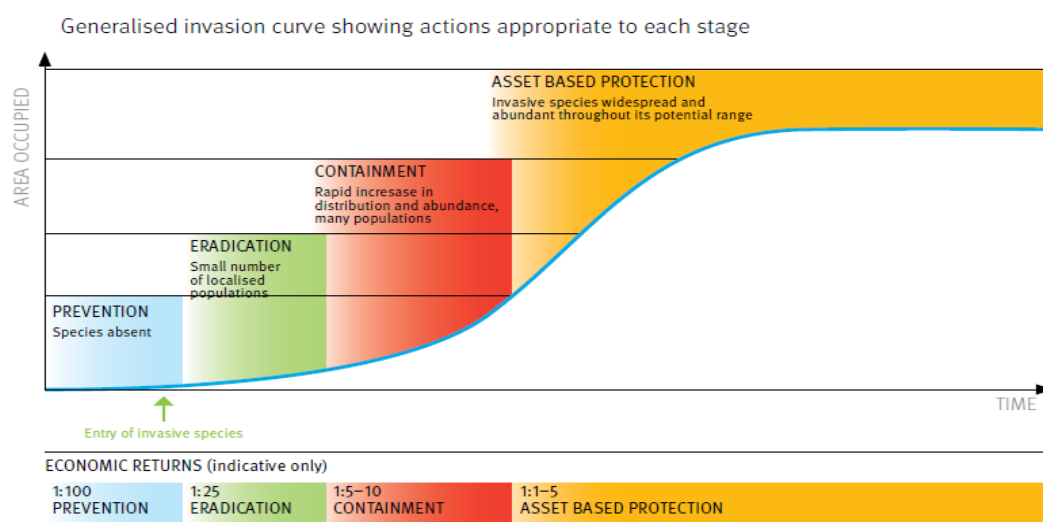
Exemptions are best targeted at the mitigation of specific risks. This may lead to a better outcome in terms of changing behaviour and a higher return on investment. For example, the NSW Biosecurity Strategy 2013-2021 acknowledges the importance and efficiency of preventative measures over eradication, containment and asset based protection.³⁵⁶ This is illustrated in Figure 8.1.

³⁵³ LHPA submission to Issues Paper, pp 21-22.

³⁵⁴ NSW Farmers submission to Draft Report, p 9.

³⁵⁵ Mr K Lee, Roundtable Transcript, 28 October 2013, p 31.

³⁵⁶ Department of Primary Industries, *NSW Biosecurity Strategy 2013-2021*, May 2013, pp 18-19.

Figure 8.1 Prioritising Biosecurity Initiatives

Data source: NSW Biosecurity Strategy 2013-2021, p 19.

Figure 8.1 shows that prevention of the invasive species produces significantly more return for every dollar spent. In the context of LLS fees and levies, the most effective form of incentive would be directly tied to the extent to which those who create risk/cost are able to demonstrate they have mitigated it. Therefore, those who do not create risk/cost do not have to pay fees or levies, and if the risk has only been partly mitigated then a partial exemption should be granted.

We also consider it good practice to encourage impactors to avoid risky/costly behaviours in the first place. The process of assessing properties for exemptions may allow staff to engage with landholders and assess properties on more than just the exemption criteria (for example, natural resource management issues).³⁵⁷

To address stakeholder concerns over transparency for exemptions there would need to be clear guidelines outlining the application, assessment and approval processes for exemptions. All incentive schemes should be subject to strict requirements for transparency, administrative simplicity and cost effectiveness. Since we released the Issues Paper, we have revised our principles to assist in establishing of a program of exemptions. These principles are outlined in Box 8.1 below.

³⁵⁷ We note that this recommendation will require legislative amendment. The regulations may specify any exempt land or class of land, person or class of persons, or activities or class of activities: LLS Act, s 208.

Box 8.1 Principles for allowing exemptions (full or partial)

1. All landholders should be subject to the fees or rates determined by their respective LLS board, except where they are specifically granted an exemption.
2. Criteria for eliminating risks should be clearly set out by the LLS boards and those criteria should be reasonable, well-founded in risk management practice, and reflect the activities and expenses that can be avoided by LLS. A common approach governing all LLS boards is preferable.
3. Exemptions should only be granted for fees and rates that are easily linked to specific areas of avoidable risk or avoidable cost (not all risk is avoidable). That is, rates and fees should be grouped in terms of avoidable and non-avoidable risk, and should not be aggregated to the point where they cannot be subject to an exemption or rebate.
4. Exemptions should be granted by way of application by the landholder and assessment conducted by its respective LLS board.
5. Landholders should only be granted an exemption after having been assessed against the predetermined criteria.
6. The exemption assessment process may be carried out by the same personnel that currently carry out enforcement activities or by private certifiers (accredited by the LLS).
7. Assessment requirements should be proportionate to potential risk (ie, stricter requirements for higher risks). For small landholders (eg, less than 20 ha), LLS should permit self-assessment, subject to review by LLS and penalties for false or misleading statements.
8. Landholders should meet the cost of assessment for their own land. Where assessment is carried out by LLS, only the marginal cost of conducting the assessment should be charged.
9. There should be clear guidelines on when exemptions may be revoked. For example, when there is an infringement of the terms of the exemption, when a property is subdivided or on transfer of property ownership.
10. LLS boards should be required to make documentation relating to the application and assessment of exemptions readily available to affected landholders.

Recommendation

- 30 LLS should establish a policy for assessing applications and granting exemptions (partial or full) from specific fees and rates.**

8.4 Treatment of annual returns

Relevant occupiers or owners of rateable land must lodge an annual return that provides details of stock kept on the holding (among other things) as at 30 June.³⁵⁸ This return is used to determine whether the person is liable to pay the AHR (and MIL).³⁵⁹

The LLS Act states that the maximum penalty for not submitting an annual return on time is 20 penalty units (\$2200).³⁶⁰ However, the LLS Regulation indicate that the LLS can only issue fines of \$300.³⁶¹ The maximum penalty can only be imposed in court proceedings.

In addition the LLS Regulation states that rateable land is exempt from any animal health rate for a year if the annual return is lodged by the due date and number of stock units reported is less than 50.³⁶² This means that any landholder that does not submit an annual return by the due date will be liable to pay an animal health rate on their property.

The Bull Report noted that the penalty for not completing and submitting an annual return (payment of the AHR) could be more lenient. Currently land holders who would be liable to pay the AHR anyway face no incentive to submit a completed annual return.³⁶³ This meant that the LHPA did not have up-to-date data on actual stock numbers for these properties.

The Bull Report recommended that the annual return be modified to simplify compliance and increase accuracy in livestock declarations.³⁶⁴

In the Draft Report we recommended that the penalty for not submitting an annual return should be higher than the cost of any additional rates (ie, AHR). However the North Coast LHPA noted 2 issues with the current penalty and IPART's draft recommendation, they:

1. unfairly penalise ratepayers without livestock more than those with livestock, and
2. cause ratepayers without livestock to subsidise the livestock industry.

The North Coast LHPA recommended that there should be a separate (set amount) penalty for not submitting an annual return, regardless of whether a landholder has livestock or not. It also recommended that landholders who are liable to pay the AHR, as determined through the NLIS, and who do not submit

³⁵⁸ LLS Regulation, cls 28-30.

³⁵⁹ *Meat Industry Act 1978* (NSW), s 59A(1).

³⁶⁰ LLS Act, s 58(1).

³⁶¹ LLS Regulation, Schedule 2.

³⁶² LLS Regulation, cl 14.

³⁶³ Bull Report, p 37.

³⁶⁴ *Ibid.*

an annual LLS return should be charged both the AHR and the penalty. It recommended that this penalty should be specified in legislation.³⁶⁵

NSW Farmers also disagreed with IPART's draft recommendation. It considers that increasing the penalty for not submitting an annual return would be viewed as revenue raising. Instead, it suggests that LLS boards should encourage land holders to submit their annual returns by providing incentives.

NSW Farmers recognise the need to encourage people to complete the stock returns however there will be scepticism that increasing the penalty is a revenue raising opportunity. LLS boards should be encouraged to demonstrate the benefits to landholders of completing the return and therefore provide incentives rather than penalties to encourage people to complete the returns.³⁶⁶

We consider that most of the issues associated with tracking actual stock numbers and movements extend beyond the scope of this review. However, it would be appropriate during this time of transition for LLS to review how the annual return system and the NLIS can be more effectively utilised, in line with the cost recovery framework. This includes assessing whether the NLIS system can be used to determine liability for the animal health rate.³⁶⁷

While penalties may be a useful tool to encourage people to submit their annual returns on time, they should not be the only method the LLS has at its disposal. LLS boards should have the option, but not be limited to, charging a penalty fee to landholders who do not submit their annual returns on time. This applies particularly to new rate payers, who may be required to submit an annual return for the first time due to a reduction in the minimum rateable land area and minimum stock units (for the AHR).

Finally we consider that the current penalty of \$300 that can be imposed by LLS³⁶⁸ is insufficient to incentivise land holders, especially large operations, to submit annual returns on time.

Recommendations

- 31 LLS should use the National Livestock Identification System as a cross check on the annual return to make sure it is getting correct information.
- 32 LLS should impose a penalty for failure to submit an annual return on time. This should be separate from any rates that landholders are liable to pay.

³⁶⁵ North Coast LHPA submission to Draft Report, October 2013, pp 1-2.

³⁶⁶ NSW Farmers submission to Draft Report, October 2013, p 9.

³⁶⁷ This may require legislative amendment.

³⁶⁸ LLS Regulation, Schedule 2.

9 Implementation of the funding framework

LLS will require some time to assess the activities it is to provide against the funding framework. We consider that the framework should be fully implemented by no later than 1 July 2016. The framework can be used at a high-level to co-ordinate action across LLS areas. It should be used to assess individual activities at the board level when considering budgets. LLS boards are responsible to their ratepayers and to external funders and thus should consider what support they need and determine how it should be provided.

The Chair of the LLS Board of Chairs (LLS BoC) has indicated that a task force might be created to assist with its functions. This support body could be useful to LLS boards if they require advice on using the framework.³⁶⁹

In the sections that follow we discuss our findings on the following implementation issues:

- ▼ Timeframe for implementation and other arrangements.
- ▼ LLS planning process and the funding framework.
- ▼ Consultation and the funding framework.
- ▼ Flexibility in using the funding framework.
- ▼ Support for LLS to use the funding framework.
- ▼ Systems to support the funding framework.

9.1 Overview of framework implementation

There should be a clearly defined time limit for implementation of the framework. At the latest, the framework should be in place by 1 July 2016.

LLS boards will require assistance to implement the framework which should be provided by the NSW Government. This assistance should not be at the cost of LLS boards' independence.

³⁶⁹ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 45:17-18.

9.2 Timeframe and arrangements to implement the funding framework

Each new LLS board has become operational since 1 January 2014. It is reasonable for each LLS board, in conjunction with the LLS BoC, to have assessed existing and new activities within 2 years. Therefore, following an initial transition period of 6 months, assessments should occur from 1 July 2014, and be implemented by no later than 1 July 2016. This timeframe is achievable because draft budgets are in place for LLS until 2017/18 that allow for some certainty in planning.

Recommendation

- 33 The funding framework should be fully implemented for fees and rates applying from 1 July 2016. LLS boards will need to prepare for this implementation with early reviews of existing and planned activities and associated funding.

9.3 LLS planning processes and the funding framework

The funding framework can be used at multiple points in the LLS planning process. The 2 main decision points within LLS processes in which the framework will be used are:

- ▼ LLS boards' processes to develop budgets
- ▼ the LLS BoC process to review LLS boards' budgets.

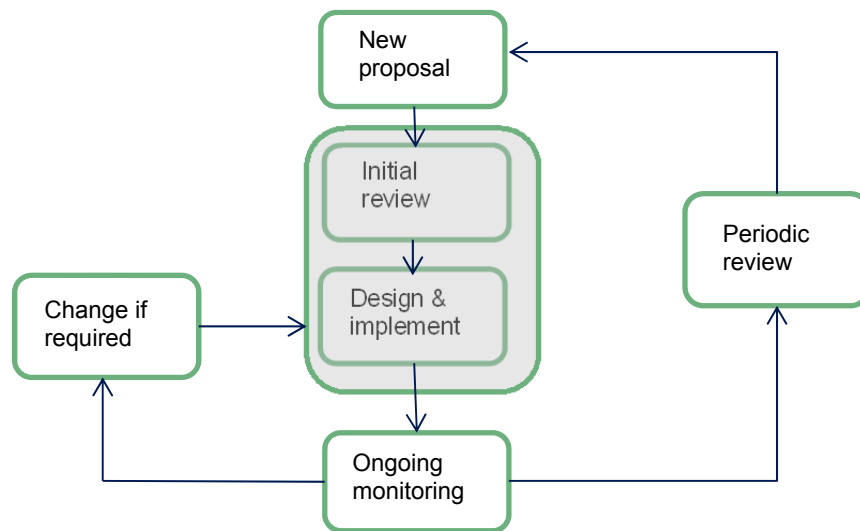
The funding framework is intended to be used as a tool to inform the cost recoverability of an activity or a group of activities with clear common characteristics.³⁷⁰ For example, a program may require surveillance before control. The framework should be applied separately to each of these activities. Therefore, the framework in general is applicable at the activity level and this is useful as part of a LLS board budget process.

The Productivity Commission's principles recommend that cost recovery apply at activity level or close to that scale. The concern is that where cost recovery is applied at a higher scale across many activities, the link between the charge and what is it being used to recover for weakens, and the charge starts to take on the properties of a tax.³⁷¹

The funding framework at the activity level is illustrated in Figure 9.1.

³⁷⁰ The fewer activities that are grouped the more likely it is the characteristics will not diverge, and hence lead to incorrect attribution, and potential cross-subsidisation.

³⁷¹ PC (2001), p XLIII.

Figure 9.1 Process for assessing cost recovery at the activity level

Source: PC (2001), p XLVII.

However, this process could lead to unnecessary duplication if LLS boards propose activities to address a problem that is best addressed at a state level. Application of the framework at the LLS board level should not preclude strategic direction at a higher level where boards can co-operate and avoid duplication.

The LLS processes and framework are linked as follows:

- ▼ Strategic planning at the LLS BoC and LLS board level takes into account State plans and priorities. Where common problems exist across LLS areas it may be efficient to work together, ie, identify economies of scale.
- ▼ Strategic plans inform service provision. LLS boards consider what activities are required to deliver on state/local strategic plans and assess them using the funding framework.
- ▼ The portfolio of services will inform the annual budget and feed into budget planning. LLS boards set rates and apply for grants to fund activities consistent with the funding framework.

Figure 9.2 illustrates how the funding framework interacts with the LLS planning and budget process. Key elements of this interaction are as follows:

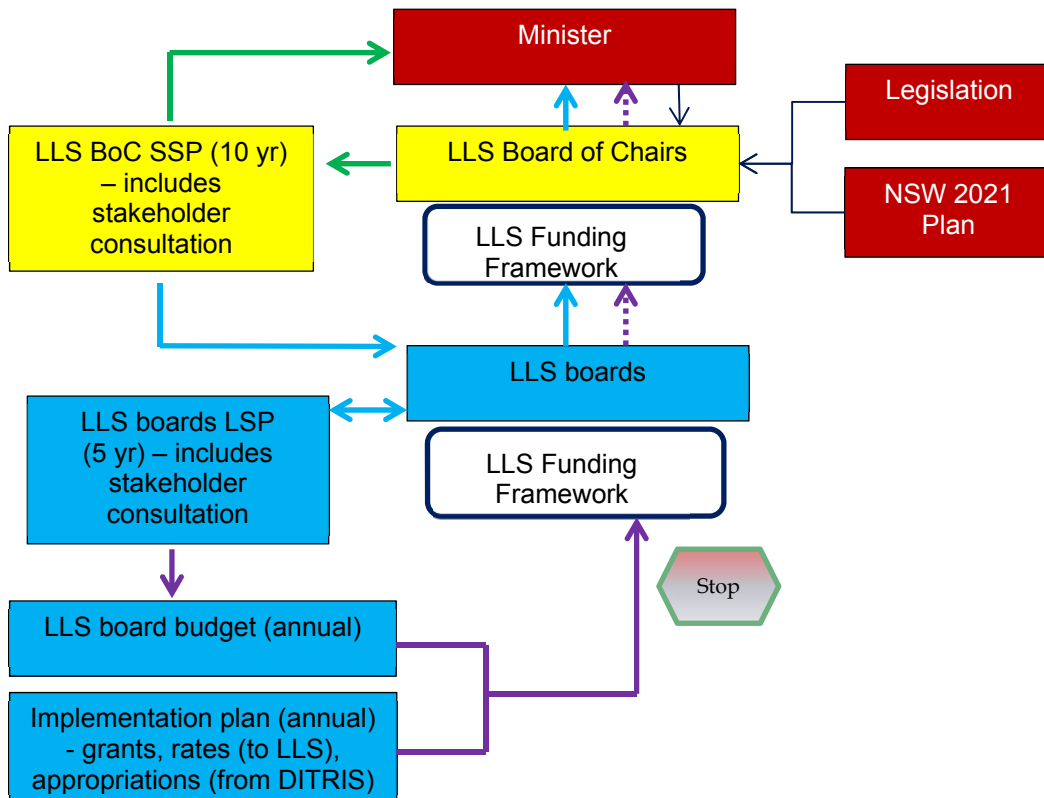
- ▼ Ministerial direction, legislative requirements and state priorities are key objectives that LLS must comply with.
- ▼ The LLS Board of Chairs is required to prepare a 10-year State Strategic Plan³⁷² (SSP) that sets out the high-level priorities of the organisation; consultation on the plan is a statutory requirement.

³⁷² LLS Act, s 36(2).

- ▼ The SSP is signed off by the Minister for Primary Industries and is further developed by LLS boards into 5-year Local Strategic Plans (LSP);³⁷³ consultation on LSP is a statutory requirement.
- ▼ The funding framework should be applied at the LSP stage as objectives, outcomes and hence activities are known; consultation is a feature of the framework and it would make sense to combine the consultation effort.
- ▼ The LSP is considered by the LLS BoC to ensure it is consistent with the SSP; the funding framework could be considered at this point to ensure efficient co-operation and outcomes are achieved across LLS boundaries.
- ▼ Each LSP is signed-off by the Minister for Primary Industries.
- ▼ Annual implementation of each LSP is a separate process but is consistent with the funding framework. It involves funding services through rates, grant funding and budget appropriation.
- ▼ Annual implementation plans and budgets are signed-off by each LLS board, but are partly subject to normal budget process for the government funded component (illustrated by the Stop sign in Figure 9.2):³⁷⁴
 - Each LLS board determines how it spends its budget, from various funding sources, to meet its stated LSP outcomes.
 - LLS are a part-budget funded agency, so it is likely the consolidated entity will apply for funding rather than each individual board. The LLS BoC would be the co-ordinating body for budget appropriations.
 - The Minister (for Trade and Investment, Regional Infrastructure and Services) signs-off on the cluster's request for funding from the State Budget.

³⁷³ LLS Act, s 45(2).

³⁷⁴ The NSW Government has committed funding to LLS for the 4-year period until 2017/18. See The Hon Katrina Hodgkinson, MP, Minister for Primary Industries, The Land, 22 August 2013, p 22.

Figure 9.2 Funding framework in the LLS planning process**Note:**

LLS BoC means LLS Board of Chairs, SSP/LSP means state/local strategic plan.

The dark green and blue line represents the strategic planning process that links outcomes to priorities and requirements.

The purple line represents the annual implementation/budget process that links funding to outcomes. The dotted purple lines mean that part of the total funding process is subject to the consolidated entity (LLS) applying for budget funding.

The Minister for the planning process (dark green / blue line) is the Minister for Primary Industries and the Minister for the budget process (purple line) is the Minister for Trade and Investment, Regional Infrastructure and Services.

Grants are competitive grant funding from Commonwealth and State government programs such as Caring for our Country.

Data source: IPART.

One stakeholder requested clarification as to where the funding framework sits with respect to strategic planning.³⁷⁵ The funding framework follows on from the (state and local) strategic plans, see Figure 9.2.

³⁷⁵ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 46:31-35, 41-42.

Local Government NSW submitted that LLS boards should consider councils' community strategic plans and delivery programs when developing their own plans. This will ensure LLS boards do not impinge on, duplicate or charge for programs already undertaken by councils.³⁷⁶ We agree with Local Government NSW - LLS boards should consider council plans and programs to be consistent with the principle of compatibility with legislation and government policy.

9.4 Consultation and accountability

Consultation is an important component of the funding framework and other LLS processes prescribed by the LLS Act. The importance of consultation was noted by the NSW Irrigators' Council.³⁷⁷

We have not made an explicit recommendation about LLS consultation because it already forms part of Step 3 of the funding framework, and is required in relation to certain processes under the Act.

For example, the Act requires the LLS Board of Chairs and LLS boards to:

- ▼ consult on strategic plans – State (section 39) and local (section 48), and
- ▼ (LLS boards only) establish Local Community Advisory Groups that are representative of the interests of the local community and stakeholders in the region (section 33).

The Chair of the LLS Board of Chairs has acknowledged that consultation is good practice and expected of LLS NSW.³⁷⁸

To achieve accountability, an independent body will audit the financial and performance records and Action Plans of LLS boards.³⁷⁹ LLS boards are also required to prepare annual reports by 30 March each year.³⁸⁰

9.5 Flexibility for LLS boards

All stakeholders appear to accept it is important to ensure that LLS boards can, where possible, service the needs of its community. The framework must be able to accommodate local situations and solutions. The NSW Government's stated view is that "Local Land Services will be managed by local people on local Boards, working closely with farmers, land managers and communities, to

³⁷⁶ Local Government NSW, Review of Funding Framework for Local Land Services, Submission to IPART's Draft Report, 9 October 2013, p 1.

³⁷⁷ NSW Irrigators' Council submission to Draft Report, 15 October 2013, p 5.

³⁷⁸ IPART, Review of a rating framework for Local Land Services – Roundtable – 28 October 2013, p 45:30-33 and p 56:11-13.

³⁷⁹ See, http://www.dpi.nsw.gov.au/__data/assets/pdf_file/0009/468180/Top-20-frequently-asked-questions.correction.pdf, 'Strategic Planning and Accountability', accessed 19/11/2013.

³⁸⁰ See, LLS Act 2013, s 30.

deliver services relevant to their local needs.”³⁸¹ There is strong support across most submissions and at the roundtable for the ‘localism’ of LLS boards.

We caution, however, that flexibility lies in the nature of the problem and the potential solution in each area, **not** in the interpretation of the economic principles underlying the framework. Where it is efficient and cost-effective for impactors or risk creators to fund an activity, then they should do so. Where this is not the case, the assessment should follow the hierarchy and consider other potential funders, ie, beneficiaries and then taxpayers.

With respect to the type of activity or program of activities that is considered, the framework is neutral as to which solution to the problem is devised. However, activities should be considered separately where they do not share the same characteristics as another activity.

For regulatory activities considered through the framework, flexibility may occur in the design of the activity to be undertaken to meet the relevant requirements (where regulation does not specify how to undertake an activity). Here, consultation with relevant stakeholders will be beneficial to all parties. For non-regulatory activities, which have a distinct discretionary element to them, it is best to leave the choice of approach to boards and their stakeholders to consider. For example, some stakeholders consider voluntary land management systems could be a useful tool for LLS boards to overcome problems for mutual advantage.³⁸²

In the framework, we have also recommended a flexible approach to minimum land area and in the rating base for general rates in certain cases.

Flexibility in the framework may also be required to:

- ▼ Adjust or fine tune the framework on commencement or over time.

We recognise the need for this flexibility but consider that LLS should not be responsible for changes to the funding framework. LLS should not be responsible for setting the rules on whom and how to charge when it is the charging authority. Amendment of the framework should be the responsibility of an independent party and LLS should inform this party of any issues in its application of the framework.

- ▼ Account for regional differences, recognising underlying principles.

We recognise the need for this flexibility, as outlined in Section 9.3 above.

³⁸¹ See DPI website: <http://www.dpi.nsw.gov.au/locallandservices>, accessed 20 February 2014.

³⁸² Serrated Tussock Working Party for NSW and the ACT submission to Draft Report, 15 October 2013, p 5.

▼ Adapt to seasonal needs and to emergency situations.

We consider that it would be counterproductive to delay a response to an emergency situation to consider who should pay. The emergency deeds allow for action to occur before the final cost allocation is clarified.³⁸³ Nevertheless, it would be prudent for LLS to consider how to fund emergency services for the community before an emergency occurs. This approach works in a similar fashion to insurance.

We recognise that government may be required to provide (temporary) funding to cater for significant unforeseen emergencies. For example, LLS boards may have insufficient resources to overcome an unanticipated biosecurity incident or natural disaster. Government may provide temporary relief funding (as it has done in the past) that is subsequently repaid, or decide to fully fund the cost of the event.

A submission from T. Hackett (individual) strongly disagreed with this view. Ms Hackett noted that, normally emergency events are dealt on a departmental level as a matter of public health or interest instead of someone having to pay for unforeseen events that can threaten the population at large.³⁸⁴

Emergency services provided by LLS boards should be assessed through the framework to understand the purpose they serve and who they benefit. We disagree that all emergency activities benefit the wider community. However, some activities may have characteristics that mean funding locally is inefficient.

In Box 5.3, we discuss an example of an emergency activity – the outbreak of avian influenza (H7) in 2013 and the impact on egg prices. In this example, the outbreak was not the highly pathogenic H5N1 and the NSW Food Authority confirmed there were no food safety issues.³⁸⁵ As such, this emergency did not impact other industries or the health of the community. The emergency, in this instance, was wholly contained within the industry and was best handled by the industry (in conjunction with the Department of Primary Industries). This appears to be supported in a statement by the NSW Farmers Association, “When the clean-up is completed, I am sure the industry will sit down and work out some protocols”.³⁸⁶

³⁸³ We understand that a 50-50 split is the default until the biosecurity threat is clarified.

³⁸⁴ T. Hackett (individual), Submission to IPART’s Funding Framework for Local Land Services NSW Draft Report, 15 October 2013, p 3.

³⁸⁵ NSW Department of Primary Industries, *Avian Influenza outbreak – surveillance and tracing*, October 2013.

³⁸⁶ Michael Condon, *Egg Shortage looms after bird flu*, ABC Rural – NSW Country Hour, 4 December 2013, accessed 5 December 2013.

In the Draft Report we discussed some examples of cost sharing for emergency services.³⁸⁷ A further example is the NSW State Emergency Service (SES), which is funded by a combination of recurrent government funding and contributions from insurance companies and local government.³⁸⁸ This split in funding recognises that the SES serves multiple purposes and provides private benefits to individuals.

We understand that LLS boards can be directed by the Director-General according to the LLS Act to undertake action in an emergency.³⁸⁹ LLS is likely to have a role under the State Emergency Management Plan³⁹⁰ similar to the previous role of LHPAs. For example, LLS may be required to contribute to an Emergency Response Team under the direction of an Area Controller, similar to the previous involvement of the LHPA.³⁹¹ The LLS Board of Chairs may also co-ordinate emergency action or preparedness.

Where LLS boards do set up an emergency response structure, they should not duplicate other structures in place. We note that LLS employees will have specific skills related to livestock and plants that another body such as the SES or fire services may not be able to provide. For example, LLS could provide specialist resources under the Agricultural and Animals Services Functional Area to support lead combat agencies such as the Rural Fire Service during a natural disaster.

▼ Add new services and functions.

The funding framework is generic so it can be used to assess any service. The relevant department is responsible for coordinating any legislative amendments that are required to provide for new services and functions.

▼ Respond to changes in government policy.

This is appropriate under the principles of the funding framework as legislation and LLS boards' strategic plans inform the activity to be undertaken and assessed.

Stakeholders commented on the complexity of determining cost shares and suggested that this complexity could be reduced by IPART providing firm guidance on who boards should charge and how.³⁹² We consider this approach would undermine the ability of LLS boards to respond to local problems and propose local solutions.

³⁸⁷ IPART, *Review of the Funding Framework for Local Land Services NSW, Other Industries – Draft Report*, September 2013, p 123.

³⁸⁸ See, Annual Report Appendices, pp A39-40, <http://www.ses.nsw.gov.au/about/annual-reports/AnnualReport1112>, accessed 19/11/2013.

³⁸⁹ LLS Act, s 12.

³⁹⁰ This plan is required under section 12 of the *State Emergency and Rescue Management Act 1989* (NSW).

³⁹¹ NSW Department of Primary Industries, *Local Land Services to strengthen emergency management*, Media Release, 6 June 2013.

³⁹² For example, Central West LHPA submission to IPART, June 2013, p 2.

Some of the solutions proposed by stakeholders could be accommodated using the funding framework when properly applied. Two examples of stakeholder proposed approaches include:

- ▼ B. Tomalin (individual) suggested a rating and funding structure that provides a base level of recurrent funding with a component for beneficiary pays and fee-for-service. The funding structure would accommodate core administration, general and local public benefit, a regulatory component and private benefits, with these components split into the functions LLS would cover.³⁹³

This approach requires an assessment of the functions (and implicitly the activities within) to consider which:

- are for the general benefit of the wider community
- can be internalised by the local community
- are for regulatory purposes
- create benefit where previously none existed.

All of these possible impactors or beneficiaries and hence potential funders could be considered within the proposed framework. However, we consider that assessment should take place at the activity level to ensure costs are allocated to landholders, industry and the taxpayer accordingly. The framework provides a systematic approach to undertake this task.

- ▼ Serrated Tussock Working Party (STWP) suggested that LLS boards should:
 - i) consider what is needed to achieve its goals,
 - ii) consider how best to meet those needs or avoid adverse consequences and
 - iii) then work out the best funding arrangement for the situation.³⁹⁴

Further, it discusses a process like a budget allocation flowing from a rough and ready guide.³⁹⁵

We consider that the framework is consistent with STWP's proposal. Steps (i) to (iii) ask the same questions as Steps 1-3 of the framework. Figure 9.2 and the creation of a Manual are also consistent with the STWP's budget allocation suggestion.

³⁹³ B. Tomalin (individual) submission to Draft Report, 15 October 2013, p 1.

³⁹⁴ Serrated Tussock Working Party for NSW and the ACT submission to Draft Report, 15 October 2013, p 3.

³⁹⁵ *Ibid.*, p 6.

9.6 Support required for LLS to assess services

As noted previously, LLS boards will require assistance to implement the framework. The Chair of the LLS Board of Chairs (LLS BoC) has indicated that a task force might be created to assist with its functions. This support body could be useful to LLS boards if they require advice on using the framework.³⁹⁶

Further, the Department of Primary Industries, at the roundtable, indicated there was a role for it to provide some support, at the state board level, to develop the capability in the applying the framework.³⁹⁷ We encourage a partnership between the department and the task force to assist LLS to develop its capability to apply the framework into the future.

However, we consider that it may also be in the interests of each LLS board to seek its own advice rather than rely on a centralised task force unit. This is a matter for LLS to decide. LLS boards are responsible to their ratepayers and external funders and they should consider what support they need and how it should be provided. How the task force is financed and its scope is a matter for LLS and the government to determine.

9.7 Systems to support the framework

We consider it is essential that systems are developed to track expenses. This should be made a priority to ensure activities are efficiently provided and accountability is achieved. These systems will help to allocate indirect costs to the appropriate activity and reduce the risk of cross-subsidisation. We discussed Activity Based Costing, as an example, to allocate indirect costs, in Section 5.7. This is an administratively complex but accurate approach.

Further, these systems are also important for reporting to external bodies that may fund LLS activities. We are unsure what systems are in place for CMAs that could be adopted by LLS. LLS is best placed to determine the type of system that fits its purpose.

Accountability for costs and their attribution to services is a concern for stakeholders. It is discussed in the Ryan Report³⁹⁸ and was raised at our workshops.³⁹⁹ We consider that LLS should specify and establish systems to support the funding framework now, as part of the creation of the new entity.

³⁹⁶ John Macarthur-Stanham, IPART, Review of Funding Framework for Local Land Services – Roundtable – 28 October 2013, p 45:17-21.

³⁹⁷ Ibid, p 54:16-18.

³⁹⁸ Terry Ryan, *Report on The Review of the NSW Livestock Health and Pest Authority (LHPA) Model*, February 2012, p 12.

³⁹⁹ Mr Murdoch, IPART, Transcript for Public Hearing at Wagga Wagga, 14 June 2013, p 39.

10 Step 6: Auditing Local Land Services boards' compliance with the funding framework

IPART was asked to “develop an appropriate audit methodology for assessing the extent to which efficient cost recovery pricing has been applied to the services offered by LLS boards”.⁴⁰⁰

LLS boards will nominate their approach to cost recovery pricing in their local strategic plans. The strategic plans will identify the outcomes sought and the actions required including resourcing to achieve those outcomes.

An audit of local strategic plans provides the opportunity to assess the extent to which efficient cost recovery pricing is being applied. This is achieved by ascertaining whether the funding framework described in this report is being applied.

Each local strategic plan must be audited within 3 years of its approval.⁴⁰¹

An audit trail is established through Cost Recovery Impact Statements (CRIS) that are prepared for release at 5-yearly intervals with each local strategic plan. This is supported by a statement of charges proposed for the coming year that is included in LLS boards' annual reports.⁴⁰² This combination and timing of information enables consultation on strategic plan outcomes, activities to be undertaken and the funding of those activities as part of the consultation process established under legislation for the strategic plan.

It provides stakeholders with sufficient information to have an informed say in the ongoing funding of Local Land Services.

The conduct of audits is dictated by Australian auditing standards (linked to international auditing standards).

The sections below discuss our recommended audit approach and describe the contents of a CRIS and annual compliance statement.

⁴⁰⁰ Minister for Primary Industries, *Letter to IPART*, dated 22 February 2013, p 1.

⁴⁰¹ LLS Act, s 54(2).

⁴⁰² LLS Act, s 30, A local board is required to prepare before 30 March each year an annual report on the performance of its functions.

10.1 Audits specified in legislation

LLS is subject to numerous audits. They are summarised in the table below.

Table 10.1 Audits of LLS

Audit process	Purpose of audit	Who can audit	How often
Periodic audit of compliance with the LLS Act	Determine whether LLS is carrying out functions conferred by Act efficiently and effectively (s 24(1)).	Ministerially appointed independent auditor	Not later than 5 years after commencement of Act, then every 5 years.
Spot Audit	Audit of all or any particular function of LLS (s 24(3)).	Ministerial appointee	At any time
Periodic audit of compliance with state strategic plan	Ascertain whether LLS is giving effect to provisions of state strategic plan (s 44 (2)).	Ministerially appointed independent auditor	Every 5 years
Audit of compliance with local strategic plans	Ascertain whether each local strategic plan is being given effect (s 54(2)). Local strategic plans can be reviewed at Minister's discretion	Ministerially appointed independent auditor	Within 3 years of approval of each local strategic plan which have a life of 5 years (s 45(2))
Financial Audit	Ensure LLS and local boards comply with accounting standards and have appropriate controls and risk management strategies (<i>Public Finance and Audit Act 1983</i> (NSW)).	NSW Audit Office	Annual
Performance audits	For example, ascertain compliance with Standard for Quality Natural Resource Management and National Animal Health Performance Standards.	Eg, Natural Resources Commission	Annual

Source: LLS Act, Natural Resources Commission.

Local strategic plans link outcomes, actions and resourcing. The funding framework is an integral component of the strategic planning process. Therefore, linking the audit of the extent efficient cost recovery pricing has been applied with the audit of local strategic plans is both effective and efficient.

Any exemptions to service fees that are granted by LLS boards can also be audited when strategic plans are audited. Chapter 8 discusses exemptions further.

10.2 Consistency of funding with Local Strategic Plans

Section 47 of the LLS Act prescribes the content of LLS board's draft local strategic plan. This includes "outcomes that are expected to be achieved by the implementation of the plan in relation to the region and the timeframes for achieving those outcomes."⁴⁰³ The term of a local strategic plan once approved by the Minister is 5 years.⁴⁰⁴

In addition, in formulating a draft local strategic plan for its region, the LLS board is to have regard to:⁴⁰⁵

- ▼ any State priorities for local land services
- ▼ the State strategic plan
- ▼ the provisions of any environmental planning instrument under the *Environmental Planning and Assessment Act 1979* that applies to the region
- ▼ any other existing natural resource management plans (including any such plans in the course of preparation) for the region including the State Water Management Outcomes Plan and any management plan under the *Water Management Act 2000*
- ▼ sound evidence-based practices to support primary industries, resilient communities and healthy landscapes
- ▼ the need for engagement of the community, including the Aboriginal community.

Under the LLS Act, the Minister is to ensure that each local strategic plan is audited, within 3 years of its approval, to ascertain whether its provisions are being given effect.⁴⁰⁶ The audit is to be carried out by an independent person, body or panel appointed by the Minister.⁴⁰⁷ In addition, the Minister may arrange an audit of a local strategic plan at any time.⁴⁰⁸

Auditing cost recovery at the time as auditing strategic plans is consistent with comments made by the LHPA State Management Council:

... audit program of Local Land Services and Local Boards should focus on the achievement of outcomes, and not just activities and processes. Such a focus will drive improved performance in the agency over time and provide stakeholders with the confidence that their contributions are leading to the achievement of planned outcomes.⁴⁰⁹

⁴⁰³ LLS Act, s 47(1)(a).

⁴⁰⁴ *Ibid*, s 45(2).

⁴⁰⁵ *Ibid*, s 47(3).

⁴⁰⁶ *Ibid*, s 54(2).

⁴⁰⁷ *Ibid*, s 54(4).

⁴⁰⁸ *Ibid*, s 54(3).

⁴⁰⁹ LHPA State Management Council, *Review into the Development of a Funding Framework for Local Land Services NSW, Response to the IPART Issues Paper*, 2 July 2013, p 26.

The LHPA State Management Council further noted that: '... development of strategic and local plans will be critical processes to consolidate the service offering and service level expectations of the new organisation. These planning activities must provide the context for the application of the funding framework'.⁴¹⁰

At the Roundtable, the Natural Resources Commission noted the difference between compliance and performance audits. It stated:⁴¹¹

The NRC has been in the past the performance auditor of the CMA side of the business. Those audits have been focused on performance prioritisation, strategic planning and implementation which are different in nature than compliance audits. The audit strategy proposed is a compliance-based audit which has its valid role but it does not have the same role as a performance audit. To do compliance audit and a performance audit at the same time would actually not remove duplication; it would create confusion.

The objective of a compliance engagement 'is to enable the assurance practitioner to express a conclusion on whether an entity has complied in all material respects, with requirements as measured by the suitable criteria'.⁴¹²

The objective of a performance engagement 'is to enable the assurance practitioner to express a conclusion.... concerning the economy, efficiency or effectiveness of an activity against identified criteria.'⁴¹³

The audit of local strategic plans and the audit of the application of the funding framework are designed to assess the extent the respective provisions are being given effect. The choice of standard is highly dependent on the adopted audit criteria and the level of detail included in the local strategic plans.

With suitable criteria, we consider that an identical audit approach can be adopted for both, given the common basis of assessment ('whether provisions are being given effect') and the cross over between the local strategic plans and cost recovery. The audit should be conducted in accordance with the Standard on Assurance Engagements, ASAE 3100.⁴¹⁴

⁴¹⁰ LHPA State Management Council, *Review into the Development of a Funding Framework for Local Land Services NSW, Response to the IPART Issues Paper*, 2 July 2013, p 2.

⁴¹¹ Mr Wilde, IPART, *Review of Funding Framework for Local Land Services - Roundtable - 28 October 2013*, p 47.

⁴¹² Auditing and Assurance Standards Board, *Standard on Assurance Engagements ASAE 3100 Compliance Engagements*, Reissued September 2008, p 9.

⁴¹³ Auditing and Assurance Standards Board, *Standard on Assurance Engagements ASAE 3500 Performance Engagements*, July 2008, p 9.

⁴¹⁴ Auditing and Assurance Standards Board, *Standard on Assurance Engagements ASAE 3100 Compliance Engagements*, Reissued September 2008.

Recommendation

- 34 The audit of the extent to which efficient cost recovery pricing has been applied to the services offered by LLS boards should be undertaken simultaneously with the audit of local strategic plans.
- 35 The audit in recommendation 34 should be conducted in accordance with the Standard on Assurance Engagements, ASAE 3100.

10.3 Audit methodology

An audit is a 'systematic, independent and documented process for obtaining evidence and evaluating it objectively to determine the extent to which the criteria are fulfilled'.⁴¹⁵

The relevant criterion in this case is the extent to which efficient cost recovery pricing has been applied. We propose this criterion be assessed against the funding framework described in this report.

ASAE 3100 specifies a compliance report shall include:⁴¹⁶

- ▼ the period of compliance being reported on
- ▼ identification of the criteria used in the assessment
- ▼ where appropriate, a description of any significant limitation associated with the evaluation of compliance
- ▼ a summary of the work performed
- ▼ the auditor's conclusions.

Recommendation

- 36 The funding framework described in this report should be adopted as the audit criteria.

10.4 Establishing the audit trail

The audit of a local strategic plan will occur after the plan and associated price paths have been adopted. This implies reliance on publication of proposed prices prior to their implementation with sufficient information provided to enable informed consultation with stakeholders. Such consultation is consistent with the requirements for consulting on the draft strategic plan.⁴¹⁷

⁴¹⁵ Intergovernmental Agreement on Biosecurity, Section 6 - Glossary of terms, 13 January, 2012.

⁴¹⁶ Auditing and Assurance Standards Board, *Standard on Assurance Engagements ASAE 3100 Compliance Engagements*, Reissued September 2008, p 29.

⁴¹⁷ LLS Act, s 48.

Consultation will be assisted by each LLS board publishing a cost recovery impact statement at the same time as the strategic plan that includes a 'summary of charging arrangements table' (see Appendix C). As events unfold over the 5-year life of a local strategic plan it may be necessary to depart from the charges specified in the CRIS.

We propose that each LLS board include a statement of proposed charges for the coming year in its annual report. The statement should state that all fees and rates are set in accordance with the funding framework. An example of the annual statement is at Appendix D.

The Irrigators' Council acknowledges the value of regular auditing but considers the proposals in our Draft Report could be costly to implement. It suggested that we undertake a cost benefit analysis to assess the proposed audit methodology.⁴¹⁸

There is a balance between LSS boards providing sufficient material to stakeholders to enable them to effectively participate in the price setting process and the associated cost of preparing that material. An alternative is to rely solely on LLS boards with their mix of government appointed and elected members to assess proposed charges on behalf of stakeholders. LLS boards will require a similar level of information to what we have proposed and we consider they will benefit from informed stakeholder input in making their assessment.

10.5 Cost recovery impact statement

The preparation of a CRIS by each LLS board will facilitate the audit. The suggested format of a CRIS is similar to that described in the template provided by the Australian Government on cost recovery.⁴¹⁹

⁴¹⁸ NSW Irrigators' Council response to the IPART Draft Report, October 2013, p 11.

⁴¹⁹ Commonwealth of Australia, *Australian Government Cost Recovery Impact Statement Template*, p 3.

The CRIS will:⁴²⁰

- ▼ provide a general explanation of the purpose and function of the services subject to cost recovery
- ▼ assess whether services, where grouped for fee setting, have sufficiently common characteristics and objectives to make such grouping(s) reasonable
- ▼ describe and review the application of the compliance framework including:
 - stating the legal authority for the service fee
 - demonstrating the service fees⁴²¹ comply with the criteria,⁴²² including where relevant, compliance with Treasurer's directions and government policy
 - identifying the costs (\$) incurred in performing the service, demonstrating they are efficient costs, and nominating what costs (eg, fully distributed costs or marginal costs) are proposed to be recovered and from whom
 - nominating and justifying whether a fee (for service) or a rate (eg, notional stock carrying capacity) is charged. The structure of the fee or rate should also be nominated and justified
 - describing the level and feedback of stakeholder consultation on the proposed service fees.

A CRIS published at the time the draft local strategic plan is prepared will ensure transparency and inform stakeholders. This will assist stakeholder engagement in the price setting process.

Recommendation

37 A Cost Recovery Impact Statement should be developed simultaneously with the draft local strategic plan. It should be published in a form that enables stakeholders to effectively engage in the service fee setting process.

10.6 Annual statement of proposed charges

In the absence of an annual compliance audit we recommend that each LLS board publish a statement of the coming year's charges as part of their annual report (Appendix D) of the coming year's charges.

The statement should include:

- ▼ a description of the service
- ▼ method of recovery (fee or rate)
- ▼ volume of activity

⁴²⁰ Adapted from the Australian Government Cost Recovery Impact Statement Template.

⁴²¹ We have assumed the term 'service fees' in first term of reference for the review (see letter dated 22 February 2013 from The Hon. Katrina Hodgkinson, MP) includes both fees and rates.

⁴²² That is, the funding framework, the rating base and the fee collection mechanism.

- ▼ current price
- ▼ proposed charges for the coming year.

We propose the annual statement incorporates an explanation of any variance in charges from the CRIS. An additional column could include charges in dollars of the day, ie, after CPI adjustment.

Recommendation

- 38 Each LLS board should include in their annual report a statement affirming their charges are set in accordance with efficient cost recovery pricing.

10.7 Worked examples of Step 6 of the funding framework

Table 10.2 continues the examples from Step 5, providing example answers to the questions posed in Step 6 of the funding framework. Note these are only examples of how specific issues can be assessed in Step 6; answers may differ depending on regional and local circumstances.



Table 10.2 Examples - Step 6: Has efficient cost recovery pricing been applied?

Questions	Agricultural Advice	Biosecurity Risk	Natural Resource Management & Farm Productivity
Identified problem (restated for convenience)	Private horticulturists are not investing in beneficial research as: <ul style="list-style-type: none"> ▼ the cost of the research exceeds the private benefits gained by any one landholder ▼ the outcomes of the research, once available, may be used by others without contributing to the cost 	A disease outbreak occurs on a landholding posing a threat to livestock on adjoining properties but not a public health risk nor threat to native animals.	Wild dogs are found in national parks, on forestry land and private landholdings attacking livestock and native fauna.
Is the framework being given effect?	<ul style="list-style-type: none"> ▼ Audit undertaken at time of strategic plan audit (ie, within 3 years of strategic plan being approved) has/has not confirmed compliance. The audit trail included: <ul style="list-style-type: none"> ▼ a CRIS released to coincide with preparation of the 5 year local strategic plan ▼ annual statement verifying charges comply with the CRIS & where they deviate they have been calculated in line with funding framework. 	<ul style="list-style-type: none"> ▼ Audit undertaken at time of strategic plan audit (ie, within 3 years of strategic plan being approved) has/has not confirmed compliance. The audit trail included: <ul style="list-style-type: none"> ▼ a CRIS released to coincide with preparation of the 5 year local strategic plan ▼ annual statement verifying charges comply with the CRIS & where they deviate they have been calculated in line with funding framework. 	<ul style="list-style-type: none"> ▼ Audit undertaken at time of strategic plan audit (ie, within 3 years of strategic plan being approved) has/has not confirmed compliance. The audit trail included: <ul style="list-style-type: none"> ▼ a CRIS released to coincide with preparation of the 5 year local strategic plan ▼ annual statement verifying charges comply with the CRIS & where they deviate they have been calculated in line with funding framework.

Source: IPART analysis.



Appendices

A Terms of Reference





The Hon Katrina Hodgkinson MP
Minister for Primary Industries
Minister for Small Business

IPART	
Date No	213/4716.
File No	12/626.

MOC13/543



22 FEB 2013

Dr Peter Boxall AO
Chairman
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB POST OFFICE NSW 1230

Dear Dr Boxall

The decision on Cabinet Minute 12-43 *Consolidated regional delivery of services to landholders* authorised advice being sought from the Independent Pricing and Regulatory Tribunal (IPART) in relation to the development of a rating framework and complementary service pricing system for Local Land Services NSW (LLS).

Local Land Services NSW will provide a range of services to landholders to help drive productivity and growth in regional NSW. To ensure efficient service delivery, services are to be funded either by individuals, by certain landholder and industry groups, or jointly funded with government, in accordance with 'risk creator' and private, industry and public benefit principles.

It is intended that service categories will be matched to the most efficient funding option, such as direct fees-for-service or compulsory levies, recognising that some services will provide a predominantly private benefit, whereas others may have industry specific benefit or even a broad public good. LLS boards will also be able to access funds from Commonwealth and NSW Government grant programs and NSW Government consolidated revenue contributions.

Substantial progress has been made towards the establishment of LLS, and in accordance with the Cabinet decision, and I am now asking IPART to:

- 1) Develop an efficient and transparent Cost Recovery Framework that LLS boards can use to set service fees for the different categories of services they provide to the different groups of beneficiaries. In undertaking this task, IPART will assess the strengths and weaknesses of cost recovery frameworks used by other similar service providers.
- 2) Advise on an efficient rating base for compulsory fee collection and an efficient fee collection mechanism.
- 3) Develop an appropriate audit methodology for assessing the extent to which efficient cost recovery pricing has been applied to the services offered by LLS boards.

.../2

Dr Peter Boxall AO

-2-

Minister for Primary Industries

In relation to compulsory service fees, important issues will be the determination of the most appropriate rating base and fee collection mechanism. In terms of the rating base, options to be assessed include rateable land above a certain area or value, the stock carrying capacity or productive capacity of land and the unimproved land value. How well each of these align with risk creators and service beneficiaries should also be taken into account.

Consideration should also be given to the appropriateness of specific purpose levies and how they are determined, such as the Hunter Catchment Levy, Animal Health Levy, Pest Insect Levy and Meat Industry Levy and any other broader and more efficient approach to establishing levies, such as for biosecurity and natural resource management. For example, in relation to the development of an NRM levy a specific task would be an assessment of the appropriate use of the current levying powers in the *Catchment Management Authorities Act 2003*. Transaction costs will be an additional issue relevant in determining the most efficient fee collection mechanism.

Attached are several documents which may be of assistance to IPART in conducting this inquiry. They include:

- an LLS paper on governance of the organisation; and
- a draft map of the proposed LLS regions (these regions are likely to change).

A draft report on Terms of Reference should be made to the Director General, Department of Primary Industries by 31 May 2013.

It is anticipated that IPART will conduct a stakeholder consultation process and in this regard it is requested that IPART give consideration to outcomes from the public forums conducted by Mr Mick Keogh in late 2012 and the Local Land Services Stakeholder Reference Panel in early 2013.

I have instructed the Department of Primary Industries to be ready to assist the Tribunal in the conduct of this inquiry. I would also appreciate you meeting with Mr Scott Davenport, Executive Director, Strategic Policy and Chief Economist, and Deputy Director General, Agriculture NSW, Michael Bullen to discuss how the Department can assist you in relation to identifying an efficient cost recovery framework. Mr Davenport can be contacted on (02) 6391 3618 or by email scott.davenport@industry.nsw.gov.au.

Yours sincerely



Katrina Hodgkinson MP
Minister for Primary Industries

Encl.

B Research into cost recovery frameworks

We were asked to assess the strengths and weaknesses of cost recovery frameworks used by other similar service providers. Our aim was to find a framework, or elements thereof, that would be consistent with our objectives and principles.

The sections below review the features of cost recovery frameworks including those adopted in other jurisdictions having regard to our objectives and principles described in chapter 3.

B.1 Overview of our findings on other jurisdictions' cost recovery frameworks

In general, cost recovery frameworks:⁴²³

- ▼ begin with an understanding of the nature of the problem being addressed
- ▼ explore whether government intervention is justified
- ▼ discuss whether the good being provided has the characteristics of a public good⁴²⁴
- ▼ distinguish regulatory from non-regulatory functions
- ▼ invoke cost recovery strategies of impactor/risk creator pays or beneficiary pays.⁴²⁵

Further, when considering how to apply the cost recovery strategies, the following points are relevant:

- ▼ where a **property right** exists to undertake action, impactor pays is preferred to beneficiary pays
- ▼ where the beneficiary pays principle is applied, public sector funds are used most efficiently where they trigger **additional** private funds.

⁴²³ An observation made by the Livestock Health and Pest Authority State Management Council (LHPA SMC) in its submission to the Issues Paper, see p 15.

⁴²⁴ That is, any one's consumption of the good has no effect on the amount available to others and it is difficult to exclude non-payers from consuming the good.

⁴²⁵ Beneficiary pays, is a combination of user pays and beneficiary compensates.

B.2 Investigation into cost recovery frameworks

Cost recovery frameworks examined were:⁴²⁶

- ▼ Commonwealth: the Productivity Commission's and the then Department of Finance and Administration's cost recovery guidelines.
- ▼ State: Frontier Economics report for the Department of Primary Industries (Victoria) (2008); Department of Agriculture, Fisheries and Forestry (Queensland); Western Australia (Recognised Biosecurity Group areas and Industry Funding Schemes); South Australia (PIRSA and Natural Resource Management boards).
- ▼ Overseas: New Zealand and Canada.

The NSW Irrigators Council submission indicated that a cost recovery framework from another jurisdiction may not be suitable or necessarily implementable for LLS, given the structure of the new authority.⁴²⁷ This view is supported by the CMA Council of Chairs with respect to the rating framework.⁴²⁸

However, there appears to be support (to various degrees) for the Productivity Commission's criteria and principles of cost recovery. The Australian Macadamia Society strongly supports the criteria, and also notes that an important point is that funding arrangements should be used to meet the gaps in biosecurity. This point is also made in the DPI (Victoria) report by Frontier Economics.⁴²⁹ However, a submission by Mr Brian Tomalin considers the PC's principles and the South Australian concept of shared responsibility are only partially applicable.⁴³⁰

The Serrated Tussock Working Party supports Biosecurity New Zealand's emphasis on the ability to influence outcomes as a determinant of who should pay.⁴³¹ The Southern Riverina Irrigators also discuss this issue, namely, that some risk is beyond the ability of the sector to control or mitigate, but do not refer to the Biosecurity New Zealand approach.⁴³²

B.3 Current cost recovery arrangements

To understand if new cost recovery arrangements are needed, it is useful to understand the operations of the agencies that will be combined to form LLS.⁴³³

⁴²⁶ IPART, *Review into the development of a funding framework for Local Land Services NSW - Issues Paper*, May 2013, pp 24-28.

⁴²⁷ NSW Irrigators Council submission to Issues Paper, p 4.

⁴²⁸ CMA Council of Chairs submission to Issues Paper, p 2.

⁴²⁹ Australian Macadamia Society submission to Issues Paper, p 3.

⁴³⁰ B.Tomalin (individual) submission to Issues Paper, p 5.

⁴³¹ Serrated Tussock Working Party submission to Issues Paper, p 4.

⁴³² Southern Riverina Irrigators submission to Issues Paper, p 8.

⁴³³ NSW Irrigators in its submission questioned the need for a new cost recovery framework, see p 3.

Livestock Health and Pest Authorities (LHPA)

No formal cost recovery framework, in the form that we are investigating, is used by the LHPAs. The LHPAs funded themselves through a combination of fees for service and rates based on legislation.⁴³⁴ It could be inferred that the use of fees for some activities and rates to fund others shows that where direct and private benefits occur, fees are used, and where direct but broader benefits or risks exist, rates were used.

Catchment Management Authorities (CMAs)

The CMAs appeared to use the principles identified by Marshall (1998)⁴³⁵ and Aretino *et al* (2001) to allocate costs.⁴³⁶ The CMA Council of Chairs provided information on approaches it used to fund natural resource management projects. The 'beneficiary pays' approach was used to allocate costs for a program used by suppliers to Bega Cheese.⁴³⁷ The Bega Cheese Environmental Management System (Bega EMS) incentive program was established in 2001 to improve environmental performance and natural resource management outcomes of the dairy industry in the far South Coast. On-farm incentive projects have been rolled out with a private investment to public funding ratio of about 3:1.⁴³⁸

The program includes a 'user pays' contribution by farmers for direct benefits received from the project and a government contribution (ie, 'beneficiary compensates') for the indirect benefits obtained by the wider community, ie, improvement to the environment.⁴³⁹ A higher percentage of funds are contributed where the benefits to the environment are greater than the benefits to individuals.

The CMAs applied an auction approach to the Southern Rivers Bush Incentives program. This approach is used to draw out private sector funds (including in-kind contributions) to complement government grants for specified natural resource management objectives.⁴⁴⁰

⁴³⁴ *Ie, Rural Lands Protection Act 1998 s 57 and Pt 7 and Rural Lands Protection Regulation 2010.*

⁴³⁵ Marshall, G.R, *Economics of Cost Sharing for Agri-Environmental Conservation*, 42nd Annual Conference of the Australian Agricultural and Resource Economics Society, University of New England, Armidale, January 1998.

⁴³⁶ Aretino, B., Holland, P., Matysek, A. and Peterson, D., 2001, *Cost Sharing for Biodiversity Conservation: A Conceptual Framework*, Productivity Commission Staff Research Paper, AusInfo, Canberra.

⁴³⁷ Southern Rivers Catchment Management Authority, *BEMS Incentives Review March 2013*.

⁴³⁸ Southern River Catchment Management Authority, *BEMS Incentive Review March 2013*, p 1.

⁴³⁹ The 'beneficiary pays' cost recovery strategy is a combination of 'user pays' by direct beneficiaries and 'beneficiary compensates' by indirect beneficiaries.

⁴⁴⁰ Southern Rivers Catchment Management Authority, *Southern Rivers Bush Incentives: Evaluation Report of Trial (Rounds 1, 2 and 3)*, December 2007.

The approach is more likely to ensure private actions that would have occurred anyway are not subsidised. As discussed in Marshall (1998), Pannell (2009) and Aretino *et al* (2001), where funds are used to subsidise private actions that would have occurred anyway, it is an inefficient use of public funds and contrary to the principles discussed in this report.

NSW Department of Primary Industries (DPI)/Biosecurity NSW

NSW DPI has an internal framework, Smith and Webster (2010).⁴⁴¹ The framework is based on the guidelines for cost recovery for government agencies developed by the Productivity Commission in 2001. However, at that time the framework was not a formal requirement when programs were developed.

We understand that some extension programs have charges attached, but most activities are provided by budget funded staff. It is unclear whether these programs have been assessed to ensure that public funds are not crowding out actions that would have occurred privately.

During the course of this review the biosecurity cost recovery framework was formally adopted by Biosecurity NSW.⁴⁴² The main concepts within this framework will inform the consideration of other jurisdictions' considerations on biosecurity matters, in particular for the emergency deeds.⁴⁴³

The Biosecurity NSW⁴⁴⁴ approach uses a decision tree based on a risk creator / beneficiary / taxpayer hierarchy and the sufficiency principle to determine who should pay. However, where a legislative requirement exists risk creators are solely considered and there is no explicit reference to a hierarchy.

B.4 Reviewing cost recovery for government goods and services

The application of economic principles to service provision can be found in the *Rural economics study* by Professor Alan G. Lloyd (1986) for the then Department of Agriculture and Rural Affairs (DARA).⁴⁴⁵ The study makes some important points. With respect to the role of government:

The basic objective from which all other objectives stem: to serve the community as a whole by maximising the community's economic and social well-being...⁴⁴⁶

⁴⁴¹ The approach developed by the authors is based on the Productivity Commission's (2001) and the Department of Finance and Administrations' (2005) cost recovery guidelines, and includes concepts such as the risk creator/beneficiary/taxpayer hierarchy and the sufficiency principle.

⁴⁴² New South Wales, *Biosecurity Strategy 2013-2021*, Appendix A.

⁴⁴³ Personal Communication, Bruce Christie, Executive Director Biosecurity NSW, 19 July 2013.

⁴⁴⁴ In our Issues Paper we refer to a biosecurity cost recovery framework by Smith and Webster (2010). The Biosecurity NSW framework is the same framework.

⁴⁴⁵ Alan G. Lloyd, *Rural economics study*, A Report to the Minister for Agriculture and Rural Affairs by Professor Alan G. Lloyd, Victoria July 1986.

⁴⁴⁶ Lloyd (1986), pp 138-139.

This is not to say that government, with their limited resources, should fund all such activities from the public purse; many will be funded from industry levies or charges for services, however, governments are uniquely placed to play a role in the provision of many functions.

The study identifies 3 major categories for government involvement, such as public goods, private goods subject to market failure (discussed in chapter 4) and social welfare goods.⁴⁴⁷ With respect to regulatory activities:

...some DARA regulatory activities have clearly identifiable beneficiaries on whom a charge may be levied. This may be the case for pest and disease control.⁴⁴⁸

With respect to allocating resources:

Economic efficiency and equity requires that whenever possible the benefitting group should fund government activity....if means cannot be devised for beneficiaries to fund the project, then it may be that government should fund it rather than not have it done.⁴⁴⁹

The Productivity Commission (PC) in August 2001 produced a report into cost recovery for Commonwealth government agencies (from here onwards referred to as PC (2001)). The main recommendations were:⁴⁵⁰

- ▼ cost recovery should be implemented for economic efficiency reasons, not merely to raise revenue
- ▼ for regulatory agencies, the prices of regulated products should incorporate all of the costs of bringing them to market, including the administrative costs of regulation
- ▼ cost recovery should not be implemented where it is not cost effective, inconsistent with policy objectives, and would unduly stifle competition and innovation
- ▼ operationally, cost recovery should use fees where possible, apply to activities, and not be used to finance unrelated objectives of general government duties
- ▼ cost recovery should be designed to generally avoid cross-subsidisation, to ensure transparency and accountability and include consultation.

⁴⁴⁷ It is without question that it is a government responsibility to provide the last category, and is considered no further. However, how a social welfare program is provided should also be subject to assessment to ensure the program is maximising outcomes.

⁴⁴⁸ Lloyd (1986), p 142. We consider that beneficiaries of the regulations may also be interpreted in this context as those creating the need for the regulation.

⁴⁴⁹ Lloyd (1986), p 142.

⁴⁵⁰ PC (2001), p XXIX.

The PC developed a cost recovery framework for agencies with regulatory responsibilities and non-regulatory agencies, ie, information agencies.⁴⁵¹ The recoverable costs differ depending on the type of regulatory or non-regulatory services provided.

The PC's report recommendations were incorporated into the then Department of Finance and Administration's 2005 guidelines (DoFA). However, few State governments have developed cost recovery guidelines in their own jurisdictions. The two publicly available frameworks are the Department of Treasury and Finance's (Victoria)⁴⁵² guidelines and Primary Industries and Resources South Australia.⁴⁵³ DoFA's and Victoria's cost recovery guidelines are considered further when we assess frameworks from other jurisdictions.

Cost recovery for LLS service functions

Cost sharing is already in place for a range of policy areas, including areas of interest to this review, that is, for biosecurity, biodiversity (ie, natural resource management), and research and development (and extension).

These suggest:

- ▼ the cost sharing approaches of 'impactor pays' and 'beneficiary pays' are both applicable to our review⁴⁵⁴
- ▼ where a property right exist to undertake action, 'impactor pays' is preferred to 'beneficiary pays'
- ▼ where the 'beneficiary pays' principle is applied, public sector funds are used most efficiently where they trigger additional private funds
- ▼ cost sharing for emergency services appears to be analogous to an insurance premium paid by the ultimate beneficiary.

⁴⁵¹ Examples of information agencies include the Australian Bureau of Statistics and the Bureau of Meteorology.

⁴⁵² Department of Treasury and Finance, 2013 *Cost Recovery Guidelines*, Melbourne.

⁴⁵³ PIRSA, *Cost Recovery Policy GO P 014*, August 2010, Version 1.0.

⁴⁵⁴ Risk creator is an analogous concept we have encountered in our research normally used for biosecurity. Impactors for environmental activities and risk creators for biosecurity activities are both relevant for the new Local Land Services NSW and the activities it will provide.

Cost recovery for biosecurity

Our research has found various cost recovery frameworks for biosecurity activities. These include:⁴⁵⁵

- ▼ Department of Primary Industries (Victoria) applies a cost recovery framework to a program to control of Queensland fruit fly based on identifying risk creators, beneficiaries and the role of the government. There is a general reference to a hierarchy, but the hierarchy was not practical for this particular example.
- ▼ Primary Industries and Resources South Australia's (PIRSA) cost recovery manual for use by internal divisions, which default to DoFA's guidelines.
- ▼ Biosecurity New Zealand's discussion paper on funding biosecurity services, which forgo a strict adherence to an exacebator / beneficiary / Crown hierarchy. The discussion paper's principles are applied in a separate report on a program to control Bovine Tuberculosis.
- ▼ Canadian Food Inspection Agency's (CFIA) cost recovery guidelines based on public/private benefits, and Agriculture and Agri-Food Canada (AAFC) application to a national traceability scheme, using public good theory.

Cost sharing for environmental conservation

A Productivity Commission Staff Research Paper, May 2001, discusses cost sharing for biodiversity conservation (from here onwards referred to as Aretino *et al* (2001)).⁴⁵⁶ The key points raised in the paper were:

- ▼ clarifying property rights is a fundamental step for determining which cost sharing principle to apply
- ▼ where conservation actions demanded by the public are in excess of required actions by the private sector, two broad principles determine who should bear the costs - 'impactor pays' and 'beneficiary pays'
- ▼ the rights and responsibilities implied by property rights is a key element in determining which cost sharing principle to apply

⁴⁵⁵ Biosecurity NSW has set out an approach that uses a decision tree based on a risk creator / beneficiary / taxpayer hierarchy to determine who should pay as was discussed in section C.3. Here, we present frameworks developed in other jurisdictions.

⁴⁵⁶ Aretino, B., Holland, P., Matysek, A. and Peterson, D., 2001, *Cost Sharing for Biodiversity Conservation: A Conceptual Framework*, Productivity Commission Staff Research Paper, AusInfo, Canberra.

- ▼ if property rights require users to meet a standard, those who fail to achieve it are considered to have generated external costs, on efficiency grounds, and the ‘impactor pays’ principle should generally be adopted:
 - however, if the costs of implementing the impactor pays principle were to outweigh the efficiency advantages of additional conservation, the ‘beneficiary pays’ principle may be considered⁴⁵⁷
- ▼ in the short term, where community expectations exceed existing property rights, the ‘beneficiary pays’ principle may be appropriate, provided the benefits warrant the costs
- ▼ if the ‘beneficiary pays’ principle is adopted, and government chooses to meet a share of costs, in principle the public contribution should be the minimum necessary to trigger additional private conservation
- ▼ over time property rights may change to reflect higher standards of expected behaviour through common law or legislation. However, redefinition of property rights should not be undertaken lightly, and may give rise to questions of compensation or other assistance.

Similar points were raised previously in a paper by Marshall in 1998.⁴⁵⁸

A key point, referred to by Marshall⁴⁵⁹ and, summarised by Aretino *et al* (2001)⁴⁶⁰ is that the public⁴⁶¹ would best be served in meeting its environmental outcomes by ‘free riding’ on the public benefits that may occur as a by-product of private actions.

Therefore, what is required is for public funds to trigger private funding, where on its own the project would not provide a net benefit to the private sector to undertake on its own.

Cost sharing for environmental works is discussed in Pannell (2009).⁴⁶² Pannell’s view is that cost sharing is difficult to apply and flawed in principle, where sharing means costs from environmental works should be borne in proportion to the benefits received. A more helpful approach to achieving the greatest environmental benefits for the available public funds is to ask the following questions:

- ▼ What is the least the government can pay and still have the project proceed?

⁴⁵⁷ The concept of ‘impactor pays’ is relevant for environmental conservation. However, the ideas discussed are relevant also for the biosecurity specific idea of risk creator.

⁴⁵⁸ Marshall, G.R, *Economics of Cost Sharing for Agri-Environmental Conservation*, 42nd Annual Conference of the Australian Agricultural and Resource Economics Society, University of New England, Armidale, January 1998.

⁴⁵⁹ *Ibid*, pp 10-11.

⁴⁶⁰ Aretino *et al* (2001), p 23.

⁴⁶¹ The ‘public’ in this context means the wider community excluding the specific private individual.

⁴⁶² Pannell, D., *Cost sharing for environmental works*, #149, March 2009.

- ▼ Given the payment of this amount, are the public benefits sufficient to justify paying this much?

The resulting transaction that occurs, whatever it may be, can be viewed as cost sharing, but it is a result of a process not a crude 'rule of thumb' input to a process of paying for a service.

Aretino *et al* (2001) and Marshall⁴⁶³ discuss the cost sharing principles, in an environmental context, of 'polluter pays' and 'beneficiary pays' and the efficiency and equity aspects of both approaches. The 'polluter pays' approach requires producers and consumers to meet the costs of their actions on the environment. This approach most closely acts to increase efficiency by making producers and consumers take into account all the cost of their activities.

The 'beneficiary pays' approach, a combination of 'user pays' and 'beneficiary compensates', allows for direct beneficiaries of biodiversity to contribute to the cost of the activity, but also applies when activities generate indirect benefits normally experienced by the wider community. Therefore, cost sharing under the 'beneficiary pays' principle only requires government (normally on behalf of a diffuse group of beneficiaries) to pay the minimum necessary to trigger additional private investment.

Cost sharing in the context of research, development and extension

The Productivity Commission in February 2011, (from here onwards referred to as PC (2011)), completed a review into *Rural Research and Development Corporations*.⁴⁶⁴ A key point, relevant to this review, is that 'additionality' is important.⁴⁶⁵

Additionality means that a policy should not result in people being paid to do things that they were going to do anyway (or were doing already). They should be doing additional works to qualify for funding.⁴⁶⁶ Therefore, public funds should be used to trigger additional investment, where the private sector would not invest on its own. This also means that government funds should not displace (or 'crowd out') private funding that would have occurred anyway.

⁴⁶³ See Aretino *et al* (2001) chapter 3 and Marshall (1998) sections 3-6, respectively.

⁴⁶⁴ Productivity Commission, *Rural Research and Development Corporations*, Report No. 52, Final Inquiry Report, Canberra, February 2011.

⁴⁶⁵ PC (2011), Box 2 (p XX), Box 4 (p XXIII) and p 289.

⁴⁶⁶ Pannell D, *Additionality in environmental programs*, #151, April 2009.

The LHPA SMC in its submission summarises the PC (2011) conclusions as follows:⁴⁶⁷

- ▼ even in the presence of spill-over, public funding support should only be undertaken where the expected benefits for a producer/industry are insufficient to motivate research that is of net benefit to the community as a whole
- ▼ industry levies address the free-rider problems and ensure that all producers who benefit from research contribute to its costs
- ▼ industry levies are unlikely to facilitate investment in research where the benefits are either spread thinly across a wide range of industries or mainly accrues to the wider community.

Cost recovery for emergency services

There are various example of cost sharing for emergency services. These include:

- ▼ NSW fire and emergency services - in the form of a tax on insurance companies passed on in the form of higher premiums for home contents insurance. The remainder of the cost, about one-quarter, is funded by the state and local councils.⁴⁶⁸
- ▼ Natural disaster assistance for councils, where the NSW Government provides grants to meet the additional costs of emergency work to restore essential services.⁴⁶⁹
- ▼ Cost sharing arrangements between the Commonwealth Government and the other levels of government for emergency management, in the form of financial assistance.⁴⁷⁰

⁴⁶⁷ LHPA SMC submission to Issues Paper, pp 14-15 – from PC (2011), Box 4.

⁴⁶⁸ Sean Nicholls, *Households to pay \$300 for fire levy*, Sydney Morning Herald, 3 May 2013.

⁴⁶⁹ <http://www.emergency.nsw.gov.au/nddassistance>.

⁴⁷⁰ www.em.gov.au/Documents/Australian%20Emergency%20Management%20Arrangements.pdf, accessed 12 August 2013.

B.5 Analysis of cost recovery frameworks – other jurisdictions

In the previous section we researched cost recovery frameworks for government goods and services, including in areas relevant to LLS. In this section we assess cost recovery frameworks by similar service providers from other jurisdictions. The most developed frameworks we found are either general government or have a biosecurity focus.^{471,472}

Table B.1 summarises our views on a number of cost recovery frameworks from other jurisdictions against our principles.

Table B.1 Analysis of cost recovery frameworks from other jurisdictions

Jurisdiction Principles	DoFA	DTF (Vic)	Biosecurity NZ	CFIA/AAFC (Canada)
Appropriate pricing	✓	✓	?	✗
Administrative efficiency	?	?	✓	✗
Institutional	✓	✓	✓	✓
Transparency	✓	✓	✓	✓
Consistency	✓	✓	?	✗

Note: Analysis of publicly available cost recovery guidelines.

Administrative efficiency in this context means that the framework is simple to understand and useable.

Source: IPART analysis.

The following summarises the main strengths and weaknesses of the cost recovery frameworks identified in Table B.1.

Department of Finance and Administration (now Department of Finance and Deregulation) 2005⁴⁷³

The Department of Finance and Administration (DoFA) developed guidelines based on recommendations from the Productivity Commission's (PC) review on cost recovery for government agencies.

⁴⁷¹ We have not considered US frameworks. However we do not consider the US to be as similar to the Australian context as New Zealand and Canada. Guidelines on fees and charges for the UK (<https://www.gov.uk/government/publications/managing-public-money>, chapter 6) are available but we do not consider them to be relevant; some key point are that costs should be fully recovered based on whether a statutory requirement exists; no discussion of economic concepts.

⁴⁷² An investigation into cost recovery is broader than an investigation into State government guidelines on user charges, which only inform one part of a broader cost recovery framework. Therefore, we have not reviewed user charges guidelines for this review.

⁴⁷³ These guidelines are presently being reviewed: <http://www.finance.gov.au/financial-framework/financial-management-policy-guidance/cost-recovery/review-of-cost-recovery.html>.

DoFA provided broad guidelines with decision trees for both regulatory and information agencies to apply. The decision trees for either type of agency are similar, but information agencies do not have regulation which must be enforced (eg, the Australian Bureau of Statistics). DoFA's guidelines refer to parties that create the need for the regulation or benefit from service provision, which is similar to thinking about impactors/risk creators and beneficiaries. DoFA's guidelines include a section on what a cost recovery impact statement should include which aids transparency, which IPART considers to be a valuable tool.

DoFA's guidelines depart from the PC's by allowing for partial cost recovery. These guidelines are used by Primary Industries and Resources South Australia (PIRSA) for its own design and implementation of cost recovery arrangements.

DoFA's current guidelines provide a useful basis to create a framework, in particular the decision trees and explanation surrounding these. The document has broad application within the Commonwealth Government and would need to be modified to meet the specific needs of LLS.

[Department of Treasury and Finance \(Victoria\) 2013⁴⁷⁴ / Department of Primary Industries \(Victoria\) \(circa 2010\)⁴⁷⁵](#)

The Victorian Department of Treasury and Finance (DTF) has developed comprehensive guidelines for department/agency use. The guidelines include chapters on:

- ▼ the objectives and principles of cost recovery
- ▼ market failure (including public good issues)
- ▼ 10-step process to designing and implementing cost recovery arrangements
- ▼ process issues relevant to agencies in Victoria.

The Department of Primary Industries, Victoria (DPI), has a worked example of how cost recovery applies to a specific biosecurity problem. The case study is based on a Queensland fruit fly (QFF) program, and covers the issues relevant for cost recovery frameworks. The analysis presents a set of key questions which amount to a cost recovery framework, on which the analysis of the QFF program is based. The analysis also discusses key economic concepts that must be understood, for example, the case study discusses public (private) goods and cost recovery strategies (ie, 'risk creator pays', 'beneficiary pays').

⁴⁷⁴ <http://www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Cost-recovery-guidelines>, accessed 18 July 2013. Open PDF file link.

⁴⁷⁵ Link to DPI's website is no longer active; paper available on request. This paper references a cost-benefit analysis for QFF by DPI in 2010, which was "recently undertaken" (see p 8).

The DTF's guidelines are designed for use by policy officers within government departments and agencies, including those preparing Regulatory Impact Statements, a function LLS will not be undertaking.⁴⁷⁶

The guidelines produced by DTF are useful and the 'key questions' in the DPI example are also consistent with questions asked in other approaches and are simply stated.

Frontier Economics for the Victorian Department of Primary Industries (2008): Mechanism for funding biosecurity measures

This paper prepared by Frontier Economics for DPI precedes DTF's (Victoria) cost recovery guidelines and the DPI QFF analysis. Therefore, we consider these later documents are the current views of this jurisdiction.

The paper suggests that 'beneficiary pays' is the primary approach that exists in cost sharing approaches such as the plant and animal deeds.

The paper does not reference land management (duty of care) requirements, eg, controlling noxious weeds and pest animals. Their inclusion undermines the primacy of the 'beneficiary pays' proposition. For example, refer to discussion in Aretino *et al* (2001) and within the DPI QFF example discussed above.

The paper also has a narrow definition of risk creators.⁴⁷⁷ A broader definition of risk creator would include activities that are susceptible to risk and exacerbate risk. These characteristics allow for those creating the need for action to be considered.

Primary Industries and Resources SA (PIRSA) / Department of Agriculture and Food Western Australia (DAFWA)

PIRSA provide an easy to understand policy document for agencies to begin to work through cost recovery issues. The cost recovery policy document is a high level, rather than a step-by-step, manual. The Divisions within PIRSA are required to adhere to the 11 principles discussed, based on the PC (2001) review.

The PIRSA guidelines refer the reader to the Australian Government's (DoFA) guidelines and the decision trees contained within for the review, design and implementation of cost recovery.

⁴⁷⁶ However, we note that LLS has an important role in helping government to shape its policies and strategies in the areas of natural resource management, agricultural production, biosecurity and emergency management, see NSW Government, *LLS: Functions and Services*, April 2013, Paper 6, p 2.

⁴⁷⁷ Frontier Economics, *Mechanisms for Funding Biosecurity Measures*, A report prepared for the Department of Primary Industries, Victoria, November 2008, pp 12-13.

ACIL Tasman reviewed 3 DAFWA industry funding schemes (entirely industry funded) established under the *Biosecurity and Agriculture Management Act 2007* (WA). The consultant used the principles of cost recovery to review the 3 industry funding schemes to ensure the efficiency of the schemes and assess if there was cost shifting of costs from DAFWA to livestock, grain and hay producers. The cost recovery guidelines used by the consultant were the OECD's best practice guidelines and those developed in the PC (2001) review.⁴⁷⁸

These jurisdictions in effect replicate the Commonwealth's approach and the principles developed by the PC which we have already discussed.

New Zealand: Biosecurity New Zealand^{479, 480}

Biosecurity New Zealand uses 'key questions' based on three primary funding principles to determine who should pay for biosecurity services. However, unlike other approaches, its approach forgoes a strict hierarchy of exactors / beneficiaries / Crown, due to problems encountered with its application.⁴⁸¹

The main departure of this framework from others is the simultaneous consideration of exactors (ie, risk creators), beneficiaries and the Crown (ie, the taxpayer) when considering who should pay.

This approach was applied to a Bovine Tuberculosis program. The outcome was that industry was required to pay 100% of the cost of the control program, as the program provides clear private benefits, and a well-defined group exists to bear the costs. The part of the program dealing with disease carriers (ie, possum) is shared across the various land types where the disease carrier exists, both on public land and private land (an example of multiple risk creators and nil tenure). We consider that a framework with a hierarchy could replicate this outcome.

The Biosecurity New Zealand approach is considered to be useful and likely to lead to efficient outcomes if applied correctly. This approach is not pursued further as we consider that a hierarchy of risk creator (impactor) / beneficiary / taxpayer is accepted in Australia and more likely to lead to efficient and equitable outcomes.

⁴⁷⁸ ACIL Tasman, *Industry funded biosecurity management in Western Australia: A review of the Western Australian industry funded biosecurity management schemes*, prepared for the three Industry Management Committees, through the Department of Agriculture and Food Western Australia, June 2012, p 10.

⁴⁷⁹ Animal Health Board, *National Bovine Tuberculosis Pest Management Strategy: An Amendment Proposal Prepared by the Animal Health Board Incorporated*, September 2009, see chapter 16-17.

⁴⁸⁰ <http://www.biosecurity.govt.nz/bio-strategy/papers/biosecurity-funding-review.htm>, The Bovine Tuberculosis example is based on the 2004 discussion paper's principles.

⁴⁸¹ The problems encountered include difficulties charging exactors, beneficiaries being better placed to be charged and in some cases difficulty in distinguishing between exactors and beneficiaries. We are unsure how these issues could not be accommodated in a framework that considers both those that create the need or benefit from the activity.

The framework, however, raised relevant issues that should be accommodated in our approach. For example, that the most relevant party is able to do the following:

- ▼ modify their behaviour to reduce the costs of the service or the risk that caused the need for the service over time
- ▼ capture enough of the benefits of the service to be prepared to pay for its provision.

Canada: Canadian Food Inspection Agency (CFIA) and Agriculture and Agri-Food Canada (AAFC)⁴⁸²

The CFIA applies the ‘beneficiary pays’ cost recovery strategy, where it considers the use of user fees for direct private beneficiaries, and government contribution where indirect benefits exist (eg, health and environment). The cost recovery framework includes 7 guiding principles, with some features of the framework similar to the Productivity Commission’s guidelines. There are some differences with explicit consideration of affordability and the impact on competitiveness against similar service providers from other jurisdictions (including Australia).

The framework concentrates on private versus public benefits, but incorrectly confuses these with public and private goods, which is likely to lead to flawed analysis, as discussed in Department of Primary Industries (Victoria)⁴⁸³ and in Pannell (2004).⁴⁸⁴ Since this framework has a ‘beneficiary pays’ approach, there is no consideration of impactors which excludes considering negative externalities.

The AAFC appears to have a similar cost sharing approach, as the CFIA, based on ‘beneficiary pays’. However, the AAFC framework provides a clearer understanding of public/private good issues and how they should be applied, and separately considers public and private benefits. The AAFC framework is applied to the Canadian National Livestock and Poultry Traceability Scheme. Other issues considered include quality control programs, agricultural research, environmental stewardship and other verification programs.⁴⁸⁵

⁴⁸² The Treasury Board’s guidelines are the basis for these bodies; a public-private benefit ratio is discussed, which we consider is a fallback not the preferred way of allocating costs.

⁴⁸³ Department of Primary Industries (Victoria), *the Case for Cost Recovery*, (circa 2010) pp 3-4. The web page with this example is no longer available.

⁴⁸⁴ Pannell, D, *Thinking like an economist 5: Public goods and public benefits in NRM*, #22, 2004.

⁴⁸⁵ The application of public good theory to different characteristics of a traceability program appears to be consistent with the PC’s view. However, this approach is not widely applicable.

C Example of summary of charging arrangements table

A summary of charging arrangements table shows the current charges by activity and those proposed by an LLS board together with the revenue generated. The table will need to show charges year by year if major changes are proposed over the 5-year term of the CRIS.

Table C.1 An example of a summary of charging arrangements (adapted from Australian Government guidelines)

Activity	Method of recovery	Projected volume of activity Y ₁	Current price Y ₀	Current revenue (Volume Y ₁ * Price Y ₀)	Cost recovery price- Y ₁	Cost recovery revenue- Y ₁	Revenue surplus/ (shortfall)	
1.1	Processing costs of an application	Fee-for-service	1,000 applications	\$200 per application	\$200,000	\$200 per application	\$200,000	\$0
2.1	Sale of information publications	Fee-for-service	1,200 publications	None	\$0	\$10 per publication	\$12,000	(\$12,000)
3.1	Agricultural advice	Fee-for-service	200 queries	\$160 per query	\$32,000	\$160 per query	\$32,000	\$0
4.1	Locust levy	Rate	5,000 landholdings	\$10 per holding	\$50,000	\$12 per holding	\$60,000	(\$10,000)
	Total fee-for-service				\$232,000		\$244,000	(\$12,000)
	Total rates recovered				\$50,000		\$60,000	(\$10,000)
	TOTAL				\$282,000		\$304,000	(\$22,000)

Note: Actual charges in Year 1 will be as per the table increased by the percentage change in the CPI.

Source: Adapted from the Australian Government's Cost Recovery Impact Statement Template sourced 24 September 2013 from: <http://www.finance.gov.au/financial-framework/financial-management-policy-guidance/docs/CRIS-template.pdf>

D Example of annual statement of proposed charges for coming year

Table D.1 Example of Annual statement Year 2 (Y₂)

Activity	Method of recovery	Current price Y ₁	Price in Strategic Plan Y ₂	Proposed price Y ₂	Comply with CRIS
1.1 Processing costs of an application	Fee-for-service	\$200 per submission	\$200 per submission	\$200 per submission	Yes
2.1 Sale of information publications	Fee-for-service	\$10 per publication	\$10 per publication	\$10 per publication	Yes
3.1 Agricultural advice	Fee-for-service	\$160 per query	\$160 per query	\$120 per query + \$40 per hour if query is longer than 1 hour	No
4.1 Locust Levy	Rate	\$12 per holding	\$12 per holding	\$12 per holding	Yes

Example explanation of variations from CRIS:

(i) Consultation services

The proposed price (Year 2) is \$120 per query plus \$40 per hour if a query takes longer than 1 hour. This compares to the CRIS price for Year 2 of \$160 per query. The variation is a result of a review of consultation services. A copy of the review is available at (www.lls.nsw.gov.au). It highlighted:

- ▼ an increase in the length and sophistication of consultations particularly consultations associated with programs x and y
- ▼ landholders receiving short consultations were subsidising those receiving longer consultations.

Glossary

Avoidable cost	The costs that would be avoided if a particular activity was no longer undertaken.
Beneficiary	<p>Some entity that benefits from the activity. This requires identification of the beneficiaries and assessment and apportionment of net benefits across them. The 'beneficiary pays' principle has 2 elements, ie:</p> <ul style="list-style-type: none">▼ User pays – requires anyone who derives a direct private benefit from the activity to contribute to the costs of undertaking the activity (linked to sufficiency principle).▼ Beneficiary compensates – requires anyone who derives an indirect benefit from an activity to contribute to the cost of undertaking it. This component of 'beneficiary pays' is usually associated with government funding (linked to additionality principle).
Club good	Products or services from which it is possible, at low costs, to exclude non-payers outside of a distinctive group of beneficiaries from its use, such as an industry. Its use by one party within the group, however, does not detract from its use by another.
Competitive neutrality	A policy principle that involves achieving a fair market environment by removing or offsetting any competitive advantages or disadvantages due to public ownership of government businesses.
Cost recovery	The recovery of the costs of government-provided or government-funded products or services that, at least in part, provide private benefits to individuals, entities or groups, or reflect the costs their actions impose.
Cross-subsidisation	Where one group of users pays more than the costs of the goods/services that they receive, and the 'surplus' is used to offset the cost of goods/services provided to other users.
Direct costs	Costs that can be readily and unequivocally attributed to a product or activity because they are incurred exclusively for that particular product/activity (eg, labour and materials).
Efficiency (allocative)	In the context of cost recovery, efficiency tends to mean the allocation of resources to the most valuable uses for society as a whole.
Equity	In general, the term 'equity' reflects concepts of fairness or justice. In a public finance context, relevant to this review, 'horizontal equity' refers to treating people in similar situations in similar ways. 'Vertical equity' refers to those with greater means contributing proportionately more than those with lesser means.
Excludability	The extent to which it is possible to exclude a party from the consumption/benefits of a good/service.

Externality (spillover)	The uncompensated effects on a third party to a transaction (or action) that is not fully accounted for in the price or cost of the transaction. Externalities can be either positive, when an external benefit is generated, or negative, when an external cost is imposed upon others.
Free rider	A party who derives a benefit at no cost from a good/service that is being provided to a cost to another party.
Full cost recovery	The recovery of all those costs associated with those activities or products. Full cost represents the value of all the resources used or consumed in the provision of an output or activity. In addition to the costs directly associated with the output/activity, full cost includes an appropriate allocation of indirect (including capital) costs.
Fully distributed costing	An accounting framework that allocates the total costs of all resources used/consumed in the provision of the output, not just those that are directly attributable to the output (e.g. including indirect and capital costs).
Impactor	The activity that has directly caused the problem, for example pollution or contamination. The entity that has caused the problem should internalise the costs imposed on others.
Incremental costs	The increase in costs attributable to the production of a particular type of activity.
Market failure	A condition where the allocation of goods and services in a market is not efficient.
Marginal cost	The change in costs associated with producing an extra unit of output. Marginal cost in the short run includes all costs variable with production, hence excludes overheads and capital costs.
Private goods	Products or services where consumption by one party conflicts with its use by another, and where the benefits of consumption only accrue to the consuming party.
Property rights	Property rights determine who owns a resource (such as land) and how it is used. These rights are created, restricted and regulated by legislation and common law.
Public benefit	'The public' is the aggregation of all private individuals (eg, big business, polluters, taxpayers, consumers). Therefore, private benefits exist to a narrowly defined individual or group of individuals and public benefits accrue to everyone else.
Public goods	A good (or service) that is non-rivalrous and non-excludable, which means consumption of the good by one individual does not reduce the amount of the good available for consumption by others, and no one can be effectively excluded from using that good.
Risk creators	The activity that creates the risk, rather than the activity that is known to cause the damage. This term can also be known as the risk generator. The characteristics of the activity include: <ul style="list-style-type: none"> ▼ susceptibility – a risk creator may be undertaking an activity that is susceptible to a potential threat ▼ exacerbation – a risk creator may also be someone that increases the probability of the risk occurring by not undertaking actions to reduce the risk or actively doing something that intensifies the problem.
Rivalry	The extent to which a party's use of a good/service affects another party's use of the same good/service.

Source: IPART; Department of Treasury and Finance, *2013 Cost Recovery Guidelines*, Melbourne, p 39.

