

# Transport regulatory system

Funding principles

September 2018

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**Thanks are given to all of the transport agencies that have contributed to the development of this document and the funding principles contained within it.**

## Transport regulatory system - Funding principles

### Purpose

1. This paper outlines a set of principles to guide funding reviews and advice on the appropriate funding sources for regulatory activities carried out within the transport regulatory system.
2. This set of principles is intended to support a consistent funding framework for activities across the Ministry and transport regulatory agencies and provide transparency to the participants in the system.
3. These principles are intended to inform the analysis undertaken when developing a cost recovery proposal. For example, having a clear policy rationale for cost recovery and being able to demonstrate a clear line of sight between activities, services and costs.
4. The principles relate to the preferred source of funding for the performance of policy and regulatory functions in the transport system. The setting of charges for commercial activities is out of scope. The principles are relevant to determining when it is appropriate to seek access to Crown funding or targeted taxes (such as the National Land Transport Fund) or when to establish levies or fees.
5. The principles build on, and are consistent with, the practice guidance issued by the Treasury and the Office of the Auditor-General (OAG).

### Government has a role in the transport regulatory system...

6. Transport of people and goods play a crucial role in New Zealand's social and economic wellbeing. Effective regulatory systems are essential to maximise the social, economic and environmental protection benefits of transport for New Zealand, which has led successive governments to intervene through investment in infrastructure and the regulation of participation and outcomes.
7. The resulting transport regulatory system has common objectives of achieving an integrated, safe, responsive, and sustainable transport system.<sup>1</sup> The transport regulatory system is made up of laws (for example, statutes, regulations, and rules), institutions, and practices which combine to achieve a given set of behaviours or outcomes. The Ministry, transport agencies, and other participants have functions and powers that support the achievement of the objectives.

### And funds those roles through a mix of funding sources ...

8. These functions and powers are funded through a mix of sources as described in more detail below, but at a high level:
  - a. Ministry functions are generally Crown funded, with some access to targeted taxes.<sup>2</sup>
  - b. Transport regulator functions are funded through a mix of targeted taxes, levies, and fees, with some Crown funding.<sup>3</sup>

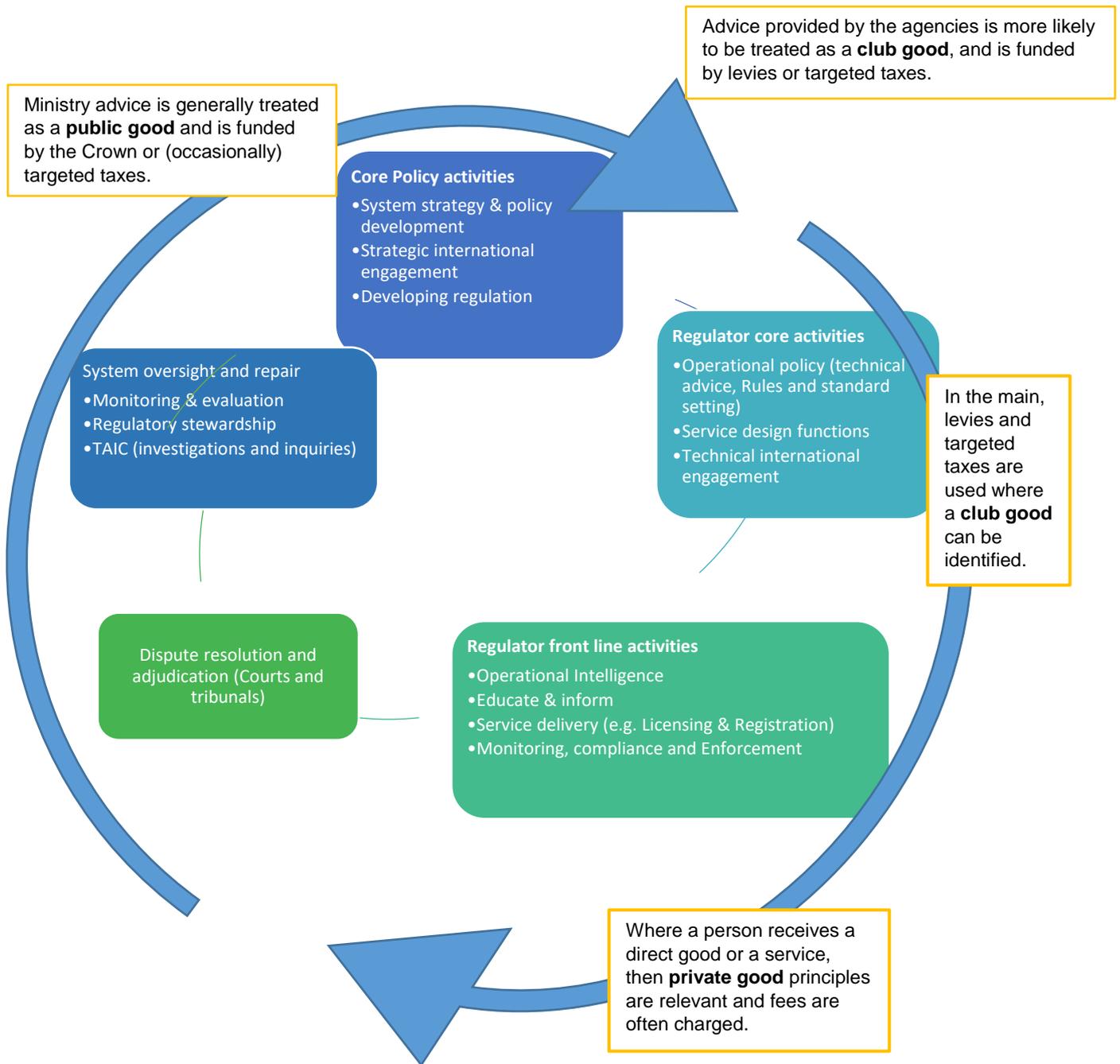
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<sup>1</sup> See Civil Aviation Act 1990, ss 14 and 72AA, Maritime Transport Act 1994, ss 5 and 430, Land Transport Act 1998, s169, but compare Land Transport Management Act 2003, s94.

<sup>2</sup> In this paper, Crown funded means funding from the consolidated fund, as distinct from targeted taxes (such as the National Land Transport Fund) or levies collected on behalf of the Crown and then appropriated (such as the Working Safer Levy).

<sup>3</sup> In this paper the term "levies" is used to describe charges imposed on risk exacerbators and beneficiaries to fund functions and activities carried out in relation to the regulatory system. The term "fees" describes cost recovery for the provision of services. However, legislation in the transport and other regulatory systems use the terms fees, levies and

9. The figure below shows the Government functions undertaken within the transport regulatory system and the mechanisms generally used to fund these functions.



charges inconsistently, which is confusing. The wording of the empowering provision matters, rather than the term used.

10. In accordance with the Treasury guidelines, the concepts of club, private and public good guide the allocation of costs of providing policy and regulatory functions in the transport regulatory system.<sup>4</sup>

### **Focusing on the risk exacerbators in the transport regulatory system leads to an emphasis on funding that system from the club**

11. Individuals and businesses enter the transport system because they see a personal, social or commercial benefit in participating in the system. This participation creates risks for other people (such as safety, security or environmental risks).
12. To address these risks and to manage impacts on the public and transport system, it is necessary to put in place operational requirements, guidance, education, regulator operational policies and compliance and enforcement strategies. Regulatory requirements such as certification or registration (for example, driver licensing or certification of aviation or maritime operators), can also be effective.
13. These activities include systemic risk activities involving the identification and treatment of trends in risk across multiple accidents, incidents and non-compliance so that interventions can be targeted to best effect. Regulators can also be involved in air, land and sea incident response and coordination.
14. Most of these regulator functions have characteristics of club goods. Participants benefit from operating within an efficient and effective system which targets the costs of that system to the risk exacerbators and the direct and indirect beneficiaries.

### **It is important to have well designed cost recovery regimes**

15. Cost recovery regimes create and shape market incentives that inform how regulated parties behave. Recognising this impact, it is important that entities have a clear understanding of the impacts on behaviours that different funding approaches may have. They also need clarity that cost recovery mechanisms are designed in a way that best achieves the desired behaviour change. For example, if an audit by a regulator is charged by the hour, it incentivises regulated parties to want speed of audit. On the other hand, if the audit is club-funded, more time, education and discussion around compliance will be valued.
16. The design of cost recovery mechanisms also has an impact on how costs and benefits are shared. When designed well, cost recovery regimes ensure costs are effectively placed on the exacerbators of risk and those who benefit most, while minimising the spill-over costs to others within the regulatory system.
17. Conversely, the absence of the regulatory context has the potential to incentivise undesirable behaviours and create unintended consequences that could undermine the desired policy outcomes.

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<sup>4</sup> Mechanisms generally used to fund these functions include:

- **Club goods** - most funding of the transport regulatory system occurs through levies that are spread across groups of people who are the primary risk exacerbators and who underpin the need for the regulation, as well as (often) the primary beneficiaries of an effectively functioning regulatory system. The Treasury Guidelines apply to cost recovery for club goods, as well as private goods.
- **Public goods** - Crown funding is generally used in situations of public goods. Some transport regulatory functions have a range of broad benefits (including reputational, general economic, or environmental protection benefits) that are wider than the transport system and are not directly or indirectly attributable to the participants or primary beneficiaries; these can be considered as activities with a public good. Crown funding can be used in these cases.
- **Private goods** - where charges can be imposed on a specific individual or organisation for a good or service or regulation directly provided to (or directly benefiting) that individual or organisation. These types of charges must be set at no more than the amount necessary to recover the cost attributable to providing the private good. The OAG Guidelines apply to cost recovery for private goods.

18. In line with Treasury and OAG guidelines, cost recovery regimes should be reviewed regularly to prevent systemic over or under-recovery. The Ministry maintains oversight of the cyclical review of funding regimes by working collaboratively with the relevant agencies (the regulators) and incorporates such reviews within its wider policy programme and regulatory change timetable.

### The following principles are proposed for funding the transport regulatory system

19. In addition to the principles in the Treasury and OAG guidelines (set out in the Appendix to this paper), the transport system funding principles are:
- **Funding supports system objectives:** The method of funding should support, and at least not conflict, with the objectives of the transport regulatory system and the purpose of the funding.
  - **Funding model is sustainable:** The funding model should be sustainable over time. Regulators and the Ministry should be funded to carry out their regulatory and other functions in a financially sustainable and efficient manner to meet the Government's desired outcomes from the transport regulatory system.
  - **Risk exacerbators and beneficiaries pay, principally focused on the main risk exacerbators:** Costs should be allocated primarily according to who creates and exacerbates the risks in the system and receive benefit from participating in the system; where particular groups create more significant risks or derive more benefit, graduated approaches should be used.
  - **Users pay for services, but incentives are important:** When users access a regulated transport service (for example, licensing and registration or access to dispute resolution or adjudication), the user should pay the cost of the provision of that service, unless there is a good reason not to e.g.: to create behavioural incentives or because of one or more of the other issues for consideration listed below.
  - **Crown funding is limited to certain functions:** Crown funding should be limited to functions with broad, indirect or very widely distributed benefits. In the transport regulatory system, Crown funding will cover most Ministry activities and fewer regulator activities.

### Issues for consideration

20. When applying these principles, the analysis must take into account:
- The statutory functions of the relevant entities that are to be funded and the relevant empowering provisions. Care needs to be taken because provisions can overlap, creating choices as to which empowering provision to use. Terms like "fees" for example, sometimes empower funding for either club goods or private goods.<sup>5</sup>
  - The ability to pay of the particular sub-sector user and how costs are likely to be passed on to end-users. For example, some aviation levies are imposed on the airlines on a per passenger basis. As the airlines routinely pass these costs directly through to the passengers, charging airlines is essentially a proxy for an end-user charge. Operators in other transport sectors have less ability to pass costs onto end users, which means that the costs are carried by the operators.

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<sup>5</sup> For an example of an overlap, see section 60 of the Railways Act 2005 and section 168 of the Land Transport Act 1998. These two provisions provide for cost recovery of broad functions as 'fees and charges', whereas section 191 of the Maritime Transport Act 1994 and section 42A of the Civil Aviation Act 1990 refer to 'levies' for a similar cost recovery mechanism.

- The risk of over- and under- recovery of costs and cross subsidisation. If costs are not fully recovered, any cross subsidy should be made transparent.<sup>6</sup>
- The impact of new charges or changes in charges in the context of the range of government charges that a fee/levy payer may face.
- Whether the funding model creates the right incentives. For example, a service audit could be attributed to an individual operator and charged as a fee for service. However, an audit fee imposed on individual operators based on regulator time creates incentives for operators to seek to avoid audits or push for them to be undertaken quickly. This pushes against an objective of an audit, which is to provide an opportunity for the regulator and the operator to work on what “good” looks like for that operator. In this circumstance, the cost may be better treated as a levy funded club good.
- It is possible to fund capital or operational expenditure out of regulatory charges, but this needs to be transparent, and care must be taken to not double charge. For example, if a capital injection or an agency’s retained earnings is proposed to fund the capital expenditure (e.g. a new register), then the annual depreciation of the resulting asset is charged to fee payers. Alternatively, a positive historic account balance from a fee or levy class may fund the capital expenditure, but if so, the depreciation of the resulting asset cannot also be charged to fee payers.
- The need to:
  - Demonstrate a clear line of sight between activities, services, costs and outcomes.
  - Define the outputs and business processes/systems required to achieve the desired policy outcomes – this includes setting out the direct, indirect and capital costs to produce outputs. A robust cost allocation methodology should also be included.
  - Ensure that new or amended charges are simple, predictable and inexpensive to administer.
  - Provide robust analysis of cost drivers (volume data and other information that assists in developing a picture of how costs are changing over time).
  - Collect (on an ongoing basis) service performance data to improve understanding of cost/time and quality relationships.
  - Set out information (strategies and plans) that support understanding of likely service pressures or changes to inform better forecasts.

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<sup>6</sup> Cross-subsidies between different classes of user for a private good (e.g. a licence fee that recovers the cost of providing a licensing function) is not appropriate, because the users are paying more than the cost of provision of the service.

## The principles are likely to result in these outcomes

Function	Type of good	Funding source	Rationale
<b>Regulatory settings/ framework, and significant policy.</b>	Public good	Crown funding	<b>Ministry activities</b> such as advice on system design and structural change, policy development, legislation/regulation are more likely to be public goods. <b>Regulator involvement</b> in supporting these activities is more likely to be a club good.
<b>Other rules and standards' development and implementation</b>	Club good	Participant group funding	<b>Regulator activities</b> such as the development of technical/ operational rules and standards for a sector lends itself more to those who benefit from participation and/or create the risks.
<b>International conventions</b>	Public good/ Club good	Crown and participant group funding	Some international engagement, particularly strategic engagement will deliver a broad range of outcomes and international reputation, and so can be a public good. However, some international rules benefit an identifiable part of the domestic industry e.g. operational and technical areas.
<b>System oversight and repair (includes regulatory stewardship and monitoring and evaluating the regulatory system)</b>	Public good/ Club good	Crown funding and participant group funding	<b>Transport system regulatory stewardship</b> is more likely to be a public good. <b>Agency-specific</b> regulatory delivery is more likely to be a club good.
<b>Operational policy functions, including service design</b>	Club good	Participant group funding	System costs should be allocated to groups of beneficiaries and risk exacerbators.
<b>Education and information functions</b>	Club good	Participant group funding	System costs should be allocated to groups or beneficiaries and risk exacerbators.

Function	Type of good	Funding source	Rationale
<b>Service delivery and compliance (e.g. audits)</b>	Club good/ Private good	Participant group funding and user funding	Direct costs of services should be included in the user fees, but if there are concerns about incentives, then costs are spread to risk exacerbators and beneficiaries.
<b>Licensing and registration</b>	Private good	User funding	Costs should be paid by recipients of the service.
<b>Dispute resolution and adjudication</b>	Public good/ Private good	Crown Funding for Courts and tribunals, supported by filing fees etc. User funding for administrative costs	The Crown traditionally funds the Court system, with some elements of user pays for direct administrative costs.
<b>Regulatory monitoring, intelligence, compliance and enforcement activity</b>	Club good	Participant group funding	Users benefit from a properly regulated system (club good).  There may be some cases, however, where regulators re-coup costs where significant enforcement action is required.
<b>Incident response and coordination</b>	Club good/ Public good	Participant group and Crown funding	Benefits to the public and for international reputation for tourism, trade, security and environment are generally Crown-funded. System costs are allocated to beneficiaries and risk exacerbators as a participant group.

## Appendix – Treasury and Office of the Auditor-General Guidelines

### The Treasury: Guidelines for Setting Charges in the Public Sector

The Treasury has developed a guidance document to assist government agencies in designing and advising on cost recovery regimes and to effectively manage and monitor cost recovery. As part of designing a cost recovery regime, government agencies should consider the following key principles:

- **Authority:** does the public entity have legal authority to charge a fee for the goods and services provided?
- **Effectiveness:** is the level of funding fit for purpose? Are resources allocated in a way that contributes to the outcomes being sought by the activity?
- **Transparency:** is information about the activity and its costs available in an accessible way to all stakeholders? Including managing and monitoring the regime.
- **Consultation:** Has stakeholders been engaged in a meaningful consultation with opportunities to contribute to policy and design of the cost recovery activity?
- **Equity:** Will stakeholders be treated equitably? Has the impacts of the cost recovery regime been identified, including impacts over time?
- **Simplicity:** is the cost recovery regime straightforward and understandable to relevant stakeholders?
- **Accountability:** public entities are accountable to Parliament and the public.

Cost recovery regimes should be reviewed regularly to ensure that they are operating efficiently and that over-recovery or under-recovery is minimised.

These guidelines apply to fees and levies, but not taxes and commercial arrangements.

### The Office of the Auditor-General: Charging Fees for Public Sector Goods and Services

The Office of the Auditor-General has produced guidance intended for all public entities that have statutory authority to charge a fee for the goods and services that they are obliged to provide. The guidance is based on three principles:

- **Authority**
- **Efficiency**
- **Accountability**

In addition to these principles, fees should be set at a level to recover costs. Setting a fee that recovers more than the cost of providing the goods or services could be viewed as a tax and need to be expressly authorised by statute.

These guidelines do not apply to levies, taxes or commercial arrangements.