6 FEES, CHARGES AND LEVIES

Where a fee is charged for access to public goods or services, there are some specific rules about how the charge should be determined. It is important to protect Parliament's right to decide which services should be charged for, and how public resources are to be allocated.

Basic policy

6.1.1 It is government policy to charge for many publicly provided goods and services. This approach helps allocate use of goods or services in a rational way because it prevents waste through excessive or badly targeted consumption. It also makes for easier comparisons with the private sector, promotes competition and helps develop markets.

6.1.2 The norm is to charge at full cost. Some exceptions are noted in box 6.1.

box 6.1: exceptions to full cost charging

- **Subsidised services**: where ministers decide to spend public resources on lowering costs for some or all consumers of public services, eg free prescriptions for children.
- **Taxation**: where Parliament authorises charges above cost, eg vehicle excise duty.
- **Information services**: where charges are generally low or minimal as a matter of policy, eg most freedom of information (FoI) requests.
- Certain discretionary services provided in **competition** with the private sector, where a commercial rate is normally charged, eg letting out public space for private use.
- **Levies**: licences to operate using public goods, often set to recover associated costs such as supervision by a regulator, eg gambling licences.

6.1.3 The guidance in this chapter applies to all charges and levies set by ministers or by an extensive range of public bodies: departments, trading funds, NDPBs, the NHS, non-devolved services in Scotland, Wales and Northern Ireland, and most public corporations. It also applies to charges for goods and services one central government organisation supplies to another; and to certain other statutory charges set by ministers, eg some local government fees. Those setting up a service carrying a charge may find the checklist in annex 6.1 useful.

6.1.4 Central government bodies usually need primary legislation to charge for a service provided to the public since Parliament expects to control use of public resources. Except in the case of commercial services (see section 6.4), if the charge exceeds the cost of supply, the excess must be remitted to the Consolidated Fund. If the excess is significant, the Office of National Statistics (ONS) may classify the whole charge as a tax.

6.2 Setting the charge

6.2.1 Setting a fee for a public service normally[1] requires powers in primary legislation. These powers are usually fairly general, with the fee structure and each fee set in secondary legislation. Prior Treasury approval is required for primary legislation empowering charges. Even if the primary legislation does not call for it, the delegated authorities within which the organisation operates (see paragraph 2.1.5) will often insist upon Treasury consent to charges.

[1] This requirement does not apply to discretionary services: see section 6.4.

6.2.2 In a limited range of cases, it may be possible to rely on secondary (rather than primary) legislation. One such group of cases is implementation of EU legislation. Depending on the policy to be implemented, it may be possible to use secondary orders under s2(2) of the European Communities Act 1972 for the substantive policy and under s56 of the Finance Act 1973 to set charge levels.

6.2.3 In certain other cases, charges can be adjusted where otherwise primary legislation would be necessary by using an order under s102 of the Finance (no 2) Act 1987. Because such orders amend primary legislation, they are unpopular in Parliament and are therefore used rarely. Box 6.2 explains the routine. Use of the s102 procedure often indicates that the fee is classified as a tax.

box 6.2: restructuring charges using s102

- Explicit prior Treasury agreement is essential.
- The order can vary or extend the powers in existing primary legislation by permitting specified factors to be taken into account in setting fees, eg to restructure fees to recover costs not directly related to the current costs of the service, or to recover past deficits.

But

- A s102 order cannot undermine primary legislation, eg it cannot authorise a charge for which no primary legislation exists, nor lift explicit statutory restrictions on which groups of consumers should pay a charge for a service.

6.2.4 When deciding the level of a charge, it is important to define:

- the range(s) of services for which a charge is to be made; and
- how any different categories of service are to be differentiated, if at all, in setting charges.

6.2.5 Normally the same charge should apply to all users of a defined category of service. The policy might be to charge at a uniform rate for all varieties of a service; or different fees may be set for objectively different categories of service costing different amounts to provide. Box 6.3 has some acceptable distinctions. It is often helpful to consult the Treasury as the categories to bear different charge levels are developed. This is essential if the proposed arrangements entail any features which could affect other parts of the public sector or set precedents for them.

6.2.6 Annex 6.2 contains guidance about how full cost should be measured for the purpose of setting charges. Special rules apply to charges for information services: see annex 6.3.

box 6.3: possible ways of setting charge for different categories of service

- Supply differences, eg in person, through the post, over the telephone or using the internet.
- Priority, eg where consumers pay more for a faster, more expensive, service.
- Scale or value, eg where a premium service offers more facilities to the customer than others.
- Structural, where it costs more to supply some consumers with a consistent service.

But not

- Differentiation by different kinds of customer, eg less for personal consumers and more for corporates (unless permitted or required by the primary powers).

6.2.7 Once defined, the full cost of each category of service should be measured realistically and objectively: see annex 6.2. The cost should be estimated, extrapolating past trends and forecasting future consumption patterns. The calculation should take full account of non-cash items eg depreciation, the cost of capital and the notional cost of insurance where applicable. There is some limited flexibility about the charge in any single year, since demand cannot be forecast precisely and it may make practical sense to round charges. But neither factor can justify planning to recover less or more than 100% of costs.

6.2.8 If ministers decide on a financial target short of full cost recovery, there should be a plan to achieve full cost recovery within a reasonable period. If this is not intended, it is important to decide (and document) clearly why and how long any deliberate public subsidy should last.

6.2.9 In general, cross subsidies are not good practice, eg businesses subsidising individuals or large businesses subsidising small ones. They may foster inefficient or wasteful patterns of consumption. Thus they always require explicit ministerial agreement and primary legislation (or a s102 order). And such charges are often classified as taxes.

6.2.10 Charges within and among central government organisations should be made at full cost, including the standard cost of capital. To charge otherwise would risk creating unwarranted subsidies or distorting competition.

6.3 Levies

6.3.1 Compulsory levies, eg licences to operate charged by statutory regulators, or to support industry specific research foundations, are normally classified as taxation. Such licences are justified in the wider public interest and not to provide a beneficial service to those who pay them. The Treasury may allow such bodies to retain the fees charged if this approach is efficient and in the public interest.

6.3.2 As with other fees and charges, levies of this kind should be designed to recover the full costs of the service provided. If the legislation permits, these costs can include the costs of the statutory body, eg a regulator could be empowered to recover the cost of supervision as well as registration to provide a licence. It may be appropriate to charge different levies to different kinds of licensees, depending on the cost of providing the licence.

6.4 Commercial services

6.4.1 Some public sector services are discretionary, ie no statute requires them. Services of this kind are often supplied into competitive markets, though sometimes the public sector supplier has a monopoly or other natural advantage. The key steps to take before setting up such a service are outlined in box 6.4.

box 6.4: setting up a commercial service

- Check whether the service is supplied in a competitive market.
- Establish whether adequate statutory authority exists for undertaking the planned activity.
- Consider whether Estimate authority is required to use public resources to supply the service.
- Agree the required rate of return with the Treasury.
- Obtain Treasury consent for any adjustment to the supplier's financial objective.
- If the intended commercial service is likely to be significant and to endure, tell Parliament of the plan to provide it.

6.4.2 For these services, the charges should be set at a commercial rate, including delivering a proper return on the use of resources acquired with public funds. So the financial target should be in line with market prices, using an appropriate risk weighted rate of return on capital. The rate of return used in pricing calculations for sales into commercial markets should be:

- for sales into commercial markets, in line with competitors' assessment of their business risk, rising to higher rates for more risky activities; or
- where a public sector body supplies another, or operates in a market without competitors, the standard rate for the cost of capital (see annex 6.2).

6.4.3 If a publicly provided commercial service does not deliver its target rate of return, outstanding deficits should be recovered, eg by adjusting charges. Any objective short of achieving the target rate of return calls for ministerial agreement, and should be cleared with the Treasury. In particular, discretionary services should never undermine the supplier organisation's public duties, including its financial objective(s).

6.4.4 It is important for public suppliers of commercial services to respect competition law. Otherwise public services using resources acquired with public funds might disturb or distort the fair operation of the market, especially where the public sector provider might be in a dominant position: see annex 6.4.

6.4.5 Wider markets activities are a special case of commercial services. See annex 7.6 for a fuller discussion.

6.5 Taking stock

6.5.1 As with any other use of public resources, it is important to monitor performance so that the undertaking can be adjusted as necessary to stay on track. It is good practice to review the service routinely at least once a year, to check, and if appropriate revise, the charging level. At intervals, a more fundamental review is usually appropriate, eg on a timetable compatible with the dynamics of the service. Box 6.5 suggests some issues to examine.

box 6.5: reviewing a public service for which a charge is made

- Is it still right for a public sector organisation to use public resources to supply the service?
- Does the business structure still make sense? Are the assets used for the service adequate?
- Would another business model (eg licensing, contracting out, privatising) be more satisfactory?
- For services supplied within the public sector, is there scope to supply others to take advantage of economies of scale?
- Is the financial objective right?
  - for a statutory service (or one supplied to another public organisation) if full costs are not recovered, why not?
  - for a commercial service, does the target rate of return still reflect market rates?
- Can efficiency and effectiveness be improved?
- Looking ahead, what developments might change the business climate?
- Do any discretionary services remain a good fit for the business model and wider objectives?
- Should any underused assets be redeployed, used for wider markets activity, or sold?

6.6 Accounts

6.6.1 As with public expenditure, the resources used in supplying public services and the proceeds of charges should be properly recorded and accounted for. Each service should keep records of its costs and the associated receipts. A memorandum trading account (MTA) prepared in accordance with GAAP and any relevant accounts direction is often a convenient way of doing this. Because MTAs record how the costs and revenues evolve, they help generate the end year resource accounts, whether the operation of the service is consolidated with the parent department's business or not.

6.6.2 The *FReM* discusses audit and reporting of trading funds in more detail.

Annex 6.1 Checklist for setting up new services

Annex 6.2 How to calculate fees

Annex 6.3 Charging for information

Annex 6.4 Competition law