

# **CENTRE FOR ECONOMIC POLICY RESEARCH**

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## **Rejuvenating Financial Penalties: Using the Tax System to Collect Fines\***

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## ABSTRACT

The current system for the imposition and collection of fines in Australia is significantly flawed. Fines are often inappropriately imposed or not imposed, inequitable, have high default rates and are expensive to enforce. This paper suggests an alternative scheme for the enforcement and collection of fines, a Fine Enforcement Collection Scheme (FECS). It is based on the principles underlying the Higher Education Contribution Scheme, which involves the proposition that fines may be paid depending upon an offender's future income.

Though requiring a substantial re-casting of federal/state legal arrangements and an extension of the role of the Australian Taxation Office, the paper argues that such a scheme would increase the appropriate use of fines, be more equitable, improve collection rates and thus revenue to the imposing authorities. Concomitantly FECS has the high potential to enhance the credibility of the criminal justice system overall. If successful, this scheme could be expanded to help enforce a wider range of monetary sanctions.

## 1 Introduction

There are significant problems with the current system for the imposition and collection of fines in Australia. Some of the major difficulties are as follows.

First, in some cases the penalties imposed may not be a true reflection of the severity of offences, or penalties may not be imposed even when apparently warranted. One reason for this is the belief by some judicial officers that fines are inappropriate for some types of offences. Another is the expectation that high fines are less likely to be paid, partly because of the poor economic circumstances of many offenders.

Second, and related to the above, is the unacceptably high prospect that the imposition of “just” fines will be associated with high default rates and that default implies both high personal costs for offenders and high social costs. In the event of default all parties suffer: the offender because it may result in loss of property or personal freedom and the taxpayer who not only foregoes the income from the penalty but has to fund alternative default penalties such as community service or imprisonment.

Third, there are high costs associated with the enforcement of fine default. Non payment requires visits by sheriffs’ officers or police and extra court or administrative proceedings. Following up non-payment of fines is expensive.

In short, the current system for imposing monetary penalties and ensuring that they are paid is significantly flawed. This paper suggests a possible alternative. It involves the proposition that fines could be paid depending on an offender’s future income. The notion is consistent with a general economic policy instrument known as “income related loans”.

The best known application of the idea is the Higher Education Contribution Scheme (HECS), introduced in Australia in 1989 (Chapman 1989). HECS is a system in which those enrolling in higher education are able to postpone the payment of student charges until their future incomes reach a certain level, and has turned out to be a fair and administratively efficient mechanism to collect university charges. There are sound reasons to believe that the principle can be applied sensibly to the collection of criminal

finer. Such a policy might be labelled the “Fine Enforcement Collection Scheme”, or FECS.

## **2 Some theoretical reflections**

The use of monetary sanctions in the criminal justice system can be traced back to Anglo-Saxon times, when the blood feud was abandoned in favour of the levying of a money prize payable partly to the victim (or their relations) and partially to the lord to whom the parties owed obeisance (Fox and Freiberg 1999:362). Though fines and other monetary penalties are the most frequently imposed sanctions, the jurisprudence of fines is an impoverished one. In the history of punishment, the character and meaning of financial penalties is under-theorized.

Today fines are assumed to be minor penalties used for less grave offences. In our view, this placing of fines at the bottom of a sentencing hierarchy mis-specifies its history and under-estimates the possibility of fines being considered equivalent to punishment measured in other metrics of pain. The penal impact of the fine tends to emerge more in its breach than its imposition so that the very high rate of non-compliance with fines, far higher than for any other sanction, is a cause for concern not only for its fiscal implications for governments but for the criminal justice agencies responsible for their enforcement (Freiberg and Ross 1999:158).

Modern sentencing theory tends to place the fine at almost the lowest level of the sentencing hierarchy, but, in principle, so long as the level a fine available to a court is sufficiently high to accommodate the gravity of the crime, there is no reason why it may not be legitimately used as punishment for all imprisonable offences. In theory, there is no reason why any crime, from petty theft to murder, could not be punished through a monetary payment, without any implication that the crime and the sanction were ontologically equivalent.

While it might require a high level of social imagination to be able to quantify equivalence between personal harms and remedies expressed in terms of a universal medium of exchange, this is not an impossible task.

In practice, there appear to be two impediments to the use of monetary sanctions for serious offences, especially offences against the person. The first is that sentences have symbolic as well as utilitarian purposes. The talionic principle that punishments should fit the crime seems to imply that punishments should be drawn from the same register as the crimes they sought to deal with. For long, this has not been the case, and the principle of legal equivalents (blood for money, or for community service) has operated to broaden the acceptable range of legal sanctions.

However, this principle appears to have its limits. Studies by Doob and Marinos (1995) and Marinos (1997) on the interchangeability of punishments found that sanctions vary qualitatively as well as quantitatively. Some punishments are not considered, by either the courts or the public, as “appropriate” for certain offences, and thus will not be used, whatever the objective rationale their application. Fines, they found, were regarded by sentencers as being more appropriate for less serious property or violent offences, but inappropriate for sexual assaults. According to Young (1992:187), this is not because the fine could not deliver an appropriate quantum of pain and suffering, but because it failed to fulfil wider cultural expectations of what punishment ought to be like. It is the wider cultural and symbolic meaning of the sanction that is important, not just its narrow penal value (Freiberg and Ross 1999:154).

The second reason why the fine might not be used in respect of serious offences is that it may never be paid. This would render it a hollow and ineffective sanction, lacking retributive and deterrent power.

### **3 The diversity of financial penalties**

Court imposed fines are only one of a number of financial penalties employed by the criminal justice system. Others include administratively imposed penalties (eg “on-the-spot fines” or infringement notices), compensation orders, costs, payment to court funds to support local charities (“poor box”) and recognisances.

About half of offenders sentenced by magistrates in most Australian jurisdictions are given a fine as their most serious penalty. In New South Wales, in 2001, some 55,000 people were given a fine as their most serious penalty out of the 105,000 adults sentenced

by local courts, with average fine amounts ranging from \$400 to \$600 for most offence types. Others were given fines in addition to more serious penalties. Not all fines result in a formal 'conviction' being recorded. While most fines relate to state or Territory offences, others are imposed for Commonwealth offences, such as social security or Medicare fraud, but are handled by local courts. Fines can be imposed instead of, or in addition to, imprisonment or other sanctions.

Administrative agencies may impose penalties for breaches of their regulations. According to the Australian Law Reform Commission there are over 2,400 federal regulatory penalties in 1,345 federal statutes. There are also numerous state and local authority regulations covering building, public health, pollution, noise and other matters. Many administrative penalties are levied on companies, but individuals may be subject to administrative penalties for matters like breach of quarantine regulations, dumping noxious materials or building unapproved structures.

It is clear that money has become a major currency of punishment in our society but it is its very ubiquity rendering it problematic because monetary obligations may accumulate. When magistrates consider an individual in terms of whether a fine would be appropriate, they might have to take into account his or her other financial obligations such as debts, child support obligations and scheduled repayments (Moore 2003:16).

Paradoxically, at the same time as financial penalties imposed by the state are becoming more pervasive, there is also a trend away from their use in criminal courts. For example, in England and Wales the proportion of offenders fined for indictable offences dropped from 51 per cent in 1989 to 39 per cent in 1994, and to 33 per cent in 2000; this almost exactly matched the rise in immediate custody between 1994 and 1999 from 7 to 13 per cent (Home Office 2001; Moore 2003:13). In Victoria, the fine has almost disappeared as a sanction in the higher criminal courts (Freiberg and Ross 1999:165).

## **4 Problems with the current fine system**

### **Equity**

In theory, sentences for like offences should be so calculated as to impose an equal impact on the offenders who receive them. A fair criminal justice system should attempt

to avoid imposing sanctions that produce grossly unequal effects on offenders with differing resources (Fox and Freiberg 1999:373). Current common law and statutory provisions permit a court to impose a fine lower than that which might otherwise be appropriate to the offence on an offender who is unable to pay the higher amount. However, a fine heavier than that warranted by the gravity of the offence should not be imposed upon a wealthy person, even though this might achieve an equal correctional impact.

A more fundamental problem is that the idea that a particular monetary amount is an appropriate penalty for a given offence is inconsistent with the principle of equal impact. In particular, it should be observed that the financial impact of a given prison sentence varies according to the earning capacity and other circumstances of the offender.

In a number of European jurisdictions, this equity paradox is dealt with through what is known as a 'day fine' scheme which involves the setting of penalty units and then adjusting these to the offender's income (see NSWLRC,1996:52; Ireland,1991:para 100). Though often considered by law reform bodies and academic commentators in Australia, this scheme has never found favour with legislatures primarily because of difficulties of access to tax records for verification purposes and the dislike by the courts of variable or sliding scale forms of penalisation.

Other than by taking the means of the offender into account, the courts currently recognise offenders' difficulties in making payment by allowing time to pay or permitting payment by instalments or ultimately by waiving the fine. Recent Irish research illustrates the problem of lack of means. Of those imprisoned in Ireland for fine default, two-thirds were in 'basic' poverty, lacking key items essential for ordinary life, while all of them suffered secondary deprivation (Redmond 2002). An English study identified the major reasons for non-payment as other debts, and changed financial circumstances, with the vast majority of non-payers not having a job (Whittaker and Mackie 1997). Moore's study of 259 English fine defaulters found that 77 per cent of those whose employment status could be ascertained were unemployed (Moore 2003:16). Given the high proportion of defendants in criminal courts which is unemployed, dependent on social security, poor or otherwise disadvantaged, this is an endemic problem.



## **Enforcement mechanisms**

The imposition of a fine, whether by a court or by an infringement notice, means little if payment is not made (Freiberg and Fox 1994:2). The failure to pay fines may undermine the credibility of the criminal justice system both on a specific and a general level. Offenders escaping payment may be less deterred in future and come to believe that they may in future commit similar offences with impunity. Courts may seek alternative sanctions if it becomes known that monetary penalties are unmet and the community might call for harsher penalties as they lose faith in the sanctioning system.

Experience in Australia and elsewhere indicates that difficulties in collecting fines are endemic although there are variations between the different levels of courts and between different kinds of offences. In Victoria, the Auditor-General reported that as of 30<sup>th</sup> June 1997, Victoria had \$324.5 million in outstanding fines, of which only 24 per cent was considered collectible (Victoria, Auditor-General 1998; Storey 2001: 2).

Governments' concern with this problem is evidenced by the fact that over the last decade almost every Australian jurisdiction has reformed or refined its enforcement system (see eg *Sentencing Act* 1991 (Vic); *Fines, Penalties and Infringement Notices Enforcement Act* 1994 (WA); *Fines Act* 1996 (NSW); *Statutes Amendment (Fine Enforcement) Act* 1998 (SA); *State Penalties Enforcement Act* 1999 (Qld)). A considerable body of experience has now developed in relation to fine enforcement indicating that while a majority of offenders eventually pay their fines, a small proportion of offenders prove recalcitrant and it is these offenders who consume the majority of enforcement resources.

Fine default cannot be seen in isolation but must be regarded as part of the broader process of sentencing, enforcement and punishment (Freiberg and Fox 1994:4). Fines must be appropriate to both the offence and the offender. Default can be considered as much a failure of the fining process itself as a failure of the offender. Research into fine default has shown that the initial sentencing process is crucial to the effectiveness of the collection of the fine and to the promotion of voluntary compliance. Compliance with fines is not merely a function of the nature and degree of enforcement but it associated with the total amount of the monetary sanction imposed, including costs and fees (Cole

1992:145). Fines which are set at levels that offenders cannot meet, or which cannot be paid over a reasonable period of time are less likely to be paid than those which are set at levels which are within the means of the offender.

There are three broad legal models for the enforcement of fines: the criminal, the civil and the administrative. Legislation sometimes sets out a hierarchy of measures which must be employed which attempts to ensure that imprisonment is a remedy of last resort.

The criminal model permits courts or their officers to employ a range of sanctions including imprisonment, community work, home detention and curfew orders with electronic monitoring to encourage or coerce the payment of fines. Imprisonment in default of payment has been criticised as being unjust and unfair in relation to impecunious offenders, dangerous to vulnerable offenders, expensive, administratively inconvenient and unduly affecting indigenous offenders. Though community work is considered more constructive and less expensive than imprisonment, program costs have risen as the number taking up this option have risen and such options have the effect of decreasing the revenue obtained from fines. Relatively high breach rates create further problems for program managers.

The sanctions of suspension or cancellation of driver licences are the most rapidly growing means of enforcing fines. They are used in almost every jurisdiction either in relation to vehicle related fines or to fines generally. Such suspensions or cancellations may be imposed by courts or result from administrative action. While much success is claimed by enforcement authorities, there is evidence that a significant number of offenders violate the sanction and that it results in unlicensed (and uninsured) drivers being on the road. It also tends to escalate the default penalties as the punishment for driving whilst disqualified/suspended/cancelled tends to be relatively heavy.

The civil model empowers the criminal courts to use one or more of the civil powers of the court to enforce monetary penalties. These include warrants of seizure and sale, attachment of debts and attachment of earnings. Attachment of income or debts is widely available both for civil debts and fine enforcement and is closest to our proposed FECS scheme. However it is used sparingly for a number of reasons. Many offenders are unemployed, or, if employed, notification to the employer, who must remit the payment

to the court, could result in loss of employment. Many offenders change their jobs frequently. For small businesses, the cost of administering these orders is disproportionately high and employers sometimes resent the administrative burden. (Whittaker and Mackie 1997: ix; Freiberg and Fox 1994:57).

In the United Kingdom there is also a power to attach social security pensions or benefits. Deductions cannot be greater than 5 per cent of basic level income support (Whittaker and Mackie 1997:11). Like our proposed FECS scheme, it provides an interest free loan to the offender. It was expected, when this measure was introduced in 1992, that the number of persons imprisoned for fine default would be reduced, but that did not occur.

The scheme has proved to be difficult to administer. The amount deducted is relatively small (the maximum is £2.70 per week) and some magistrates felt that attachment of earnings orders or deduction from benefit removed the responsibility for paying fine from offender, which lessened the impact of the fine as a punishment. It is also limited in its use because it cannot be used if there are already three other deductions, and many offenders found themselves in such a position, with numerous utility bills and loans to be repaid.

In Australia, deductions from pensions and benefits have not been favoured, partly because they are Commonwealth responsibilities and partly because it has been considered that the amounts that could be recovered in this way might be too small to be significant. There is also an aversion to this technique because it runs counter to the prevailing ethos behind the provision of such benefits.

The administrative model shifts the responsibility from the courts to an administrative agency. Sanctions available to administrative agencies include preventing the offender from renewing or transferring his or her vehicle registration, licence suspension, assigning debts to private collection agencies, seizing personal property, including motor vehicles, placing orders on the offender's bank account and deducting amounts from the offender's wages. In some jurisdictions fines are payable by credit card, which shifts the burden of enforcement on to the card issuing financial authority.

## Collection rates

The major problem with the current system is that it is not effective. If one uses the “aggregate collection rate” (that is, the amount collected by the courts expressed as a proportion of the amount imposed) as a criterion the picture is mixed, at best (Freiberg and Fox 1994: 29ff).

For example, the Victorian Auditor-General noted that as at 30 June 1997, \$324.5 million of fines were outstanding, of which only \$76.1 million was considered collectible (Auditor-General 1998:para 3.4.60). In that year, of the total amount collected or accounted for (\$48.64 million), 81 per cent was settled in cash (\$39.4 million), 10 per cent was “paid” in the form of community work, 2 per cent by imprisonment and another 7 per cent was revoked or written off. 79 per cent of outstanding fines had been unpaid for more than one year.

In this context a 1994 study of court fines imposed in Victoria in 1992 found that there was a 44 per cent recovery rate only. The study examined motor vehicle and traffic offences in particular and found that the lowest recovery rates were strongly associated with offences which indicate fraud or dishonesty, poverty or some form of secondary deviance<sup>1</sup>. The least compliant offenders were those who committed offences involving fraud, failure to provide information to the authorities, unlicensed driving, driving whilst disqualified and having unregistered or unroadworthy vehicles (Freiberg and Fox 1994). These are offenders who are least likely to be located through motor vehicle records, most likely to provide incorrect information to authorities and most likely to move residence frequently. These are the offenders for whom a FECS scheme would be likely to be more effective, provided that the information relating to their (tax) identity was available and reliable

The Victorian Parliament’s Public Accounts and Estimates Committee found that approximately 83 per cent of infringement notices are finalised by the issuing agency, but the remaining 17 per cent required some form of enforcement action (Victoria PAEC 1997:21). The Sheriff’s Office reported that 50 per cent of defaulters located had no

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<sup>1</sup> That is, offences relating to activities by persons who having once been convicted of an offence and sanctioned, have further offended because of the imposition of the sanction, eg being fined for

assets or had protected assets (Victoria PAEC 1997:21). However, many offenders are difficult to locate. 60 per cent of warrants issued were returned as “left address” (p.39). A major problem is that of recidivist offenders. The Committee reported that as at April 1997 there were 3,400 people who had 20 or more warrants issued for infringement notices owing total of \$16.1 million or an average of \$4,700 each. \$96.3 million was owed by 313,000 people, with 1 to 4 warrants, or \$300 each (Victoria PAEC 1997:23). Similar problems are encountered in other jurisdictions.

For example, in Western Australia, 19 per cent of court fines require enforcement action and 5 per cent of infringement notices (Storey 2001:33). In 1996/97 South Australia had a 51 per cent collection rate in respect of court fines and 70 per cent of expiation notices did not require enforcement action.

In England and Wales, the House of Commons Public Accounts Committee reported in November 2002 that less than two-thirds of court fines are collected. In 2001-02, of £387 million in fines imposed, only £228 million was collected, some of which had been imposed in previous years (UK, Public Accounts Committee, 2002; Woolf 2002). In 2000-2001, £74 million in financial penalties, or 19 per cent of the total amount of financial penalties imposed in that year, was written off (Moore 2003:13).

### **Collection costs**

A paradox of fine enforcement is that enforcement action may steeply increase the amount required to be paid, which, in turn, may render it more probable that the fine will not be paid. For example, in Victoria, enforcement action can add another \$64 to a \$100 fine (courtesy letter \$14.60, registration fee \$32.00 and enforcement certificate \$17.40). If a warrant is issued, a further \$79 is added (costs as at 1996).

It is difficult to estimate the cost of the enforcement infrastructure generally. An accurate estimate would include the costs of court officials, such as registry officers, police and sheriffs officials as well as the costs of imprisonment, community service and similar agencies. The only financial estimate of the cost of an enforcement agency comes from Victoria where, in 1998-99, some of the functions of the Enforcement Management Division of the Department of Justice and the Traffic Camera Office of the Victoria

Police were outsourced to LMT Australia, a consortium of Lockheed Martin and Tenix Defence Systems.

The outsourced functions related to the operation of traffic cameras, the processing of fines, collection of fine revenue and responding to public queries regarding fines and managing outstanding fines (Victoria, Auditor-General 2000:para 3.44). The service costs the government about \$30 million per year excluding its own costs of \$19.4 million for internal costs and the costs of managing the contracts (Victoria, Auditor-General 2000:para 3.4.21).

## **5 Income related loans in theory and practice**

### **Introduction**

The essential motivation of this paper is to examine a radically different approach to the collection of criminal fines. This approach entails the use of the tax system to collect fine obligations; fines are then paid depending on an offender's level of income. The model is thus based on an economic policy instrument that is known as "income related loans" (IRL).

An IRL operates as follows. In certain circumstances an individual is able, or required, to incur a debt to the government, such as with respect to the payment of a university charge. The debt is recorded with the taxation authorities and is repaid in the future, with the extent and structure of repayments depending on the level of the individual's income. In the presence of an interest subsidy this arrangement means that in true financial terms debtors with low future income pay back less than do those with high future incomes.

Higher education financing provides an excellent example of the desirability of the approach because, in the absence of government intervention, capital markets will not offer loans to help finance the participation of the poor. There are at least two broad types of government intervention: up-front fees with government guaranteed and subsidised bank loans, and universally available IRLs.

However, government default guarantees for bank loans are expensive because of the relatively high probabilities of default<sup>2</sup>, and this has ensured that they are typically not universally available. Further, there is the problem of moral hazard: government guaranteed default coverage is likely to minimise the effort that banks put into loan recovery, which in turn may lead to default rates that are higher than would otherwise be the case. Finally, some prospective students qualifying for loan assistance will be unwilling to commit to the loan because repayments are required on the basis of time, and are thus not sensitive to an individual's future financial circumstances. Thus in the event of an incapacity to pay, individuals in debt will incur the costs of default.

An alternative approach to the higher education financing problem involves the universal provision of IRLs. This policy has several advantages over bank-subsidised loans. First, since repayment arrangements depend on a prospective student's future capacity to pay, IRLs have no default risks for borrowers. Second, unlike other possible government interventions addressing the higher education financing issue, an IRL scheme can be designed to be progressive in a lifetime income context. The major challenges relate to administration and the collection mechanism, considered further below.

The important conclusion is that - if there is an efficient collection mechanism - IRLs for the financing of higher education have major social, economic and administrative advantages over their alternatives.

### **The history of, and Australia's experience with, HECS**

In 1989 an Australian Labor government introduced a HECS scheme in order to expand the number of higher education places by increasing the contributions from students themselves (Chapman 1997; Edwards 2001). The scheme required that all Australian undergraduates should be required to pay a uniform charge, with the timing and annual level of payment being dependent on future income. It was unique internationally at that time.

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<sup>2</sup> The evidence on default rates from such loans illustrates the associated government costs. For example, Harrison (1995) shows that in the US around 10-30 per cent are defaulted for college, and that the percentage increases to around 50 for two year Proprietary School borrowers.

Since then, schemes of this genre have been instituted in several other countries, including New Zealand and the UK. As well, they have been suggested by the World Bank and other international agencies for a host of others, including Hungary, Namibia, Ethiopia, Rwanda and Indonesia. In Australia, the HECS mechanism was used to extend student income support in 1993 (Chapman 1992) and to cover post-graduate charges in 2002 (Chapman and Salvage 2002).

Labor lost power in 1996, but the incoming Coalition government maintained the essence of HECS. However, in 1997, charge levels were increased by about 40 per cent on average, differential charges by course were introduced and the first income threshold at which former students began to repay their loans was decreased from around \$32,000 to \$21,700 per annum<sup>3</sup>.

### **The effects of HECS on revenue**

In view of the difficulties of enforcing fines and the consequent revenue loss, the potential effects of IRLs on revenue are now examined. Under the HECS scheme, students have the choice of paying their HECS charges upon enrolment with a discount of 25 per cent (explained further below), or through the tax system depending on their future incomes. Figure 1 shows the revenue received by the government from 1989 to 2000, and projections of future payments to 2005.

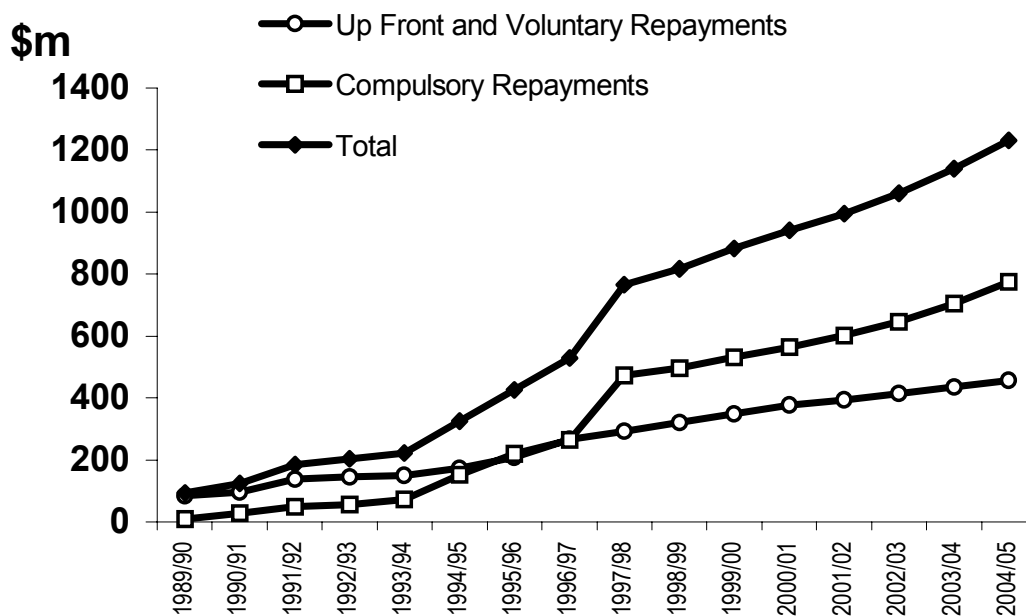
Up-front payments and repayments through the tax system (“compulsory”) are shown separately in the Figure. It is of interest that even in the first year of HECS around \$100 million was raised from up-front payments encouraged by the (then) 15 per cent discount. This shows for policy that the introduction of an IRL scheme can provide substantial revenue to governments quite quickly.

Not surprisingly, repayments through the tax system were modest in the early years of the operation of HECS. This is because very few graduates earned incomes high enough to require repayment. However, tax based repayments increased substantially as more graduates became eligible for repayment, and as a higher proportion and number of graduates faced higher repayment rates as their incomes increased with individual labour market experience.



**Figure 1**

**Actual and Projected HECS Revenue: 1989-2005**



Source: Commonwealth Department of Education, Science and Training.

Taken together, up-front fee and income contingent repayments through the tax system now represent a very significant and growing proportion of the cost of higher education in Australia. In 2001 students provided over \$800 million, which is around 20 per cent of the total recurrent costs of higher education. In 2005 it is projected that this proportion will rise to over 30 per cent.

### **The administrative arrangements of HECS**

The administrative requirements for the efficient collection of HECS are straightforward (even if they did not appear to be so at the time of its design). This is best understood through an explanation of the processes involved in the recording and collection of the

<sup>3</sup> The effects of these changes are analysed in Chapman and Salvage (1997).

debt. It will become clear that while the rationale for HECS and FECS are fundamentally different, there are important lessons for the administration of an income related fines system from the arrangements involved in Australian higher education financing.

When a student enrolls in a university course, they are offered a choice with respect to the payment of tuition charge obligations. One option is to pay the charge up-front, and in this case the student receives a 25 per cent “discount”. It is not truly a discount since there is no real rate of interest on the debt after it is incurred; this means that for many students up-front payments will not turn out to be a financially prudent decision.

The second option is for the student to agree to repay the charge in a way depending on their future personal taxable incomes. In this case the debt is recorded against a student’s unique tax file number and registered with the Australian Tax Office. When the student’s (mostly as graduate’s) income exceeds the first threshold of HECS repayment (currently at \$23,462, and adjusted annually for price inflation) the repayment obligation is deducted from income and the debt is reduced accordingly. Repayments are set as a percentage of annual income, starting at 3 per cent, and increasing progressively with income up to 6 per cent at around \$36,000 per annum. It takes about 10 and 13 years for typical male and female graduates respectively to repay a typical HECS debt (Chapman and Salvage 2002).

Of interest is that there are myriad HECS debt levels. This is due to course charges being different (there are three levels, determined essentially by teaching costs), in part to the fact that course charges vary (there are three levels, determined essentially by course costs), and varying course lengths and completion rates.

These details are of direct relevance to the potential institution of FECS. There will be many different fine levels, due to the heterogeneity of offences and the previous criminal experiences of offenders. These factors are similarly true for individual students’ HECS obligations.

A critical point for policy is that HECS costs very little to administer and collect. At the time of its institution the government paid the universities about \$10 million (in 1989 terms) per year for the costs involved in issuing tax file numbers where necessary, dealing with up-front fee payments, and transferring the individual debt information to

the Australian Taxation Office. As well, it was estimated in the early 1990s that the costs of HECS for the ATO were around \$12 million per year.

Thus, in 2002 dollars, the recording and collection costs would be about \$30 million per year, which is a trivial sum given that the revenue received is currently around \$800 million. That is, administration costs are less than 4 per cent of the annual receipts<sup>4</sup>, important information for the debate concerning the possible efficacy of a FECS system.

## **6 The basis for an income related collection mechanism for criminal fines**

### **The lessons from HECS for criminal fines repaid depending on income**

There are surprisingly close similarities between HECS and FECS. Both systems are designed to minimise the possibilities and costs of individuals defaulting on payment obligations to the public sector. Both systems can be made progressive, in that those with debts with low future incomes pay less. And both systems accommodate easily highly differentiated individual repayment obligations.

Moreover, the administrative costs associated with debt recording and collection are likely to be very low compared to the alternatives. To explain this point further it is instructive to illustrate how such a system might work.

### **How FECS might work**

What follows is not comprehensively developed at this point, and is offered as a possible illustrative example. Imagine that a person is convicted of a criminal offence, for example, an assault or property crime.

The offender<sup>5</sup> would be given the option to pay immediately and offered a discount for so doing. The discount can be interpreted as the requirement that those choosing the pay-later option are implicitly charged a small amount for access to the default-protection inherent in income related collection. As has been noted, if there is no additional real rate

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<sup>4</sup> For a FECS arrangement the relative collection costs are likely to be somewhat higher than this given that the average fine would be a lot less than the average HECS debt.

<sup>5</sup> The FECS option would not be available to offenders who do not hold tax file numbers, such as tourists.

of interest on the debt, this does not necessarily mean that those choosing to pay later pay more (in present value terms); this will depend on their future incomes.<sup>6</sup>

There are no data in Australia which indicate what proportion of fines are paid on the day, but the UK Public Accounts Committee cites British data that between 1.8 and 4.3 per cent of fines were paid on the day (UK, Public Accounts Committee, 2002: para 15). It is likely that the proportion choosing to pay up-front under FECS would be higher than is currently the case, because for some individuals there would be an expected economic benefit from so doing, and this is not so at the moment.

If the offender chooses, the payment obligation may be deferred through the FECS scheme, in which case it is related to future income with set percentages of the debt being collected through the PAYE system. As with the case with HECS, there would be no real rate of interest after the fine is incurred, so the debt would be adjusted to take account of inflation. And again as with HECS, this arrangement means that in effect there is a blunt form of a real interest rate, which operates through the discount for an up-front payment.

The Court will require those taking the pay-later option to provide a tax file number, and against this will be recorded the level of the fine obligation. The use of a tax file number and/or an ABN number for corporate offenders, would obviate many of the problems which bedevil the present system through the provision of false or out of date addresses (UK, Public Accounts Committee, 2002: para 22)<sup>7</sup>. Highly itinerant offenders could be traced through their tax returns or social security payments rather than their ever-shifting abodes, and this would apply wherever they were in Australia. However, The FECS scheme might be as problematic as the present systems in relation to offenders who are sentenced in their absence, unless the court has access to ATO records which allow them to attach the FECS debt without the offender's knowledge or consent.

As with HECS, the ATO will be notified of the debt, which will be adjusted for inflation only, and reduced for instalments paid, commensurate with the future incomes of offenders. The Commonwealth agrees to collect the fine and remit the money to the

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<sup>6</sup> The idea of a discount for early payment is also discussed by the UK, Public Accounts Committee, 2002: para 15.

<sup>7</sup> A UK study found that 96 per cent of the write-offs for fines in 1997-8 were due to an inability to trace or contact the defaulter (cited in UK, Public Accounts Committee, 2002: para 22).

States, and the States would divide the money between various jurisdictions as they choose. In return, the Commonwealth charges the states for the use of the ATO, say about 5-10 per cent of the fine.

In order to be administratively efficient, a FECS system, like the European day fine systems, could exclude low level fines either by providing a floor below which the system would not operate. An offender will be able to repay all or part of the debt at any time during the currency of the order or change his or her payment options. Voluntary payments, which could attract a discount of 15 or the repayment [see HECS Information 2003 para 8.9] could be made directly to the ATO by Bpay, mail, direct credit or in person at Australia Post.

For offenders in wage or salaried employment the employer would deduct obligations in line with the parameters set by government, in the same way as currently happens with income tax and HECS. This raises a possible privacy concern, which could be handled by the offender being offered a period of grace (say, a month) to pay the fine, and if this is not received by the ATO, the employer would then have to be informed of their obligation to deduct the debt.

For insight into what might be appropriate parameters, what follows now illustrates the payment consequences of different scenarios of both debt levels and repayment rules.

## **7 What FECS might mean for offender repayments**

To explore what FECS might mean for repayment obligations of hypothetical offenders we have constructed a series of age earnings profiles with data from the ABS Housing and Income Distribution Survey, 1995, updated for 2002 dollars. Using the weekly wage as the dependent variable and predicting for having no qualification, and by sex, experience (EXP) and experience squared (EXP<sup>2</sup>), we were able to create hypothetical average earnings profiles for unskilled men. The statistical results are shown in Table 1.

This is a very well behaved earnings function, and is comparable to those used in similar exercises related to HECS (Chapman and Salvage 2002). It suggests that relative to unskilled males, those with Postgraduate, Bachelors and TAFE qualifications earn around 60, 52 and 27 per cent more. The coefficients on experience suggest that when unskilled

males have been in the labour force for 10 years, their weekly wages are increasing at around 4 per cent a year.

**Table 1**  
**Log Weekly Wage Determinants**

(Constant)	5.488583**
EXP	0.072489**
EXP2	-0.00157**
Post Grad Qualification	0.607846**
Bachelor Degree	0.522491**
TAFE qualification	0.273803**

\*\*Significant at the .01 level

R2 = 0.31

The wage coefficients allow us to construct an age-earnings profile for unskilled males, the group used in the illustrations of the potential repayment streams for different variants of FECS. Several relationships are shown in Figure 3.

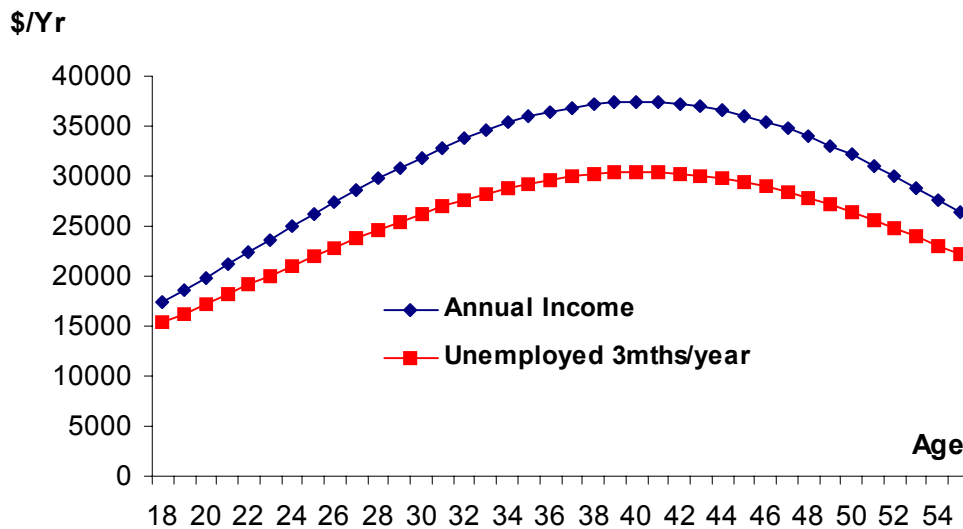
The Figure shows the annual income for unskilled males at different ages for two employment scenarios. The first, represented by the top line, is for full-time workers employed year round and earning the average income by age for unskilled males. The second is for males who earn the average income of unskilled males who work full-time for 9 months of each year, but who receive unemployment benefits (with no dependants) for the other 3 months of the year.

These data can be used to illustrate repayment streams for hypothetical individuals and repayment parameters, for assumed levels of fines. For the latter we note that in 2002 in South Australia the average fine per person was \$578. In the United Kingdom, a recent study of fine defaulters found that their average fine was £465: 12 per cent were ordered to pay more than £1000 and 10 per cent less than £100. With this background it seems

reasonable to assume that average fines per person might be between \$500 and \$1000. However, given the benefits of collecting the debt through a default-protected mechanism such as FECS, fines would be higher than this; accordingly we illustrate the time taken to repay using hypothetical fines of \$750, \$1,000 and \$2,0000.

**Figure 3**

**Age/Earnings Profiles for Males, No Qualifications, 2002\$**



In all cases it is assumed that the offender is an 18 year old unskilled male with the FECS debt repayment rules as follows. First, current HECS repayment parameters (denoted as (a), and also at rates of 3, 4 and 5 per cent of incomes with a first income threshold of repayment of \$12,000 (which just exceeds unemployment benefits for a person with no dependants), denoted respectively as (b), (c) and (d).

For all scenarios the exercises have been done separately for year round workers and for those unemployed for 3 months per year. Table 2 shows the results.

**Table 2**  
**Repayment period for Various Scenarios (years to repay)**

Fine (\$)	750	1000	2000
Year-round Workers	(a) = 5 (b) = 1.3 (c) = 1.1 (d) = 0.8	(a) = 6 (b) = 1.5 (c) = 1.2 (d) = 1.1	(a) = 9 (b) = 4 (c) = 3 (d) = 2.5
<sup>3</sup> / <sub>4</sub> Year-round work, <sup>1</sup> / <sub>4</sub> Unemployed	(a) = 7 (b) = 1.8 (c) = 1.3 (d) = 1.1	(a) = 8 (b) = 2 (c) = 1.6 (d) = 1.4	(a) = 12 (b) = 4 (c) = 4 (d) = 3

The results reveal something very important for the design of a potential FECS system. This is that, for low-income offenders, the length of time taken to repay fines using the current HECS repayment rules are far too long. For example for a fine of \$2,000 it would take nine years for a year-round full-time unskilled male, and 12 years for a similarly qualified male who is unemployed for three months of the year. Current HECS repayment parameters appear to be unsuitable for FECS.

Having 3, 4 and 5 per cent of income repaid, with relatively low levels for the first threshold, offer better prospects for the Courts. At 4 per cent of income, for example, a fine of \$1,000 would take just over one and a half years for even a disadvantaged worker. As well, at this rate, the amount paid per week for this fine level is around \$14 a week, which would appear to be reasonable.

In our view, in order to ensure that an unemployed offender may still be appropriately sanctioned through the fine, the income threshold should be low enough to include some



offenders who receive social security payments for part of a year. This is so long as no deduction, or combination of deductions, is so great as to reduce the person to penury.

## **8 What FECS Might Mean for Fine Revenue**

In the same way that we have attempted to model the implications of the FECS scheme on individual repayments, we also attempt to estimate its implications for the recovery system as a whole. We made assumptions about various parameters and these have been influenced by data provided to us with respect to both South Australia<sup>8</sup> and NSW.

In what follows we present estimates of possible fine revenues from both the current and assumed FECS arrangements. These are based on the following equation:

$$\text{Annual Fine Collections} = \text{AF} * \text{APC} * \text{TO}$$

Where: AF is the average fine per offender; APC is the probability of fine collection; and TO is the number of offenders.

It is assumed that for Australia under the current system, AF, APC and TO are respectively \$600, 0.6 and 200,000.

Given the above, the current system delivers  $\$600 * 0.6 * 200,000 = \$72$  million per year.

Under FECS two parameters change: the average fine per offender increases (we assume to \$1,000) and the probability of collection increases (we assume to 0.8).

Under these scenarios the revenue delivered from FECS is  $\$1,000 * 0.8 * 200,000 = \$160$  million, over two times higher than for the current system. Moreover we envisage that the administrative costs of collection would fall, so in this sense the above estimate differences are understated.

The calculations are illustrative only however, and a wide range of outcomes would be expected. But they highlight the potential for FECS to significantly improve revenue and cost outcomes.

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<sup>8</sup> In this respect we greatly appreciate the assistance provided by Deputy Chief Magistrate Andrew Cannon.

## 9 Federal/state issues

A major issue in implementing a FECS scheme in Australia lies in the complexity of Commonwealth/State relationships. Under our federal constitutional arrangements, Commonwealth, state and territorial parliaments have the power to create criminal offences and regulate criminal procedure (Fox 2002:1). The federal parliament may create offences in relation to matters which it has authority under the Commonwealth Constitution. However, offences against Commonwealth laws are generally heard in state courts which are invested with federal jurisdiction. Fines in respect of offences against a state are enforced under the relevant state law. In respect of offences against federal laws, the *Crimes Act 1914* (Cth), s.15A provides that state laws relating to the enforcement of fines applies to persons convicted within a state of offences against federal laws. State default laws which provide for imprisonment, community service, weekend detention or similar orders can be applied to Commonwealth offences. Though this may result in a disparity of treatment of offenders who have committed an identical federal offence in different states, the expedient of using the states' infrastructure has been used since the beginning of the federation.

Why would the Commonwealth government wish to assist the states and territories in enforcing their own laws when, to date, it has used their laws to enforce its own fines? And even if it were so minded, does it have the power to implement such a scheme?

In relation to the first question, it might be argued by analogy with the tertiary education sector, which is a *state* statutory responsibility, though almost entirely funded by the Commonwealth, that the federal government has an overriding interest in the maintenance of the peace and security of its citizens. Or it might be argued that the Commonwealth has an interest in maximising states' revenues, which might ultimately be adjusted by the Grants Commission. More prosaically, the Commonwealth, through the Australian Taxation Office may see its agency/collection role as a means of increasing its revenue, if it incorporates a profit margin in its collection fee.

The second issue raises complex constitutional issues. Could the Commonwealth, even with the consent of a state, legislate to require a state offender to repay a fine to the state through the taxation system? Section 51(xxxvii) of the Constitution permits the

Commonwealth to make laws in respect of any matters referred to it by a state, and that law need only apply to that state. A state could thus refer a law relating to fine enforcement to the Commonwealth which could then establish a HECS-like legislative scheme. Secondly, the Commonwealth could legislate in respect of fine default by corporations, using the corporations power under s.51(xx).

A more attenuated scheme might see the proposed FECS mechanism used for the interstate enforcement of fines. Currently, the scheme for the interstate enforcement of fines imposed upon natural persons is found in Part 7 of the *Service and Execution of Process Act 1992* (Cth). This scheme enables the courts of the states and territories to assist each other in the enforcement of penalties imposed by the lower courts without requiring them to return the offender to the place where the fine was imposed. A FECS scheme might allow the jurisdiction in which the default occurred to register the default with the ATO and have it enforced through that mechanism rather than seeking the apprehension of the offender around the country.

Should the Commonwealth not wish to assist the states in enforcing their fines, but consider that the FECS scheme has some merit, it could repeal or amend the *Crimes Act 1914* (Cth), s.15A and create its own scheme for the collection of fines imposed in respect of offences against the Commonwealth. Though this is a relatively small group of offences, this approach it might provide a useful trial for a larger system which might be implemented at a later time.

Changes in the nature of the enforcement scheme may have other implications for fine enforcement. Whereas unpaid fines are enforceable against the estate of the offender, HECS debts are cancelled from the period after the date of death. Penalties and fines imposed for offences against federal or state law are not provable in bankruptcy and consequently cannot be discharged in full or in part by any bankruptcy process (Fox and Freiberg 1999:421) whereas any HECS debt held prior to going bankrupt is a provable debt [HECS Information Booklet 2003: para 8.12].

## 10 Implications and conclusion

Restoring the credibility of the fine may have a number of important consequences. First, it may decrease the use of more expensive options such as imprisonment, probation, community service orders and the like, if it comes to be regarded as an appropriately retributive and deterrent sentence. A FECS scheme is not intended to remove the element of pain which inherently attends to the imposition of a punishment, but to distribute it in a temporally different and fairer manner.<sup>9</sup>

Second, it might create a fairer system, in that both poor and the wealthy individuals and corporations might be *appropriately* or *proportionally* sanctioned, rather than having more or less severe sanctions imposed in the expectation that a fine would not be paid. With the prospect of introducing a day fine scheme in Australia appearing remote (see e.g. NSW LRC 1996: 54), a FECS scheme would be distributionally fairer as well as protective of an offender's privacy because it would require only the provision of the offender's tax file number to the courts. The courts would not have access to any financial records of the offender, except their bankruptcy status.

Conflating the fine enforcement system with the tax system may be criticised for turning fines into 'taxes', thereby losing their symbolic value. In practice, most fines are imposed through the infringement notice system and are considered by those who receive them as a form of licence fee for carrying on a business or driving a vehicle. Certainly, most governments are accused of using the criminal justice system as a revenue source. However, whatever the public perception, these fines remain fines under a FECS scheme, which does not alter their essential juridical nature.

A FECS scheme would have major implications for state criminal justice systems. Police, sheriff, prison and community corrections resources would be freed up and allowed to focus upon their primary activities, rather than being diverted to the enforcement of default sanctions. Fewer indigenous offenders might die in custody. In those jurisdictions where enforcement has been contracted out, the scheme might not become fully

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<sup>9</sup> Moore's study found that magistrates consider that a penalty should be painful, though it should not cause unnecessary hardship (Moore 2003:18).

operational until the contracts expire. Specialist fine collection units could be disbanded, saving governments significant amounts of money.

In our view, on simple fiscal grounds, the introduction of a FECS scheme may ultimately produce more revenue to the Commonwealth, the states and local government authorities, though this may take time to achieve. As we have argued, current collection levels range from the acceptable to the abysmal, with many millions of dollars being written off or foregone each year.

A FECS scheme would not guarantee a 100 per cent collection rate, because some offenders can never be located and brought to court, or they might leave the country<sup>10</sup>, or they might fall completely outside the tax and social security network. However, it is a scheme very likely to do better and would likely be cheaper to implement. As with the HECS scheme, in special circumstances to be defined, an offender could apply for remission or deferral of all or part of the FECS debt on the basis that the FECS repayment could cause serious hardship. However, the evidence is that HECS, FECS and other income-related debts are fair and just systems which can arguably be implemented without jeopardising the integrity of the tax system.

Ultimately, should a FECS scheme prove effective in relation to fines, it might be extended to enforce a wider range of monetary sanctions, including costs, civil monetary penalties and confiscation orders, but especially reparation orders, which are notoriously under-enforced (Victoria 1994). In this way, not only the state, but also victims would benefit from this far-reaching reform of this important component of the criminal justice system.

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<sup>10</sup> Although authorities could perhaps handle this by making passports void for individuals with unmet fine obligations.

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