Natural Allies Environmental advocates and consultants

Review of the Revenue Framework for Local Government
Independent Pricing and Regulatory Tribunal
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Revenue Framework for Local Government, July 2008.

We offer some comments that bear on several of the issues identified in your paper.

Local government is an agency of the State Government. It is not independent of the State because its existence depends on the continuing assent of the State as embodied in State legislation. It is directly empowered by the State to act in various ways, and to collect revenues in various ways. Custom and history, and the ambitions of local councillors, have led to the general standing of local councils being perceived by the public - and particularly by participants - as a level of government distinct from the State, and the delegated power underlying all council activities has become blurred. That is partly because the legislative base of local councils in NSW does not directly define any core business of local councils, or provide any clear separation of functions or responsibilities from those of the State or Commonwealth.

> *Definition of the core business of local councils is fundamental to the establishment of a robust revenue framework for local government.*

The existence of a body of elected councillors is often seen as constituting some special expertise in service delivery (as well as reinforcing the notion of local government as a distinct tier of government). In practice, elected members of councils have no special qualifications: they do not necessarily pay rates, nor do they necessarily have any relevant technical knowledge or expertise in public sector finance. They can, however, alert administrations to local sensitivities, and that is probably their most valuable asset in the delivery of many council services, including local planning and development control.

> *Retention of external expert oversight of councils' rate- and loan-raising activity is appropriate to engender and support public confidence in the integrity of council finances.*

Following the 1993 recasting of local government's legislative arrangements in NSW, councils in NSW are empowered to do – generally - what they wish in their own right, using whatever resources they can glean.

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Their activities may include acting directly as agents of the State and/or the Commonwealth Government, with or without provision of all or part of the funding needed to do so. They may also include the provision of services that extend, or duplicate, or are ancillary to services mainly provided by other government agencies, or by the private sector.

Primary responsibility for all council activities must lie with the State, being the source of councils' power, but in practice that is not clear in the public mind or in the minds of councillors themselves.

It is arguable that councils have been excessively adventurous in exercising the freedom of action implicit in the 1993 council charter. While the range of services that councils provide has expanded greatly, the physical infrastructure of their areas has deteriorated to an extent that they and their residents wish no longer to ignore. The deterioration of local physical infrastructure really reflects the priorities that have been – actively or passively – applied to council activities by the elected members and staffs of councils. To attribute the outcome to rate-capping is to miss the point and muddy the water: in reality councils have simply exercised their discretionary prerogatives in allocating their spending.

> *Council priorities in recent times have clearly not been favourable to the construction and maintenance of local physical infrastructure; other activities have been given increasing priority.*

Especially in the realm of human services, councils ostensibly rely for justification of their non-core activities on their perceptions of community demand for such services. But council assessments of community demand are not often accompanied by rigorous – or any – formal assessments of willingness of ratepayers, users, or others to pay for the service provision. When they provide ancillary or supplementary – but essentially voluntary – services that are within the general categories of responsibility of the State or Commonwealth governments, councils assume roles as residual suppliers that are deliberately or accidentally unmet by the primary provider sectors. In recent times, the resources used for those purposes have increasingly included the rate income of councils, together with a level of loan funding.

> *Rates are levied only on rateable landowners. Because there is no obvious linkage with their property base, the burden of providing and funding services that other governments do not wish to provide should not rest with council ratepayers.*

The rate-capping mechanism has elicited constant complaint from councillors and service beneficiaries, but remains deservedly popular with ratepayers. In practice, ratecapping limits councils' expansion of their activities to the extent that those activities are funded from the rate income. If they were otherwise funded, ratecapping would not affect the level of activity in those categories.

> *It is not ratecapping that starves the traditional infrastructure activities of councils. Rather, those activities have been effectively relegated to lesser importance by the councils themselves, as they have diverted available funding to other activities.*

There is an unavoidable and appropriate cost of sustaining a council structure for each area. Arrangements intended to minimise the burden of council rates on

landowners are not unusual, but have impacts on equity beyond those implicit in the use of land values as the basis of rate revenue-raising allocation along landowners.

The 50% legislative restriction of the base charge is a statutory recognition of the base costs of sustaining a council; however, because the 50% is an arbitrary number having no practical basis in an individual council area, it requires a complementary mechanism in the minimum rate. The role of the minimum rate is unduly restricted by the present ratecapping arrangements.

> *Ratecapping should not limit the level of the minimum rate chargeable by councils.*

The diversion of rate income away from the traditional local council tasks of physical infrastructure construction and maintenance into human services has resulted in construction and maintenance backlogs of large proportions. The outcome – but ***not*** the underlying cause - has fuelled loud demands from councils for freeing the rating mechanism from the present restraints so that the backlogs can be met, and/or for the return of infrastructure responsibilities to the State (and Commonwealth) governments.

Elected councillors, and many residents, see little electoral advantage or acclaim in the provision of public infrastructure to an amorphous and shifting collection of local and non-local users, and much more potential for electoral gain in expenditures for human services where the service delivery is personal and local. Ratepayers as a category have no direct influence in this context, given the fungibility of the council income which (eventually) pays for everything the council does.

> *There is no reason to suppose that councils would alter their demonstrated preferred activity priorities and direct proportionally more funding to infrastructure if ratecapping were removed.*

Ratepayers cannot effectively grapple with the level of aggregation of published accounts and the impenetrability of the management plans of councils in on-the-ground terms. It is not clear that elected councillors can necessarily comprehend them either.

Council rating revenues are not hypothecated by law or by councils to individual services or – more importantly – to specified service categories. Assuming that funds are generally scarce, councils that use rate revenue to fund the provision of a variety of optional (usually human) services which could be funded by users and/or by other levels of government or even supplied by others, effectively divert funding from essential local physical infrastructure services that have no other sources of funding.

The impact of such diversions is abundantly apparent in the increasingly frequent practice of councils to seek – and obtain – Ministerial approval for special rate levies for the purpose of funding basic infrastructure works. This approach camouflages the reality that such infrastructure works have been starved of funds over time because of priorities given – knowingly or unwittingly – by councillors to electorally more popular human services.

> *The present rate-capping mechanism enables and encourages councils' non-core activities to proliferate at ratepayers' expense within the rate-capping limits, while leaving the problems of inadequate basic infrastructure outlays to*

be resolved by Ministerial fiat for above-cap increases and/or loan funding at the added expense of ratepayers or, as councils are now demanding, by direct action by the State and/or Commonwealth governments.

There is a strong argument based on their foundation in land values to support the notion that councils' rate revenues should be directed to their local physical infrastructure activities, that is, to local property services that benefit public and private property. There is rough justice for ratepayers in this concept to the extent that such activities accrue to land values over the long term – those who pay according to their land values can perhaps anticipate some proportionate ultimate benefit. There is rough public understanding of councils' responsibilities in this sphere, at least as far as local roads, parks, drainage, public recreation and public access activities are concerned.

A regulatory framework that restricted council rate revenue outlays to expenditures for local physical public infrastructure would provide an effective discipline on rating adventurism by over-enthusiastic or financially naïve councillors, and would have an inherent logic and an observable outcome.

Many of the rough edges and opaque assumptions of the present rate-capping mechanism would be removed. Councils would regain an authority over the exercise of their quasi-monopoly on rating, but would have to confine their outlays of rate revenues to the local physical infrastructure sphere.

In practice, this would require councils to identify and justify their rate revenue outlays in terms of area-wide infrastructure priorities. By virtue of the necessity of identification of rating revenue and its actual use, councils would be directly and transparently accountable for rating decisions and outlays to the ratepayers who pay for them.

IPART would be an appropriate agency to audit compliance with such a regulatory framework.

Being based on the value of rateable land rather than the net equity of the ratepayer in the subject land, the rating mechanism does not reflect the real, current capacity of ratepayers to pay for services of any kind.

Council rates are not appropriate vehicles for funding community welfare policies.

Rating revenue is not an appropriate source of funding for (optional) human services provided by councils, especially those that are specific to individuals and small categories of the community, whether ratepayers or not. The responsibility for funding of such services properly and equitably lies with the State and Commonwealth Governments, through their broadly based taxes.

There is no obvious justification for councils being required by the State government to fund through the council rating mechanism services that Councils do not themselves provide.

The use of the council rating mechanism to implement levies for non-council purposes, such as fire services and non-local planning services provided by State government agencies, has no logic other than possible administrative economy (and

perhaps opacity of costs). There is no obvious reason why the State cannot itself levy such charges - on landowners if they must do so - directly and transparently.

> *There is no obvious reason why individual councils should not be free to charge users of their general services according to their costs of service provision.*

If uniformity of council charges for particular services is desired by the State, ratepayers in individual councils might reasonably query why they should bear the burden of that State policy. The appropriate approach for the State would be to fund the burden of equalising charges by reference to each council's costs of providing the relevant service.

> *The imposition by the State of uniform maximum fees for local development application assessments by councils defies the realities of the cost variations between councils for provision of these services. It generates ratepayer subsidies for developers in the more costly council areas, and penalises developers in the less costly areas, but to no obvious public benefit, and with some obviously perverse social impacts.*

There is a common perception that councils can and should resort to loan funding when they wish to pursue activities that cannot be funded in the current rating scenario. Inter-generational equity is often cited as a justification for such loan funding.

That approach fails to recognise the reality that loans can extend the activity reach of a council on a one-time basis when they are taken up and expended, but they restrict the activity reach of the council in all subsequent years as the interest and repayment obligations are serviced. Current councillors do not necessarily evaluate the practicality that their successors will inherit a budget constrained by debts; they clearly do not convey credit to ratepayers for past expenditures of loan funds.

Ratepayers, over time, can and do see that some – or much – of the rate income of an indebted council is effectively sterilised by the need to service old debt. This does not sit well with current works priorities as perceived by ratepayers, or (usually) the community at large. The theory of inter-generational equity sits badly with the reality of council rate expenditures and the reality of council decision-making generally. Only in the obvious instance of patent and unforeseen disaster is the use of loan funding to extend the range of council activities an acceptable option.

> *Ratepayers have no economic, efficiency, or equity goals to be served by councils using loan funding for works that councils cannot otherwise fund.*

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