



Review of the Revenue Framework for Local Government
NSW Independent Pricing & Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

5 September 2008

Dear Chairman

It is with pleasure that I provide the NSW Independent Pricing & Regulatory Tribunal with the attached submission to the Review of the Revenue Framework for Local Government.

The Insurance Council thanks the IPART for providing the opportunity to lodge the attached submission. Further, if called upon to do so, the Insurance Council would welcome the opportunity of elaborating on any aspect of the submission.

Yours sincerely

A handwritten signature in black ink, appearing to read "Kerrie Kelly". The signature is fluid and cursive, with a long, sweeping tail that extends downwards and to the right.

Kerrie Kelly
Executive Director & CEO



**INSURANCE
COUNCIL**
OF AUSTRALIA

SUBMISSION TO THE NSW
INDEPENDENT PRICING AND
REGULATORY TRIBUNAL
REVIEW OF THE REVENUE
FRAMEWORK FOR LOCAL
GOVERNMENT

SEPTEMBER 2008

INTRODUCTION

The Insurance Council of Australia¹ (Insurance Council) welcomes the opportunity to make the following submission to the NSW Independent Pricing & Regulatory Tribunal (IPART) review into the Revenue Framework for Local Government (IPART LG Review). The Insurance Council's interest in the IPART LG review rests with the recent recommendations made by the IPART in its Review of State taxation (IPART State Tax Review) to reform the NSW Fire Services Contribution system.²

The IPART State Tax Review made the following specific recommendations to the NSW government on reform of the fire services contributions system.

- *In the short term, the statutory contributions by insurance companies to fund fire services should be replaced by a corresponding increase in the contributions by local councils, with a phased implementation and accommodating increases in the municipal rate cap.*

With respect to the above recommendation, the Insurance Council has noted that the NSW government has indicated its willingness to consider the above recommendation in the context of the current IPART LG Review³

The NSW IPART in arriving at the above recommendation, made the following observations on the efficiency of the current fire funding system.

"Insurance duty and fire services funding contributions are arguably the least efficient State taxes. Both these revenue sources penalise those who are prudent enough to take out insurance, and so encourage underinsurance and non insurance. In addition, significant free rider problems are associated with the fire services funding arrangements, where non contributors benefit from the provision of fire services without contributing to the cost through insurance policies".⁴

Moreover, the NSW IPART report also addressed the equity implications of the fire services contribution system and in particular, the horizontal equity issues arising from the ability to avoid fire services contributions through free riding. The Insurance Council strongly concurs with the IPART assessment on the equity implications of the fire services contribution system where IPART observed:

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. 2008 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross premium revenue of \$30.8 billion per annum and has assets of \$90.6 billion. The industry employs approximately 60,000 people and on average pays out about \$83 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

² See IPART Review of State Taxation: Report to the Treasurer (June, 2008)

³ See NSW Treasurer, Minister for Infrastructure, Minister for the Hunter "Media Release: Gov't Welcomes Draft IPART Tax Review" (12 June, 2008)

⁴ See page 44 NSW Independent Pricing & Regulatory Tribunal (IPART) "Review of State Taxation" (June, 2008)

*"The FSL may be seen to be neutral or progressive because it is based on property values (albeit indirectly through house values). However, the opportunities for avoidance and minimisation through underinsurance means its horizontal equity is poor. Those who underinsure or don't insure avoid contributing via insurance policies to the cost of operating the fire services while they still receive the benefit of these services in the event of fire affecting their property".*⁵

Thus, with the above recommendations and policy framework in mind, this subsequent Insurance Council submission to the IPART LG Review should be considered together with, and in the context of, previous Insurance Council submissions to IPART as part of the IPART State Tax Review.⁶ The Insurance Council endorses the conclusions of IPART on the efficiency and equity of the current fire services funding system as outlined in its draft IPART State Tax Review.⁷ The IPART scored the fire services contribution system with a weighted score of 2.2 out of 5, making it the seventh (and second last) tax in its rankings of NSW taxes against the IPART criteria.

Notwithstanding the above, the Insurance Council has noted the responses of local government to the IPART recommendations on fire services funding reform. In particular, the Insurance Council notes that the IPART recommendation raises a number of issues and challenges that extend beyond fire services funding to take in the regulations regarding revenue raising by local government. With this in mind, this Insurance Council submission seeks to address some of the concerns of local government and to inform the debate as to how the IPART recommendation could be effectively implemented.

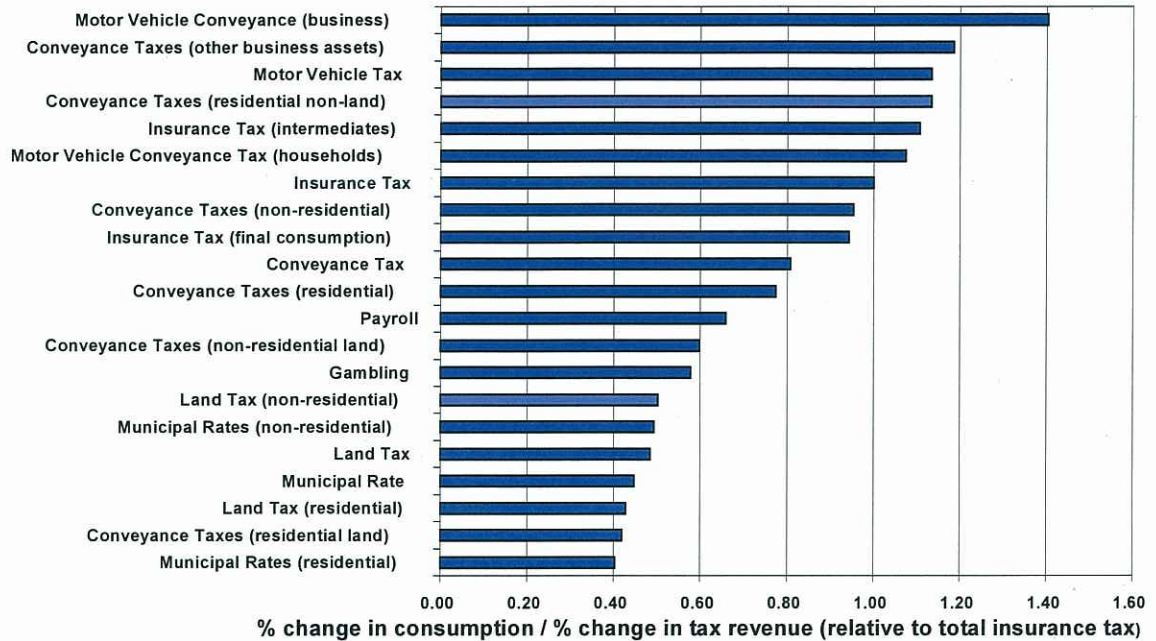
In its submission to the IPART State Tax Review, the Insurance Council drew attention to the relative inefficiencies of State insurance taxes, including the current system of fire funding through statutory contributions. The Insurance Council presented to the IPART efficiency rankings of various State taxes, including local government municipal rates. These rankings, developed by Access Economics and presented below indicated the relative inefficiency of insurance taxes vis-à-vis other taxes and also highlighted that municipal rates provide a highly efficient tax source.

⁵ See page 66, NSW IPART, "Op Cit"

⁶ See Insurance Council submissions to the IPART Review of State Taxation dated 11 July 2008 and 23 November 2007 and available at <http://www.ipart.nsw.gov.au/submissions.asp?industry=5&inquiry=142>

⁷ See in particular the IPART assessment of the fire services contribution system at pages 65 – 66 of the Draft Report.

Relative Efficiencies of State Taxes Vis A Vis General Insurance Taxes



Source: Access Economics 2008

Following the appropriate assessment of the fire funding contributions system according to the criteria of efficiency, equity, transparency, simplicity and revenue adequacy, IPART recommended the transfer of fire services funding away from the insurance sector to local government. The IPART conclusions on the fire funding contribution are well articulated at pages 65 – 67 of the IPART State Tax Review report and do not require elaboration here.

In turn, IPART recommended that:

In the short term, the statutory contributions by insurance companies to fund fire services should be replaced by a corresponding increase in the contributions by local councils, with a phased implementation and accommodating increase in the municipal rates cap.

The IPART recommendation subsequently raised a number of responses and submissions from local government. The issues raised by local government can be summarised as follows:

- Concerns over how the IPART fire services contribution system would impact on local government costs and expenses, including the administration and collection of any charges.
- The effect of the NSW government's rate capping policy and how the absence of relief in rate capping would hinder the effective implementation of the IPART recommendation.
- The importance of transparency in the presentation to rate payers in the event that responsibility for collecting and administering the charges associated with the funding of the NSW fire services were to be transferred to local government.
- Concerns over the administration, equity and transparency of the current local government fire contributions system and how this will translate over into any new system.

The Insurance Council also notes that the NSW government referred the IPART recommendation on fire services funding to the current inquiry into the local government revenue framework. Accordingly, it is foreshadowed that the above issues will also again be canvassed in the context of the IPART LG inquiry. With this in mind, the Insurance Council offers a pathway for implementing the IPART recommendation.

A PATHWAY TO REFORM

A Pathway for Implementing the NSW IPART Recommendation

The Insurance Council contends that there are a number of possible pathways to achieving a migration of fire services funding away from the current insurance-based model, notwithstanding that the overarching system proposed would remain the same for each. The proposed new system for fire services funding is outlined below, along with a discussion of the relative merits and disadvantages of each option.

Step One - Settling the Fire Services Total Funding Requirement – A Role for IPART

As a first step to reform, the Insurance Council submits that the total fire services funding required each year would be assessed independently by IPART - currently the prerogative of the Minister responsible for the fire services with the concurrence of the Treasurer.⁸ This assessment would involve an annual review of the operations of each station within each fire district to ensure the level of services provided appropriately reflected the corresponding district's needs. In instances where this was not the case, IPART would make recommendations for reallocating resources. Under this approach, local government would also be in a position to petition IPART as appropriate.

The Insurance Council acknowledges that the expanded role for IPART represents a significant departure from the current approach wherein fire services budgets are determined by the services in concert with the Minister of the day. The Insurance Council strongly holds the view that an approach that includes IPART would have the benefit of:

- Allowing interested parties and stakeholders to participate in the process of determining appropriate service levels and corresponding district needs;
- Provide greater transparency and understanding as to the relative costs and benefits of the NSW fire services;
- Provide the opportunity to assess the performance of the NSW fire services according to the appropriate benchmarks;
- Ensure that the benefits of the NSW fire services are equitably shared and that the distributional implications of the NSW fire services are articulated and shared.

It is proposed that once IPART have completed the review process, and the overall funding requirement is assessed, IPART would also play a role in determining the allocations to be paid by the NSW Government and each local authority on its own account. This process will be informed by the review process and will seek to ensure that the costs payable by the parties adequately reflect the benefits and service levels enjoyed.

⁸ See Section 45 of the *NSW Fire Brigades Act 1989* and Section 103 of the *NSW Rural Fires Act 1997*

Following the determination by IPART of the overall aggregate funding required and the distribution of that funding, the next step is to recoup these aggregate assessments from households and businesses. This is articulated below.

Step Two – Recovery from households and businesses

In the approach outlined above, at the conclusion of the IPART process, local government would receive an aggregate funding requirement, to be raised from the corporate and residential sectors in each local government area. This determination would take into account the following:

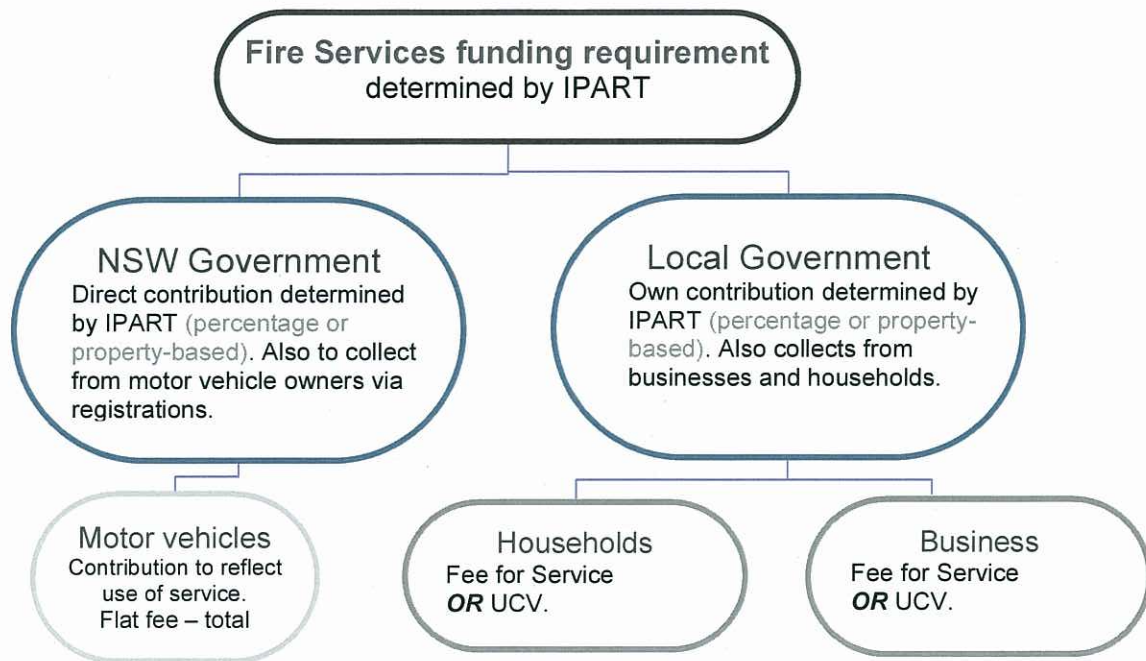
- To whom services are being provided and in what proportions, particularly where more than one local authority is serviced by an individual station or there is evidence of duplication;
- The relative adequacy of services provided in each council area including the assessment of service gaps;
- The relative risks and requirements of each council area including land use, density, activity type etc;

Following this IPART determination, it is suggested that a fire service levy be recovered from households and businesses in one of two ways. These would be:

- as a percentage of the unimproved capital value (UCV) of each property (along similar lines to the WA model) *or*
- as a *Fee-for-Service*, adjusted by a fire risk factor for each class of property and for each fire service region (along the lines of the Queensland model).

Under each of these options, described in more detail below, any fire levy recovered would be determined either by individual local authorities or by IPART. Nevertheless, the flexibility of the UCV model would sit most naturally with local government setting the charge, and the administratively detailed, *Fee for Service* model would rest more comfortably with IPART taking a further role. Both approaches would see fire services funding being collected from NSW households and businesses by local government on behalf of the NSW government and incorporated into the local authorities' rates notices.

A schematic outline of the pathways is outlined overleaf.



An Unimproved Capital Value (UCV) Model along the lines of Western Australia

In the event that fire service levies were to be based on the unimproved capital value of land along the lines of Western Australia, this would involve determining levies according to:

- property values within each local government area;
- area-level ratings (based on available services);
- land use factors;
- minimum and maximum charges; and
- the desired exemptions.

South and Western Australia provide examples of States using this method of service levy assessment. In both these States, the levy is collected by local government.

The Western Australian Approach

The model adopted by the WA Government in 2003 best illustrates this approach. Under this model, there are five Emergency Service Levy (ESL) area categories. For each of these, the fee payable is determined by applying an ESL rate to a property's Gross Revenue Value (GRV). The rate reflects the type and level of fire and emergency services available to a property. Properties with more services available to them will contribute more. For example, in 2008-09 the ESL charge for properties located in ESL Category 1 (the Perth metropolitan area) is \$0.0117 per dollar GRV, while in category 4 regions (covering 90 regional towns) the rate is \$0.0041 per dollar GRV. There is a minimum charge of \$40 and a maximum charge of \$125 per household. For non-residential properties, the minimum and maximum charges are \$40 and \$125,000 respectively. Vacant land is not exempt.

Properties in ESL Category 5 and mining tenements pay a fixed charge of \$40.

Pensioners and seniors who receive a rebate on their council rates also receive the same level of rebate on their ESL charge.

The South Australian Approach

The South Australian model also fits best with levies being determined by local government as part of an overall rates assessment. South Australia's system, adopted in 1999, operates along broadly similar lines but is somewhat more complex. In addition to four area classifications there are also seven land use factors. The ESL payable is determined by weighting a basic charge (\$0.0117 per dollar GRV) by the appropriate regional rate and the property use rate.

Concessions are available to pensioners, people receiving an eligible Centrelink benefit and self-funded retirees (with a State Seniors Card).

Nevertheless, as well noted by IPART, adopting a rates based assessment regime would require an adjustment of NSW local government rate caps in the first year of operation or alternatively, an ability to recover through existing provisions in the NSW Local Government Act that allow Councils to recover costs, works or services.⁹

A Fee-for-Service Model along the lines of Queensland

An alternative to an unimproved capital value (UCV) approach would be to recover from households and businesses on a *Fee for Service* basis. In this regard, assessing levies on a fixed *Fee for Service* arrangement would involve the administrative determination of some, or all, of the following elements:

- An assessment of each property's features (such as number of levels in a building, nature of chemicals stored or number of kitchens) within each local government area. This would be used as a proxy for the risk of fire in the respective building or structure.
- area-level ratings (based on available services);
- any minimum and maximum charges payable; and
- any applicable exemptions.

Arguably, Queensland provides an example of this method of service fee assessment. Queensland was the first state to move from an insurance-based assessment system more than thirty years ago. The Queensland model assesses fire services levies according to three factors:

- The region in which a property is situated - there are four classifications for the state – classed A to D;
- The individual property's purpose - there are 16 broad Fire Levy Groups; and

⁹ See Sections 495 and 496 of the NSW Local Government Act 1993

- The size and nature of improvements made to the property - there may be as many as 60 individual sub-categories under each of the 16 broader groups, reflecting, for example, student numbers in a school, levels in a high rise or volume of oil processed at a refinery.

Annual rates in 2008 range from \$18.80 for vacant land in a Class D region up to \$286,293.60 for Fire levy group 16 properties in a Class A region. Pensioners receive a 20% discount.

WHAT IS THE PREFERABLE APPROACH? COMPARING THE UCV APPROACH AGAINST THE FEE FOR SERVICE SYSTEM.

The Insurance Council has set out to review the above systems against the criteria set out by IPART in its State Tax Review. Moreover given that in the context of the current LG Review, the IPART has expressly asked stakeholders as to what should be the ongoing role for IPART, the Insurance Council has also taken upon itself to outline a possible role for IPART in a reformed fire funding system.

The two models have been assessed under the criteria of:

- Efficiency
- Equity
- Role of the Regulator (aka IPART)
- Transparency
- Simplicity, including administrative simplicity

Efficiency

Both reform options represent an efficient approach and in particular, represent a more efficient approach than the current statutory contributions system. This has been confirmed by IPART which has indicated that insurance based fire funding is one of the most inefficient of State taxes.

Equity

Both the UCV and the *Fee for Service* approach have differing equity impacts notwithstanding they both tackle the fundamental equity issue of free riders in the current system.

In the case of a UCV model, concern could be expressed that large landowners or multi tenanted property holders (such as shopping centres, commercial buildings etc) could face additional costs. Nevertheless, the UCV model does allow for flexible adjustments to be introduced between residential and commercial contributions and for exemptions for disadvantaged individuals. For example, the 2004 NSW Public Account Committee Review recommended exploring the adoption of fire risk and/or property use factors to be used to adjust property value-based levies in commercial premises as appropriate. Adopting this arrangement would represent something of a blend between the *Fee for Service* approach and the UCV model.

Moreover, in the event that local government seeks to apply their own rate policies and rating framework there is the scope that similar style buildings across differing jurisdictions may see incompatible fire services funding contributions.

On the other hand, the *Fee for Service* model has the advantage that like for like buildings would play the same levy irrespective of the value of the property. Any variations would be as a result of regional fire risk.

Role of the Regulator (aka IPART)

Under both approaches IPART would play a key role, firstly in establishing the parameters of the proposed new system (once the broad objectives are set by the NSW government) and subsequently in an on-going capacity as the system regulator.

Under either the UCV or the *Fee for Service* model, IPART has a potential role to determine levies payable by individual households and businesses (and, indeed, councils). However, in the case of the UCV model it remains possible for IPART to abrogate its role to local government to allow the local authority to determine its preferred rating approach according to its own circumstances and rating policy. On the other hand, a *Fee for Service* approach would see the IPART playing a role as the fee setter, eliminating any discretion to local government.

Governance, in particular Local Government Governance

In a UCV model, local governments have wider scope and arguably more autonomy. This will come about in two ways. First, local government would have the opportunity to determine service levels in their own jurisdictions by submitting to IPART their desired/needed service levels according to capacity to pay and service preferences. Second, local government will also have the opportunity to apply their own local rating policies and frameworks to the finalised cost of their chosen service provision. A key caveat may be the need to lift the rate cap to allow for the one off adjustment to the new system. In this approach, the IPART would act as the independent arbiter of service levels and will set the appropriate *Fee for Service*.

Transparency

A key concern for consumers, fire services and local government is the transparency of any reformed system. However, the transparency of any reformed system will manifest itself in two ways. Firstly, the transparency of the overall system as it applies to service levels, resourcing and funding limits and secondly, the transparency of the charge used to recover the cost of the system from households and consumers. Although, transparency has been hitherto raised as an issue of concern by local government, this has tended to be focussed on the transparency of the charge itself. The models addressed above attempt to tackle the transparency of the system in terms of both systems and recovery charges.

Nevertheless, there is a risk in the UCV model that transparency is clouded to the extent that local governments exercise their scope to apply their own rate policies and frameworks. For example, in the event that a local government seeks to recover their applicable fire funding obligations through using cross subsidies or other similar style arrangements between households and consumers.

On the other hand, the *Fee for Service* level is the most transparent approach. At the initial level, it still allows for a transparent review of funding and service levels etc and at the later recovery point, the *Fee for Service* obligations can be easily identified.

Simplicity

Both systems are potentially simple to administer and comply with. Nevertheless, it should be clearly noted that a trade off appears to exist so that with the greater the degree of accountability and transparency the greater is the degree of complexity. For example, the Queensland model has some 16 broad Fire Levy Groups, within which there may be as many as 60 individual sub-categories of risk.

In terms of administrative simplicity, both models would make use of local government's rating base and collection systems. In this regard, it would be appropriate to provide a level of support and consideration to local government for the application of these systems.

OTHER CONSIDERATIONS – THE ROLE OF MOTOR VEHICLES

It is appropriate that as the transition to a new fire funding system takes place, policy makers apply themselves to considering what further efficient sources of funding are available for consideration. For local government, efforts to harness support for the fire services from equally equitable locations will assist in mitigating LG obligations.

In this regard, to coincide with the move away from an insurer based approach for fire services funding to recovery from householders and businesses through local government, it is suggested that vehicle owners may also pay a contribution to the fire services through their motor vehicle registration costs. While Access Economics have identified motor vehicle taxes in their current form as being relatively inefficient vis-à-vis other States taxes, the charge on registration should be considered as a *Fee for Service*, rather than a tax. It should be noted that in South Australia such a charge on motor vehicles is applied. The Roads and Traffic Authority (RTA), as an authority of the NSW Government, would be in position to collect and administer such a charge.

The PAC inquiry suggested that the current levy paid by vehicle owners did not appropriately reflect their use of the fire services. In this regard, it would be appropriate for IPART to consider in its overall determination on fire services funding the extent to which motor vehicle owners should contribute to the service in aggregate and in turn what any individual contributions would need to be.

CONCLUSION

The Insurance Council endorses the IPART draft recommendation in its State Taxation Review to abolish the insurance sector statutory contributions to the fire services and to replace such funding with a corresponding increase in the contributions by local governments, with a phased implementation and adjustments in the municipal rate cap. In this regard, the Insurance Council supports IPART's policy framework best summarised in this passage from the IPART State Tax Review Draft report.

"IPART considers that the fire services levy could be replaced by a corresponding increase in the current contribution from local government. Local government would, in turn, increase rates to recover the cost. IPART proposes a phased introduction with appropriate increases in the rate cap to accommodate the shift in funding arrangements. Effectively, this would increase the contribution from all property owners via local government rates. ... In addition to its administrative simplicity, this approach enhances both economic efficiency (by greater use of the comparatively efficient municipal tax base) and equity (by reducing the free-rider feature of the current predominantly insurance-based system)"¹⁰

However, the Insurance Council is cognisant that the IPART recommendation on fire funding has been referred to the IPART LG Review by the NSW government and that several local governments have expressed concern regarding the implementation of the IPART fire funding recommendation. For these reasons, this submission to the IPART LG review has sought to provide a range of possible pathways for successful implementation of the IPART recommendation and an assessment of what these pathways mean for efficiency, equity and transparency.

At the core of this Insurance Council submission is the key role envisaged for IPART in a future system of fire services funding. Although the pathway outlined in this submission is able to be implemented with Ministerial determination of fire funding as per current legislative arrangements, the Insurance Council believes the overall system design would be enhanced with a systemic role for IPART. For these reasons, the Insurance Council would encourage an IPART role in determining the appropriate fire funding requirement using its current consultative processes and after taking into account desired service levels, current service levels, benchmarks etc. An enhanced role for IPART would also include determining the extent to which this funding is recovered from households and businesses.¹¹

The Insurance Council appreciates that migration from the current fire funding contributions system to the model proposed by IPART requires attention and application to managing the transitional issues. Moreover, the Insurance Council notes the concerns of stakeholders in how this transition can be undertaken effectively and as seamlessly as possible. In this regard, the Insurance Council contends that this submission represents a considerable advancement in the debate by providing a pathway for decision makers and in outlining the issues and impacts of the options outlined in the pathway. Moreover, the Insurance Council contends that the pathways outlined in this submission

¹⁰ See IPART "Review of State Taxation: Draft Report to the Treasurer" (June, 2008) page 104

¹¹ Noting that under a UCV model, the scope does exist for local authorities to determine their own settings according to their rating policy and framework. If this approach was to be undertaken, then the existing rate capping regime would need to be modified.

effectively ensure that the IPART recommendation can be implemented and that, with the appropriate collaborative arrangements, reform of the fire funding system in NSW be undertaken.