

Local Government
Association of NSW



Shires Association
of NSW

Submission

To the Issues Paper of the

**Independent Pricing and Regulatory
Tribunal of NSW's Review of the Revenue
Framework for Local Government**

September 2008

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Index

1. Introduction.....	2
2. Executive summary and key positions	2
3. Key questions and subsidiary issues	5
3.1 The role of Local Government, drivers, and relationship with other levels of government.....	5
3.2 Assessment of the current regulatory framework.....	11
3.3 Sustainability, efficiency, financial indicators and performance measurement .	24
3.4 Comments on alternative revenue frameworks.....	27
3.5 Role of IPART in setting rate, charges and fees.....	29
3.6 Framework for setting charges levied by other public authorities	31

1. Introduction

The Local Government and Shires Associations of NSW (the “Associations”) are the peak bodies of Local Government in NSW representing the interests of all 152 general purpose councils, as well as about 13 special purpose councils. Thirteen regional Aboriginal Land Councils are also eligible to be members of the Associations.

The Associations welcome the opportunity to make a submission to the Issues Paper of the Independent Pricing and Regulatory Tribunal of NSW (IPART)’s review of the Revenue Framework Local Government.

The submission provides a summary of the Associations’ key positions and then proceeds to address questions and issues raised in IPART’s Issues Paper.

The Associations refer to the Final Report of the Independent Inquiry into the Financial Sustainability of Local Government in NSW (the “Independent Inquiry”) entitled *Are Councils Sustainable? – Final Report: Findings and Recommendations*. This is a current, comprehensive and independent report that is referenced extensively in our submission.

The Associations also refer to two of their recent submissions which are attached to this submission. They should be considered in conjunction with and are extensively referenced in this submission:

- Local Government and Shires Associations of NSW, Submission to IPART Review of State Taxation - Draft Report, (2008); and
- Local Government and Shires Associations of NSW, Submission to Productivity Commission Inquiry on Local Government Revenue Raising Capacity, (2007).

2. Executive summary and key positions

NSW Local Government is under financial duress. This has been confirmed by the Independent Inquiry which found that around:

- 25% of NSW councils are not financially sustainable under current policy settings;
- 50% are potentially vulnerable; and only
- 25% are in a relatively strong financial position.

A key finding of the Independent Inquiry was that, based predominantly on data from the financial year 2004/05, NSW Local Government had accumulated a huge infrastructure renewal¹ backlog of \$6.3 billion that continues to grow by \$500 million per annum. The Inquiry estimated that Local Government would need to increase revenues by at least \$900 million per annum to deal with the backlog and ongoing renewals. This does not include the additional revenue required for growth infrastructure or to deal with demands for improved services.

There are several, sometimes interrelated reasons for this financial situation, including:

- Rate pegging and other legislative constraints on councils fees and charges;
- The decline in Commonwealth and State financial support for Local Government relative to economic growth (GDP, GSP) and the growth in national taxation revenues;
- The expanding roles and responsibilities of Local Government, a trend explicitly recognised by the Commonwealth Grants Commission, The Hawker Report and other reviews;

¹ Infrastructure renewal refers to capital expenditure for sustaining infrastructure at the existing level of service. It does not capture infrastructure enhancement; i.e. construction of new or upgrade of existing infrastructure to provide new services or increase the level of existing services.

- Cost and responsibility shifting onto Local Government by the State and Commonwealth Government, again a trend recognised by the Hawker Inquiry and subsequently acknowledged by the national *Intergovernmental Agreement Establishing Principles Guiding Intergovernmental Relations on Local Government Matters*, (2006); and
- Deficiencies in Local Government financial and asset management practices.

The central issues that need to be addressed to improve this situation are:

- Defining Local Government's role and establishing a mechanism to allocate functions and associated revenue raising powers to Local government; and
- Improving the adequacy and flexibility of Local Government's revenue base to meet the demands being placed on it.

Any revenue framework needs to recognise Local Government's role as the third level of government responsible for all local matters and can only function effectively if a mechanism is in place to appropriately share public functions and correspondingly allocate funding or revenue raising powers between Local Government and other levels of government.

Such a mechanism is essential to ensure Local Government's revenue base is not eroded through tax creep or the imposition of functions (or funding of functions) extraneous to Local Government's role (cost shifting). The Associations have been calling on the NSW Government to enter into an intergovernmental agreement with Local Government to establish such a mechanism.

Any new revenue framework should also enhance local autonomy, accountability and transparency of local decision making, as well as financial governance.

Therefore, the Associations support the abolition of rate pegging (Option 5 in section 7.4 of IPART's Issues Paper) and the introduction of a long term strategic service and resource planning framework based on objectives agreed upon with the community. The framework should include comprehensive long term financial planning, asset management, and monitoring of financial sustainability. Councils who have implemented this system should not be subject to rate pegging as they will have in place adequate financial accountability and governance mechanisms as well as performance measurement and reporting frameworks ensuring financially sustainable policies and accountability to the community.

The Associations note that the Department of Local Government, through its Integrated Planning and Reporting Reform, is in the process of introducing such a framework. The Association have been working closely with the Department on the development of the Integrated Planning and Reporting framework and support its implementation.

As an interim measure, the Associations support IPART's Option 4 in conjunction with Option 2 (section 7.4 of IPART's Issues Paper). Councils who will not have implemented the new strategic planning system should be subject to a more transparent rate pegging system where the rate pegging limit is calculated using a transparent methodology that takes account of the real cost pressures relevant to groups of councils based on criteria specific to each grouping.

Furthermore, the Associations do not accept that there is a demonstrated case for imposing a regulatory framework on fees and charges that are currently unregulated. The current system is already subject to a high level of scrutiny through public consultation and the political process itself. Also, council fees and charges vary significantly to reflect local circumstances, community needs and priorities and it would be impractical and inefficient to centrally regulate the wide range and number of services and associated pricing policies.

To improve the current revenue framework, the Association also recommend that IPART consider undertaking more comprehensive reviews in the following areas:

- Rate exemptions and concessions;

- Land valuations system as the basis for determining rates; and
- Effectiveness of regulated fees and charges.

Finally, the Associations object to any proposal to extend quasi-rating powers to, share council rates with, or provide rate concessions to, property holding state owned corporations which are responsible for providing specific services in their area. Such proposals are flawed in that they fail to comprehend the nature and purpose of council rates as a form of taxation with no nexus to a defined service level.

3. Key questions and subsidiary issues

The following sections address most of the questions raised in IPART's Issues Paper. IPART has raised a number of key questions and, throughout the Issues Paper, identified a number of subsidiary issues.

3.1 The role of Local Government, drivers, and relationship with other levels of government

IPART questions and issues

- *What is the role of local government and how is it determined (question 1)?*
- *What is the current role of local government and its limits? Where does this role come from? Is it self imposed or is it legislated (subsidiary issue 12)?*
- *What should be the limits on the role of local government (subsidiary issue 13)?*
- *What infrastructure and services do councils currently provide (subsidiary issue 14)?*
- *What infrastructure and services should councils be responsible for (subsidiary issue 15)?*
- *To what extent is there overlap with other levels of government (subsidiary issue 16)?*
- *To what extent do service levels vary between councils in their scope, value and quality of infrastructure and other assets (subsidiary issue 17)?*
- *What factors cause differences between council's provision of infrastructure and services to arise (subsidiary issue 18)?*
- *What demographic, intergovernmental, economic, social, technical and environmental changes are affecting Councils now and their future revenue requirements (subsidiary issue 20)?*
- *In addition to the Pensioner Rebate Scheme, are there any other specific measures that could be introduced to address any social impact issues arising from the regulation of council revenues (subsidiary issue 38)?*

Local Government's role as the third level of government in the Australian federation

The Associations support a system of Local Government in which councils are responsible for governing all matters that affect local communities and that are most appropriately dealt with at a local level.

Facilitating local choices and making decisions on local services through a system of Local Government has a number of key advantages. Local Government has the ability to utilise local knowledge and most appropriately identify and manage local variations in needs, preferences and costs of services. Local Government, being the level of government closest to the communities, is best placed to actively engage the public in the decision making process. Furthermore, democratically elected Local Government has the political mandate to make local choices an administrative system could not be accountable to make.

The notion of making local choices at the local level is captured in the principle of subsidiarity, according to which the lowest possible level of government should deliver public functions, except where higher levels of government can undertake these functions more effectively.

For example, in federal systems, federal government should be constrained to matters that are best dealt with nationally, such as defence, foreign policy, social security, labour markets, or trade and corporate regulation. State governments, dependent on their size, tackle issues with a state-wide or major regional benefit, such as regional roads, public transport, police, prisons, courts, major hospitals and education facilities. Local Government should deal with matters that impact local communities, like local infrastructure (particularly local roads), recreational facilities, parks, local land use planning and development approvals, water supply and sewerage service provision

or waste management. Local Government should also be able to facilitate the increasing community expectations for local health and human services, culture and education.

There are a number of elements required to enable Local Government to fulfil this role, the most important of which are:

- Recognition of Local Government's role in the relevant constitutional instruments specifying it as the level of government dealing with local matters and generally assigning corresponding revenue raising powers;
- A mechanism to allocate specific functions between Local Government and other levels of government to prevent an erosion in the effectiveness of Local Government's revenue framework and to avoid wasteful duplication of service provision and confused responsibilities resulting in a lack of transparency and accountability to constituents; and
- A revenue framework that:
 - Provides the flexibility to deal with varying local needs and preferences as well as the varying cost of performing functions and delivering services and infrastructure;
 - Provides the capacity and flexibility to respond to emerging challenges;
 - Provides for transparency and accountability in local governance;
 - Balances the varying revenue raising capacity of different Local Government areas; and
 - Enhances the financial sustainability of Local Government.

An analysis of Local Government's revenue framework cannot be undertaken in isolation of the role of and allocation of public functions to Local Government. Without recognising Local Government's role and in the absence of a mechanism to allocate functions and associated funding or revenue raising powers, the effectiveness of any revenue framework for Local Government is at risk of being diminished through improper impositions of functions by other levels of government.

The recent discussion to increase Local Government's contribution to the funding of fire services clearly demonstrates the need to consider Local Government's revenue framework in the broader context of its role as the third level of government.²

Local Government does not have expenditure functions in relation to fire services and therefore, according to the correspondence principle of fiscal federalism, should not be required to fund these services through its own taxation revenue.

The requirement to fund functions extraneous to Local Government's role would erode the effectiveness of and the accountability inherent in any potential revenue framework. Other levels of government could make use of Local Government to fund their own activities and so avoid accountability to their taxpayers. Local Government's capacity to fulfil its legitimate role would be diminished and ratepayers would not have awareness of and control over activities of other levels of government funded by them.

Another example of an inappropriate imposition in the current revenue framework is the requirement for Local Government to partly fund mandatory rate rebates for pensioners. Addressing social impact issues through welfare and income support is the responsibility of higher levels of government who are able to spread the cost of such assistance more equitably and efficiently over a broader revenue base. Therefore, welfare and income support such as pensioner rate concessions should be fully funded by the higher levels of government.³

² See for further information and a solution to the funding issues: Local Government and Shires Associations of NSW, Submission to IPART Review of State Taxation - Draft Report, (2008).

³ NSW is the only jurisdiction that requires councils to fund nearly half the cost of these concessions.

There are many other examples of such cost shifting⁴ made possible under the current system that result in an erosion of Local Government's revenue base. Indicative figures from the Associations' cost shifting survey show that cost shifting amounts to around 6 per cent of councils' total income before capital amounts; i.e. about \$380 million in the financial year 2005/06 and \$412 million in 2006/07 for the whole of NSW Local Government.⁵ Other major examples of cost shifting are:

- The lack of adequate State Government funding for local public library operations to contribute to the wider educational and leisure benefits generated outside the jurisdiction of councils; or
- The lack of appropriate revenue raising powers given to councils to fully recover the cost associated with a range of regulatory functions such as companion animals control, contaminated land management, noxious weed control, food safety control, flood management, or a number of environmental regulations.

To strengthen Local Government's role and ensure revenue raising powers and financial assistance are commensurate with agreed responsibilities, the Associations have been calling on the NSW Government to enter into an intergovernmental agreement with Local Government to ultimately develop a set of principles as to how functions and funding responsibilities should be divided among levels of government.

The Associations recognise that general government involves the inherent notion of uncertainty as to individual functions and requires flexibility and the existence of default levels of government in order to address new needs and priorities. Especially given Local Government's diversity with respect to size, geography, climate, or socio-economic circumstances it is difficult to say that every council undertake a particular set and standard of functions.⁶

Therefore, an intergovernmental agreement would not itself determine responsibility for individual functions. However, it would identify a body that will determine, pursuant to a set of principles, which level of government should deliver a particular service in a given scenario and ensure that the level of government which is given the responsibility is also given corresponding adequate funding or revenue raising capacity (allocative agreement).⁷

Whatever the specific functions Local Government is to perform, its revenue raising capacity should also be sufficiently flexible to address emerging challenges in the context of local circumstances. Local Government faces a number of challenges none the least of which are:

- Increasing number and complexity of regulatory and compliance responsibilities;
- Increasing community expectations for local services in the areas of health, aged care and child care, culture, education, and economic development.
- Skills shortages;
- Demographic challenges (ageing population, sea and tree changes);
- Environmental pressures (water management, coastal protection); and
- Pressures in regional and rural areas (supplementing or back-filling state services).

However, under the existing revenue framework Local Government struggles to meet these challenges. Currently, rating is the only taxation measure available to Local Government and accounts for approximately 36% of total revenue in NSW. This narrow taxation base places a severe restriction on Local Government's capacity to raise revenue generally. Further, the rating

⁴ Cost shifting describes a situation where the responsibility for or merely the costs of providing a certain service, concession, asset or regulatory function itself are "shifted" from a higher level of government (Commonwealth or State Government) onto Local Government without the provision of corresponding funding or the conferral of corresponding and adequate revenue raising capacity. This description does not address the question of which level of government should be assigned a particular expenditure function.

⁵ For further information see Local Government and Shires Associations of NSW, *The Impact of Cost Shifting on Local Government in NSW - A Survey of Councils - 2005-06 and 2006-07*, (2008), available at www.StrengtheningLG.lgsa.org.au.

⁶ Independent Inquiry, *Final Report: Findings and Recommendations*, (2006), pages 108.

⁷ Independent Inquiry, *op cit* 6, pages 108f.

base varies significantly between councils, an aspect only partially addressed by the horizontal fiscal equalisation principles of the Local Government grants process. Unlike the Australian Government and state governments, Local Government does not have the flexibility to spread its taxation effort over a suite of taxation tools.

As pointed out by the Independent Inquiry, the current revenue framework, by restricting taxes to property rates and retaining rate pegging and regulated fees and charges, does not support Local Government's role as the level of government dealing with all local issues but constrains Local Government's capacity to a minimalist, i.e. merely property servicing role.⁸

To ensure Local Government can keep pace with emerging challenges and associated increasing demand for service delivery and infrastructure provision, there also needs to be a substantial increase in financial assistance from the Australian Government and the State Government to Local Government. Given the high degree of vertical fiscal imbalance in the Australian taxation system, it is the responsibility of higher levels of government to ensure that allocations to Local Government are commensurate with its roles and responsibilities.

The Independent Inquiry and other studies have demonstrated how grants have fallen well behind economic and national taxation growth. The Associations therefore advocate that the quantum of intergovernmental transfers from the Australian Government to Local Government should increase to at least 1% of total Commonwealth taxation revenue (excluding GST). This would ensure that councils gain access to a revenue stream that grows in line with the growth of the economy and therefore can keep pace with demand for service delivery and infrastructure provision.

Local Government's role and the tax system

The recognition of Local Government as a proper level of government and a clear understanding of its role are also crucial to avoiding an erosion of the effectiveness of Local Government's revenue base resulting from the imposition of taxes upon Local Government's general government activities.

A recent example of the tendency to do so is IPART's recommendation to remove the payroll tax exemption for councils.⁹ IPART also suggests that one model for a tax base for an expanded land tax could be utilising the municipal rates base by adding an additional percentage to the rates collected by local councils.¹⁰

The Associations' view is that Local Government, for its general government activities, should not be subject to taxes of other levels of government. Having said that, the Association recognise the need to apply the general taxation system to separate commercial activities of Local Government in order to achieve competitive neutrality objectives. The Associations note that significant commercial activities, such as water supply and sewerage services, are already subject to payroll tax.

As IPART correctly points out, taxation is the mechanism by which resources are reallocated from the private sector (individuals, businesses and other non-government entities) to the public sector to fund public services.¹¹ The public sector, such as Local Government's general government activities, should therefore be excluded from the general taxation system.

Taxation between levels of government has the negative consequence of resulting in a lower degree of transparency for and accountability to the taxpayer. Taxes imposed on Local Government's general government activities would need to be funded from Local Government's only form of taxation, council rates, without being identifiable to the ratepayer as a contribution to another level of government's general revenue.

⁸ Independent Inquiry, op cit 6, page 12.

⁹ IPART, Review of State Taxation, Other Industries - Draft Report, (2008), recommendation 2.

¹⁰ Ibid, pages 112-113.

¹¹ Ibid, page 48, box 4.2.

Finally, imposing taxes upon Local Government would also challenge the justification of rate exemptions for the State Government and require the establishment of complex and costly reciprocal taxation arrangements. Such transaction cost would present an unnecessary burden on taxpayers.

Revenue framework and local accountability

Any revenue framework for Local Government should also be embedded in a community strategic planning framework that ensures understanding of and support by the community, councillors and council staff of the community's long term goals, the resources required and trade offs involved in achieving them, and the necessity of setting priorities.

The Associations note that the Department of Local Government, through its Integrated Planning and Reporting Reform, is in the process of introducing a framework that will enhance accountability and transparency of local decision making as well as financial governance. The Association have been working closely with the Department on the development of the Integrated Planning and Reporting framework and support its implementation.

According to the Department's reform proposal, councils will be required to undertake long term strategic service and resource planning (10 years minimum) and prepare a community strategic plan based on community goals arrived at through extensive consultation and community engagement. Importantly, the community strategic plan is also to consider the level of resources that will realistically be available to achieve its goals and councils will have to prepare a resourcing strategy outlining how to utilise external and internal resources to achieve them. Internal resources will be identified and managed through long term financial planning and asset management.

The introduction of this new framework will enhance councils' accountability to their community, introduce forward-looking strategic service and resource planning, greatly improve financial governance and reporting, and so ensure financially sustainable policies. It will therefore eliminate any justification for the existence of rate pegging and any other interventionist elements of the revenue framework.

IPART questions and issues

- *To what extent are ratepayers satisfied that councils provide services that are appropriate and delivered effectively and to acceptable standards (subsidiary issue 19)?*

Community views on Local Government

There is generally a high satisfaction of ratepayers with the services provided by councils.

The Independent Inquiry commissioned IRIS Research to undertake a comprehensive survey of more than 900 NSW households to canvass community expectations on the role and responsibilities of Local Government (IRIS Survey).¹² The IRIS Survey specifically asked participants to rank council services and facilities by both their degree of importance and their satisfaction with them. The survey deliberately faced participants with the trade-offs involved in delivering services under a constrained revenue base and explored the community's willingness to pay higher rates and charges for increased service levels.

The IRIS Survey found that even though higher priority was given to highly visible services used by a large population (e.g. local roads, waste management, water supply and sewerage, public areas and environmental management) other services, including human, cultural and educational services, were rated as being of high importance by a majority of respondents. Importantly, the survey found that the community does not want councils to withdraw or curtail any other services (human services, recreation, culture and education).

¹² IRIS Research, Opinion Poll on the Role of Local Government in NSW, (2005); available at www.StrengtheningLG.lgsa.org.au. For a summary see Independent Inquiry, op cit 6, pages 72ff.

In terms of satisfaction, 50% of respondents rated their level of satisfaction as high; 35% as medium; and only 15% as low. The majority of respondents (80%) considered that council services provided good value for money.

Finally, the IRIS Survey found that at large the community does not oppose rate increases when necessary. About 70% of surveyed residents provided a medium to high support rating for the statement 'I would rather see council rates rise than see cuts in local services'. Support for a rate rise rather than service cuts was stronger in wealthier households with incomes \$100,000 and above.¹³

¹³ Independent Inquiry, op cit 6, section 9.3, page 203.

3.2 Assessment of the current regulatory framework

IPART questions and issues

- *How effective is rate pegging and what are the implications for councils and ratepayers (question 2)?*
- *How does the current regulatory framework for council revenue, or any alternative framework:*
 - *Promote the effective and efficient provision of services?*
 - *Enhance the financial sustainability of local government?*
 - *Meet the standard of principles for good regulation and taxation – efficiency, equity, simplicity, transparency?*
 - *Enhance the accountability of local government (question 4)?*
- *How does the current regulatory framework impact on the efficiency of rate setting by councils (subsidiary issue 11)?*
- *What are the implications of the different revenue sources and revenue raising capacities for rate pegging or alternative regulatory frameworks which may be proposed? (subsidiary issue 21)?*
- *What scope is there for councils to make greater use of user charges (subsidiary issue 22)?*
- *To what extent has the control of rates revenue under the rate pegging regime limited overall revenue growth or encouraged greater use of non-rate revenue (subsidiary issue 23)?*
- *Are there any other significant factors affecting financial performance of local government (subsidiary issue 27)?*
- *To what extent does rate pegging affect financial sustainability (subsidiary issue 28)?*
- *How do rate pegging and other constraints on councils' revenues affect the efficiency of councils' operations (subsidiary issue 31)?*
- *If there are negative unintended effects on financial viability [of rate pegging], what modifications or alternative mechanisms would reduce these (subsidiary issue 40)?*
- *To what extent does rate pegging enhance or diminish the revenue raising by local government when assessed against the above criteria for taxation options by altering the revenue mix or enhancing/diminishing criteria such as efficiency, equity, simplicity, and accountability (subsidiary issue 41)?*
- *If variations under Section 508(2) provide for an escalated base for future rate increases under rate pegging, what benefits do councils gain from making application under the alternative Section 508A? (subsidiary issue 32)?*
- *What is the frequency and pattern of individual council requests for special variations to the rate cap (subsidiary issue 33)?*
- *Are rate pegging special variations becoming the norm rather than the exception with local councils and should alternatives to existing rate pegging practices be considered to provide greater certainty for councils and reduce the need for Government approvals (subsidiary issue 34)?*
- *Given the role of special variations and the other revenue sources for local government, does rate pegging effectively constrain the level of rates and total revenues for local government (subsidiary issue 35)?*
- *Should councils be able to achieve a permanent increase in revenue by applying for a special variation (subsidiary issue 36)?*
- *Does rate pegging increase the affordability and/or availability of local government services especially for poorer regions and sections of the community (subsidiary issue 37)?*

Revenue trends

The current regulatory framework needs to be considered in light of the current revenue trends in Local Government.

The Productivity Commission's *Issues Paper – Assessing Local Government Revenue Raising Capacity* demonstrates an upward trend in all categories of Local Government revenue.¹⁴ This is consistent with the findings of the Independent Inquiry which found modest real growth in all categories of NSW Local Government revenue over the period 1995/96 to 2003/04. While maintaining real growth over this period of 21.6%, the Independent Inquiry found that Local Government lagged NSW State Government revenue growth of 30.3%, Commonwealth revenue growth of 30.7% and NSW Gross State Product (GSP) growth of 31.3% over the same period.¹⁵

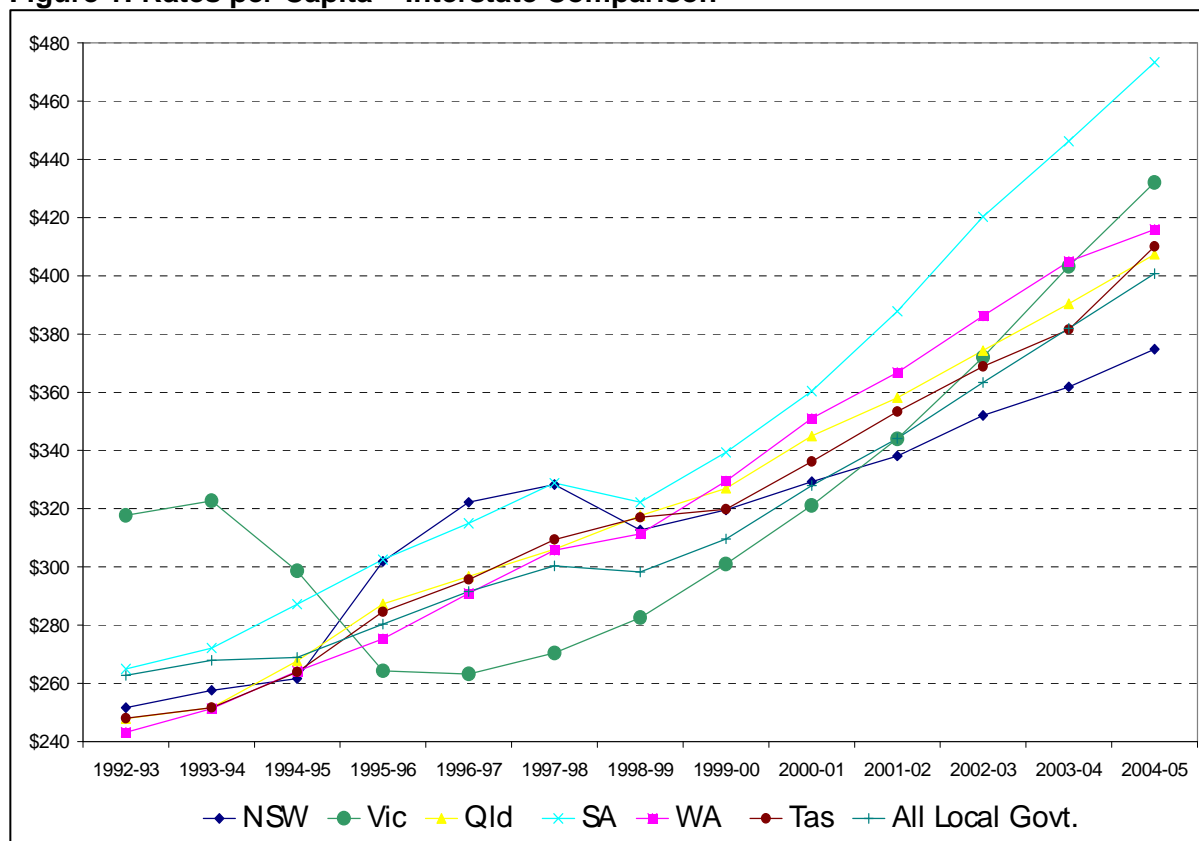
Like the Productivity Commission's *Issues Paper*, the Independent Inquiry also demonstrated varying growth rates for different revenue categories over the period 1995/96 to 2003/04:

- The slowest growth was rate income with real growth of only 0.8% p.a.;
- Grant income grew by only 1.0% p.a.;
- User fees and charges grew by 2.4% p.a.;
- Contributions and donations growth most strongly at 5.4% p.a.

There are several reasons for the differing growth rates.

As illustrated in Figure 1, rates revenue growth in NSW has lagged that of all other states and the Northern Territory during the period and as a result NSW has the lowest rates per capita of any jurisdiction in Australia. This strongly suggests that rate pegging is a major revenue constraint on NSW councils.

Figure 1: Rates per Capita – Interstate Comparison



Source: MAV Viability Index, 2007.

The major component of grant income, the Australian Government's financial assistance grants (FAGs), have grown at a similar rate to NSW rates, marginally exceeding the consumer price index (CPI). This is because FAGs are only escalated in real terms per capita (CPI plus population

¹⁴ Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, (2007), pages 12-15.

¹⁵ Independent Inquiry, *op cit* 6, section 9.2, pages 196-197.

growth) and are not linked to Commonwealth taxation growth or the growth of the gross domestic product.

User fees and charges, including annual charges, have been growing quite steadily in real terms. This suggests a growing reliance on user fees and charges for the provision of goods and services. It would also reflect the growing application of user pays and full cost recovery principles in pricing policies. This is particularly evident in the provision of water supply and sewerage services by councils, where full cost recovery is effectively mandated.¹⁶

Contributions and donations largely consist of developer contributions and, paradoxically, block grants from the NSW Roads and Traffic Authority for regional and local road maintenance.¹⁷ Developer contributions for local infrastructure are collected under section 94 of the *Environmental Planning and Assessment Act (NSW) 1979* (EPA Act) or under section 64 of the *Local Government Act (NSW) 1993* (LG Act) where they relate to water and sewerage infrastructure. The relatively strong growth in contributions revenue is probably explained by two factors:

- The increasing application of user pays and full cost recovery principles; and
- The strong growth in the Australian economy over the last decade reflected in development.

Further information on this issue is available in chapter 9 of the Independent Inquiry's Final Report.

While the longer term data supports the trends discussed above, it should be noted that the Department of Local Government's publication *Comparative Information on NSW Local Government Councils 2004/05* indicates the proportion of revenue derived from contributions and donations had declined from 12.7% to 10.8% between 2002/03 and 2004/05.¹⁸

'Other income' has grown faster than rate revenue or sales of goods and services. 'Other income' includes developer contributions. Developer contributions have been a strong area of growth over the past decade and are likely to be the main driver of growth in 'other income'.

As noted above, rate revenues in NSW have been constrained by rate pegging.

Growth in revenue from sales of goods and services has growing steadily in real terms despite the fact that many fees and charges are regulated under NSW Government legislation. Regulations cover a range of fees including planning and building related fees, health inspections, dog registrations, rating certificates and so on. Regulated fees are only adjusted periodically (3-5 years) and adjustments are usually related to CPI only.

IPART questions and issues

- *To what extent are local governments' expenditure requirements likely to grow in the future (subsidiary issue 24)?*
- *What are the implications of this expenditure growth for rate pegging or alternative regulatory frameworks proposed by submitters (subsidiary issue 25)?*

The Independent Inquiry estimated that, on a no policy change basis, i.e. councils continue to deliver the services they currently deliver and do not respond to additional challenges and functions, revenues would grow in real terms by 8%; expenditures by 9% over the next decade. Taking into account additional functions and pressures, the Independent Inquiry estimated

¹⁶ See below, section 3.5, page 30.

¹⁷ Block grants from the NSW Roads and Traffic Authority, a NSW state agency, are classified as contributions and not as grants from the NSW State Government.

¹⁸ Department of Local Government, *Comparative Information on NSW Local Government Councils 2004/05*, (2006), page 66.

operating expenditure growth to be at least double than the figure estimated for growth on a “no policy change” basis.¹⁹

The Association’s policy position on rate pegging

The Associations maintain that rate pegging is an unnecessary intervention that distorts the operation of the rating system and produces negative consequences. Not the least of which is the direct and indirect suppression of the rating effort.

The experience of other states and territories supports the Associations’ position. While rates have grown more slowly in NSW than in other states in recent years, rates in other states have not increased excessively. This supports the Associations’ view that the political process holds councils accountable.

The effectiveness of rate pegging

If the objective of rate pegging was simply to constrain council rate revenues, rate pegging has been a success. This is clearly demonstrated in the preceding discussion. NSW rate revenue growth is lagging other jurisdictions and other relevant comparative measures. The Independent Inquiry has demonstrated that real rate growth in NSW was negligible over the period 1995/96 to 2003/04.

It could also be claimed that rate pegging has been effective in terms of extracting cost efficiency gains from NSW Local Government. Objective research indicates that NSW Local Government is highly cost efficient and the need to operate within tight revenue constraints may have contributed to this. As noted elsewhere, the Independent Inquiry found strong managerial and administrative capacity and performance in nine benchmarked NSW councils and highly efficient, almost too lean councils in a corporate overheads study with 58 NSW councils.²⁰

While rate pegging may have contributed to this performance, it would be overly simplistic to conclude that it was the sole or even major driver Local Government efficiency. Other factors are also likely to have contributed, not the least of which being the close public scrutiny that councils are subject to. Local Government is highly visible and accountable.

If the objectives of rate pegging include enabling councils to satisfy the growing infrastructure and service demands of the community and enhancing the financial sustainability of Local Government it has been ineffective. This is evidenced by the infrastructure backlogs, funding deficits and prevalence of operating deficits identified by the Independent Inquiry.

Rate pegging provides an incentive not to invest in less visible, less politically sensitive responsibilities (e.g. infrastructure maintenance and renewal) when council is faced with ever increasing community expectations and does not have the option to increase revenue to match them.

Even though NSW councils may apply for special variations to general income which allow for rate increases over and above the rate pegging limit, the Independent Inquiry found that actual increases in average rate revenue only marginally exceeded the rate pegging limit for the period 1995/96 to 2003/04.²¹ This indicates that the rate pegging system has a broader dampening effect than the actual limit.

One likely explanation for the dampening effect is that rate pegging provides a public benchmark and creates public expectations about maximum rate increases, placing political pressure on councils to stay within the limit and not seek special variations.

¹⁹ Independent Inquiry, op cit 6, pages 284f.

²⁰ See below, section 3.3, page 25.

²¹ Independent Inquiry, op cit 6, section 9.3, pages 207-208.

Another related reason is that the rate pegging limit provides an easy default option from both a political and managerial perspective. Possible reasons for this include:

- The increase may be attributed to the State Government;
- Rate pegging alleviates the need for councils to undertake community consultation to justify rate increases within the rate pegging limit;
- Increasing rates within the rate pegging limit avoids the need to enter into the complex process of applying for special rate variations;
- Councils can blame the State Government for their financial deficiencies; and
- Rate pegging reduces the need for long term strategic and financial planning.

In the long run, rate pegging results in the:

- Under-provision of community of infrastructure and services;
- The deferral of infrastructure maintenance and renewal expenditure; and
- Undermining the financial sustainability of councils.

A further criticism of the rate pegging system is that it lacks transparency. There is no official or publicised methodology on which it is based and ultimately it is a political decision. While the rate pegging limit has tended to track CPI over the past 10 years, there have been exceptions and the system is vulnerable to political manipulation.

Another major flaw of the rate pegging system is that it effectively breaks the traditional nexus with land valuation. Land valuations do not drive revenue under rate pegging; they only serve to redistribute the rate burden within council areas.

It could also be considered hypocritical for rate pegging to be maintained on Local Government while NSW State Government land taxes remain uncapped.

The Associations have opposed rate pegging since it was introduced. However, while advocating removal of the system, the Associations have in past promoted the adoption of a Local Government cost index as an interim measure. The Associations developed an alternative model, the *NSW Local Government Rate Determination Model*,²² and presented this to the NSW Government in 2003. The model provided a specific Local Government cost index as the basis for determining the rate pegging limit. This would help ensure that the rate pegging limit would more accurately reflect the actual cost pressures facing councils. As a public index, it would also overcome the lack of transparency associated with the current system.

With the implementation of the Department of Local Government's new Integrated Planning and Reporting framework, the Associations would now see the index based model as a default measure applicable only to councils who have not achieved the new strategic planning and reporting requirements. This is discussed in more detail below.²³

Further information on the issue of rate pegging is available in chapter 9, pages 207 to 211 of the Independent Inquiry's Final Report.

Box section – history of rate pegging

NSW is the only state that currently applies rate pegging. Rate pegging was introduced in response to the prevailing economic and political environment of the mid 1970s and it is doubtful that the concerns of the time are still relevant.

²² Local Government and Shires Associations of NSW, *NSW Local Government Rate Determination Model*, Prepared by the National Institute of Economics and Industry Research, (2003); available from the Local Government and Shires Associations of NSW.

²³ See below, section 3.4, pages 27-28.

An interim form of rate pegging was reintroduced to NSW by the Wran Government in 1977. A revised system, much the same as is currently operating, was implemented in 1978. A form of rate pegging had previously operated in NSW between 1901 and 1952, after which it was discontinued because of its impracticality. The situation had been reached where the majority of councils were successfully applying for an exemption or variation in the limit. This situation was administratively cumbersome and ultimately self defeating.

The incoming Wran government had committed itself to the introduction of rate controls during the 1976 state election campaign. The justification and appeal of rate pegging needs to be considered against the backdrop of the time. The 1970s were a period of rapid social, political and economic change. The pertinent aspect in relation to rate pegging was that the roles of, and relationships between, spheres of government had changed substantially.

The Whitlam Government had established a more direct relationship between the Commonwealth and Local Government. While this involved substantial increases in direct financial assistance to Local Government it was also accompanied by an expanded range of roles and responsibilities. This expansion of the roles and responsibilities of Local Government were also driven by increased community demands and expectations.

To quote Independent State MP John Hatton during the debate on the rate pegging bill:

“The responsibilities of Local Government have grown so rapidly that they have completely outgrown the revenue base and, despite the impetus of money in the form of direct federal grants from the Whitlam Government, which have been carried forward by the Fraser Government, this is still the case.”

At the same time, public perceptions about government were changing, particularly in relation to perceived excesses. While this applied to all spheres, Local Government as the most accessible and familiar sphere of government was particularly vulnerable to criticism.

Most importantly, it was a period of high inflation that impacted on rates through both escalating property values and increasing council operating costs. It was also a period when many believed that wage and price freezes were an appropriate response to inflationary pressures. This view was promptly discredited, however, rate pegging, an analogous concept, is still maintained.

The impetus for the introduction of rate pegging was provided by the rapid escalation of rates in the early 1970s. In the four years, 1973 to 1976, rates increased by an average of 118% while average weekly earnings increased by only 75% and the consumer price index by 56%. Annual increases of between 30 to 40% had been applied in many areas. While this was largely the result of the factors such as expanded roles and responsibilities, it was easy for the public to perceive the increases as excessive.

Interestingly, the argument that rate increases were excessive is not supported by comparison with the revenue growth of other spheres of government. While Local Government general rate revenue increased by 148% between 1970 and 1976, NSW Government revenue increased by 212% and Commonwealth Government revenues increased by 167%. Clearly, Local Government rate increases were quite modest compared to the revenue increases of other spheres of government - a situation that persists today.

Rates are a highly visible form of taxation and because they are presented in the form of bill to be paid annually or quarterly, ratepayers are very conscious of the amount paid and changes from year to year. This is not true of many other major forms of taxation. Bracket creep allows income tax revenues to quietly escalate with little protest by taxpayers and GST revenues escalate in a like manner.

The introduction of rate pegging was also made easier by increases in the level of Financial Assistance Grants by the Commonwealth Government, which many perceived to be a substitute for rate revenue.

In brief, the rationale for the introduction of rate pegging is summarised in the following points:

- It was a period of high inflation and the public were demanding stringency measures;
- Grant funding was (wrongly) perceived as a substitute for rate revenue; and
- Rates increases, unlike many other tax increases, are highly visible.

More recent arguments for maintaining rate pegging include the view that Local Government should reduce its reliance on rate (tax) revenue in favour of user fees and charges for services. Further, the major political parties in NSW appear to believe it is popular and the relevant NSW bureaucracies appear to like to maintain the control mechanism. The experience of other states and territories supports the Associations position that rate pegging is an unnecessary intervention. While rates have grown more slowly in NSW than in other states in recent years, rates in other states have not increased excessively. This supports the Associations view that the political process holds councils accountable.

Principles for a Local Government revenue framework

As indicated above, a revenue raising framework for Local Government should:

- Provide the flexibility to deal with varying local needs and preferences as well as the varying cost of performing functions and delivering services and infrastructure;
- Provide the capacity and flexibility to respond to emerging challenges;
- Provide for transparency and accountability in local governance;
- Balance the varying revenue raising capacity of different Local Government areas; and
- Enhance the financial sustainability of Local Government.

The Associations refute the need for a highly interventionist regulatory framework for Local Government revenues. The Associations do agree that the revenue framework for Local Government should reflect the criteria proposed by IPART; i.e. a framework that:

- Promotes the effective and efficient provision of Local Government services;
- Enhances the financial sustainability of Local Government;
- Meets the standard principles for good regulation and taxation, including:
 - Efficiency;
 - Equity;
 - Simplicity; and
 - Transparency; and
- Enhances the accountability of Local Government.

The legislation that enables Local Government to raise revenue should instil these principles. This should not ordinarily require the State Government to determine increases in rate income, fees or charges. Likewise, the same principles should also be reflected in council rating, fees and charges policies.

Ideally, Local Government revenue policies should be determined by the community. This process should be facilitated through strategic community engagement mechanisms that councils are required to undertake when setting policies and determining corresponding rates, fees and charges and, ultimately, through the electoral process itself.

To ensure an adequate process for the setting of policies and revenue items, the Associations support the Department of Local Government's Integrated Planning and Reporting Project which is to introduce a mandated, integrated community strategic service and resource planning framework supported by long term financial planning and asset management. This framework will enhance

councils' accountability to their community, introduce forward-looking strategic service and resource planning, greatly improve financial governance and reporting, and so ensure financially sustainable policies. This new framework is based on the notion of local autonomy accompanied by strong local accountability. It will eliminate any justification for an interventionist regulatory framework and the existence of rate pegging. The new framework is further discussed below.²⁴

Charges and fees

The current revenue framework for fees and charges has both regulated and non-regulated components.

The Associations do not accept that there is a demonstrated case for imposing a regulatory framework on fees and charges that are currently unregulated. There are several reasons for this including:

- High level of scrutiny: council fees and charges are already subject to a very high degree of public and State Government scrutiny. Councils proposed fees and charges schedules are advertised for public comment as part of the annual management planning process. Any additional changes proposed during the year are also subject to an advertising requirement.
- Reflect local needs and priorities: council fees and charges are typically based on comprehensive policies that reflect local circumstances, community needs and priorities. Different policy criteria may apply to the pricing of particular types of services. Subsidies will often apply where there are equity or public benefit objectives; commercial or market based pricing may apply where the services are subject to competitive neutrality principles.
- Impracticalities of regulation: as a result of the wide range of services that councils provide, a schedule of council's fees and charges will often include hundreds of individual items. Further, the range of services and pricing policies vary significantly between councils. It is clearly an impractical and unrealistic proposition to suggest some form of centralised or prescriptive price regulation under these circumstances.
- Non-essential or non-monopolistic: price regulation is justified where there are monopoly characteristics. The majority of unregulated fees and charges do not reflect these characteristics. In many cases, there will be a private alternative to the council service or facility, for example, a club or hotel may provide an alternate venue to a council hall for a private function. Where monopoly characteristics may exist, it will be commonly found that the services in question are often subsidised for equity and public benefit reasons.

As this submission will discuss below,²⁵ there are probably two major areas where it could be argued that the accepted grounds for regulation may be warranted, namely domestic waste management and water supply and sewerage services. However, both areas are already effectively regulated. The LG Act ensures that domestic waste charges represent only the cost of providing the service and the water supply and sewerage activities of Local Government are regulated by guidelines provided by the Department of Water and Energy. In the latter case the challenge has been to move councils towards full cost recovery, not curtailing monopolistic profiteering, as the political process itself not only provides a disincentive to overcharge but often also an incentive to undercharge where possible.

In relation to other legislatively regulated fees and charges (e.g. planning certificates) it is more a question of whether the regulated fees fall short of cost recovery and thus represent cost shifting onto Local Government (see above for the results of the Associations' cost shifting survey).²⁶ A regulatory measure to ensure that such fees and charges enable Local Government to fully recover the cost involved in performing the related function would be a welcome improvement.

²⁴ See below, section 3.4, pages 27-28.

²⁵ See below, section 3.5, pages 29-30.

²⁶ See above, section 3.1, page 7.

The Associations recommend conducting a review of regulated Local Government fees and charges to determine whether regulation is effective; warranted in all instances; and providing for cost reflective pricing.

A summary of the current policy framework for fees and charges is provided in the text box below.

Box section - Local Government pricing policies

Overall there are 5 general cost treatments for fees and charges available to councils:

- **Legislative cost** – whereby prices are determined by legislation;
- **Zero cost** – whereby Council fully absorbs the cost of the service;
- **Partial cost recovery**- tied to a fee or charge to offset the cost of the service but which has some form of subsidy reflecting equity or public benefit objectives;
- **Full cost recovery** – tied to efficiency and revenue neutral objectives; and
- **Market or competitive pricing** – tied to council business operations and bound by competitive neutrality principles. Council business operations must have cost structures and pricing that does not use its public ownership status to generate a competitive advantage over private providers. For example competitive neutrality prohibits councils from cross subsidising their business services from non-business operations in order to offer discounted business services and undercut private sector competitors.

Fees and service revenues are the main areas where councils can apply varying cost treatments. Section 608 of the LG Act allows councils to charge or recover a fee for any service it provides such as:

- Supplying a service, product, or commodity;
- Giving information;
- Providing a service in relation to council's regulatory functions; or
- Allowing admission to a building or other council owned venue.

In determining which cost treatment is appropriate for each type of service, Councils are guided by principles of "fair imposition" and "user pays". *Fair imposition* principle is contained in Section 8 of LG Act which sets out the council's charter and states that *councils may raise funds for local purposes by fair imposition of rates, charges and fees, by income earned from investments, and when appropriate by borrowings and grants*. The principle of *user pays* is attached to those council services that are made available to the public but not necessarily provided collectively and generically to all ratepayers. Hence payment is sought from the user or direct beneficiary of the service rather than imposing that cost on all ratepayers.

Mindful of these pricing principles, councils commonly split their services and fee treatments into the following categories:

- **Simple revenue services** – such as parking fees and specific "user pays" services
- **Non-business or "traditional" council services** – free or partial cost services associated with community service obligations such as public library services or community venue hire
- **Competitive or business services** – whereby Council services compete with the private sector providers such as building approval services or nursing homes or child care facilities
- **Legislated or exclusive services** – such as charges for council infrastructure access or planning approval lodgement fees tied to exclusive or monopoly service provision by councils

For some time councils have been exploring new revenue opportunities by breaking down their broad service categories into sub-categories with different cost treatments.

For example, a council may provide a free (zero cost) resident membership for local libraries but

charge a partial cost for use of internet facilities and photocopying services, and apply full cost charges for lost or damaged books. Similarly a council may apply the prescribed legislative fee for the issue of a building certificate, a partial cost charge for variations or reissue of certificates, and full cost for the restoration work (i.e. guttering and paving) relating to the approved building work.

A council may also apply differential fees on the basis of the type of service user. For example councils may allow discount venue hire fees for not-for-profit organisations compared with hire rates for private or commercial operators.

While Councils have the discretion across these areas to set fees and charges, under section 610F of the LG Act, a council must not determine the amount of a fee until it has given public notice of the fee and considered any submissions. In addition there are transitional, disclosure and review requirements imposed on ongoing fees and charge arrangements. Through these mechanisms councils are implicitly required to assess their particular community's capacity to pay and set appropriate price policies.

Rate concessions and exemptions

There are number of rate exemptions and concessions present in the current revenue framework that result in inequities and diminished accountability to ratepayers and so reduce the effectiveness of the revenue framework. Such exemptions and concessions have the potential to violate the principle that all stakeholders should equally contribute to the public services provided by Local Government. Also, ratepayers should not have to subsidise public services to outside groups that are exempt from rating.

The Associations recommend that IPART conduct a major independent review of rate exemptions and concessions in NSW.

The LG Act provides for a wide range of rate exemptions, many of which were carried over from the *Local Government Act (NSW) 1919* and which, in the Associations' view, are outdated and no longer appropriate. The need for a review of these exemptions was recognised by the Independent Inquiry which states in its recommendation 23:

"The State Government should review and remove rate exemptions for all land use for commercial or residential purposes regardless of ownership."

A review should include State Government trading enterprises (e.g. NSW Forests' landholdings used for commercial forestry) and benevolent organisations' commercial activities (e.g. retirement homes and business premises). Councils should also be allowed to apply charges pursuant to section 611 LG Act for all commercial use of public spaces (e.g. underground pipes and cables, street poles, overhead wires).²⁷

The Associations are not opposed to rate exemptions where they are justified; for example, genuine benevolent institutions and charities, public lands, schools and hospitals. The Associations concerns are that in modern times the distinction between public and private or commercial use is becoming blurred in many instances. This arises in areas such as seniors residential and aged care facilities. Many facilities operated under the banner of churches, charities and benevolent institutions bare little distinction from privately owned complexes and facilities. Similarly, many councils cannot see why rate exemptions apply to the large land holdings of many private schools, a large proportion of which is utilised for sporting, recreational, staff accommodation and other non-core educational uses.

Further, the Associations are concerned that some commercial uses of state owned lands remain exempt from rates. This includes commercial activities within national parks, unleased properties held by land holding agencies and the commercial forestry plantations of Forests NSW. As the

²⁷ Independent Inquiry, op cit 6, section 12.6, page 307.

latter compete with private plantations, which do pay rates, there are also concerns with respect to competitive neutrality.

The Associations have also called for new a new provision to be inserted in the LG Act to allow councils wider powers to charge for the commercial use of public spaces. This relates to cables, pipes and wires under or over public corridors. Limited provision is provided under section 611 of the LG Act to charge for such usage. However, this is not enforceable in most instances.

Pensioner rebates are the major concession available in NSW. The expense of the rebate is jointly funded by councils and the NSW Government on a 45:55 basis. The level of the compulsory rebate has been static since 1993. Similar pensioner rebates are provided in other states and territories but are fully funded by the respective state and territory governments.

The cost of compulsory pensioner rate rebates is a rapidly growing burden for many councils and is affecting the level and range of services that councils are able to deliver. The scheme already costs some individual councils well in excess of \$1 million annually. The total cost to councils is now around \$76 million annually. The impact on councils is uneven with higher concentration of pensioners in many coastal councils, regional centres and some older established suburbs.

The issue of pensioner rebates is exacerbated by Australia's ageing population. Australia's population aged 65 and older is projected to increase from 2.5 million (12%) in 2002 to 4.2 million in 2021 (18%). Based on this figure, over a quarter of the population in most Local Government areas will be aged over 65. Despite growing superannuation coverage, many of the retirees will still be pensioners or partially funded retirees who will become pensioners at some stage after retirement.

There are also mounting pressures to increase the levels of the rebates and extend them to self funded retirees. Of immediate concern are recent amendments to Commonwealth legislation whereby asset limits for Centrelink purposes are to increase from 20 September 2007. These trends will potentially swell the number people receiving concessions and dramatically increase the cost of concessions.

It should also be recognised that the costs of pensioner rebates are inequitably distributed among councils. Those who qualify for rebates are disproportionately represented in low income areas; areas that already have a high demand for council services but a limited revenue raising capacity. Given the limited revenue base of Local Government it is unfair that it should be required to fund this form of welfare assistance. This form of benefits should be funded by from the broader revenue base of the state or federal governments. As previously noted, the NSW Government is the only state government that does not fully fund pensioner rate concessions.

Land valuation

As part of a review of Local Government' revenue framework, particularly the rating framework, it is also important to consider land valuation methodologies that form the basis for rate determination.

Currently, in NSW, valuations for rating and land tax purposes are provided exclusively by the Valuer General. Valuations are provided on an unimproved capital value (UCV) basis.

A change in the valuation methodology would have little direct effect on a council's revenue raising capacity in a rate pegging environment. However, it will potentially affect the distribution of the rate burden within a council area.

While it may be argued that UCV methodology theoretically promotes the highest and best use of land, many would argue that an improved capital value (ICV) basis allows for more equitable outcomes. ICV provides a more accurate reflection of the market value of a property and the owner's capacity to pay.

ICV would help alleviate the apparent distortion where, for example, very high value home units pay significantly less rates than free standing homes (of comparable or lesser value) in the same council area. For example, many high value units in many areas pay minimum rates while other properties pay significantly more.

Outside a rate pegging environment, capital values could increase a council's rate revenue raising capacity by increasing the valuation base. Within a rate pegging environment, there may be indirect advantages via greater flexibility to maximise rate revenue through special rate variations; for example, better targeting of capacity to pay.

The Associations recommend that the relative equity and efficiency of the current and alternative land valuation methodologies be specifically addressed in a separate review.

Developer contributions

Developments contributions make a significant contribution to Local Government revenue, particularly in growth areas, and should form an important element of any new revenue framework.

This is why the Associations have strongly campaigned against NSW land use planning reform proposals designed to limit the level and scope of contributions. Restrictions on developer contributions will inevitably lead to increases in rates, fees and charges.

The Independent Inquiry in its Interim Report found that:²⁸

“The principle of developer contributions is a sound one. Developer contributions are efficient and equitable. They are efficient because they set charges that should reflect the real costs of local public infrastructure needed to support a private development and so ensure that such a development does not occur when its total costs exceed its total benefits in both a private and public sense. Also, they provide a mechanism for financing development.

They are equitable because the charges are borne by the beneficiary of the works. The major beneficiary is the owner of the land on which the development is made. As shown in Abelson²⁹, when the supply of land for urban housing is fixed and the price of housing land exceeds its value in alternative uses, as is usually the case in NSW, developer charges reduce the price of land. When the supply of housing land is fixed, the number of new houses supplied is independent of developer charge. The price of new houses is determined by the relative attractiveness of the new housing compared with the existing stock of housing. This relative attractiveness is not affected by charges that the developer has paid.

However, developer charges have to be paid from somewhere and, in general, development is a competitive business so the charges cannot come out of developer profits. Faced with developer charges, developers bid less for land. Of course, if developers already hold land, they pay the extra charge as the landowner. In the absence of developer charges, the land price would be substantially higher. This would be inequitable because the landowner has contributed nothing to this higher price.

In practice, there can be problems in the application of developer charges. There needs to be a nexus between the charges and the development and it can be hard to determine in advance exactly what costs will be involved. Special problems arise when development incurs ‘lumpy’ infrastructure. It can also be difficult to identify marginal incremental costs when development occurs in established areas. Many councils simplify administration of developer contributions by estimating an average rather than marginal or project specific cost for a new development.

²⁸ Independent Inquiry, Interim Report – Findings and Options, (2006), section 9.4, page 177.

²⁹ Abelson P, The Real Incidence of Imposts on Residential Land Development and Building, Economic Papers, (1999), vol.18, pages 85-90 and Abelson P, Taxation and Subsidies for Housing and Land: Market Impacts and Economic Efficiency Implications, Paper presented to 34th Annual Conference of Economists, (2005).

Dollery³⁰ argues that this is inappropriate because it sends the wrong price signals to developers and may encourage the wrong form of development.

In a working paper on developer charges for the Inquiry, Dollery³¹ concludes that developer charges have worked well and that there is a strong case for expanding them.”

The proceeding discussion refutes the most common criticism that developer charges add to the cost of housing, particularly impacting on first home buyers. These arguments are supported by the Productivity Commission’s Inquiry Report into First Home Ownership (2004) which found:

“While infrastructure charges, like other costs of bringing housing to the market, have increased over time, they cannot explain the surge in house prices since the mid-1990s. The claimed cost savings and improvements in affordability from reducing reliance on developer charges for infrastructure appear overstated:

- *Most categories of charges are both justified and desirable on efficiency/equity grounds;*
- *Housing affordability should not be significantly affected by greater reliance on upfront charging as opposed to charging over time;*
- *Developer charges for those items of social or economic infrastructure that provide benefits in common across the wider community have generally been relatively small; though such infrastructure should desirably be funded out of general revenue sources; and*
- *Even if the cost of providing infrastructure to new developments were shifted onto the wider community, housing affordability might not be greatly enhanced.*³²

Developer charges and contributions for infrastructure should be:

- *Necessary, with the need for the infrastructure concerned clearly demonstrated;*
- *Efficient, justified on a whole-of-life cost basis; consistent with maintaining financial disciplines on service providers by precluding over-recovery of costs; and*
- *Equitable, with a clear nexus between benefits and costs.*³³

It has been argued that development contributions represent only a small proportion of Local Government revenue and therefore the proposed changes to the land use planning framework will have only a minor impact. It is estimated that development contributions represent only around 5% of council revenue.

The problem with this argument is that it overgeneralises. The importance of contributions pursuant to section 94 of the EPA Act varies significantly between councils. It represents between 5-10% of revenue in some cases. And more relevantly, it represents a much higher proportion of capital expenditure; over 30% in some instances.

³⁰ Dollery B, Developer Contributions and Local Government Infrastructure, (2005), for the Independent Inquiry; available at www.StrengtheningLG.lggsa.org.au.

³¹ Ibid.

³² Productivity Commission, First Home Ownership – Inquiry Report, (2004), page 155.

³³ Ibid, recommendation 7.1, page 177.

3.3 Sustainability, efficiency, financial indicators and performance measurement

IPART questions and issues

- *Which performance measures should be developed for councils (or groups of councils) to provide information on outcomes, outputs, processes, inputs and cost effectiveness in their service delivery (subsidiary issue 39)?*
- *What are the appropriate measures for efficiency of local government (subsidiary issue 29)?*
- *To what extent have councils undertaken efficiency reforms and has this been effective (subsidiary issue 30)?*

Financial indicators

The Associations support the introduction of a meaningful and consistent framework of indicators to measure the financial position, performance, and sustainability of Local Government.

The Associations in principle support the indicators for councils' financial position and performance as suggested in IPART's Issues Paper (section 6.1). Financial sustainability indicators should be integrated in and inform councils' long term financial planning and reporting and asset management frameworks as proposed as part of the Department of Local Government's Integrated Planning and Reporting Reform.

Financial sustainability indicators should include/consider the following:

- An appropriate operating result measure to ensure current ratepayers pay for the services they consume. The operating result should generally exclude capital amounts (e.g. grants and contributions provided for capital purposes, profit from disposal of assets). However, the portion of capital grants from other governments available for the maintenance and renewal of assets should be treated as "operating grants" for the purposes of calculating the operating result. Such capital activities are normally funded from rates and charges (directly in the case of maintenance expenses and indirectly through the funding of annual depreciation expenses in the case of capital expenditure for renewals); they are intended to relieve current ratepayers and should therefore be regarded as operating revenue.
- A measure of actual renewal of assets in comparison to their consumption (depreciation) to ensure assets are renewed at the same rate as they are consumed (depreciated).
- To ensure an appropriate perspective on intergenerational equity, any sustainability ratio looking at councils' infrastructure should distinguish between capital expenditure for the renewal of infrastructure and capital expenditure for the enhancement of infrastructure. Capital expenditure on enhancements needs to be spread appropriately between current and future generations. Infrastructure renewal expenditure, on the other hand, should be funded by the current generation as it restores a certain level of service reduced through the current generation's consumption.

The Independent Inquiry has produced a comprehensive framework of financial indicators which is set out in the table below. The Associations are fully supportive of these indicators:

Financial Key Performance Indicators	Average Council Actual	Proposed Council Target	Proposed Upper limit	Proposed Lower limit
Net debt as % of total revenue	10.5%	100%	150%	50%
Net financial liabilities as % of total capital employed	2.2%	10%	15%	5%

Net interest expense as % of total revenue	0.6%	15%	20%	7%
For general govt activities: Operating surplus as % of own-source revenue	-4.5%	5%	10%	0%
For commercial activities only: EBIT as % of non-financial assets	0.9%	5%	7%	3%
Net borrowing as % of capex on new or enhanced assets	1.3%	50%	60%	30%
Annual renewals deficiency as % of renewals capex	40.2%	0%	10%	-10%
Infrastructure renewal backlog (\$M) as % of total infrastructure assets (estimated at fair value)	8.1%	0	1%	0%

Source: Independent Inquiry, op cit 6, table 11.3

Efficiency indicators

There have been attempts to measure managerial and administrative performance and capacity of Local Government. However, such measurement is often based on qualitative research and individual judgements. It is therefore doubtful whether such measurement is suitable for comparison and benchmarking. Furthermore, undertaking regular qualitative benchmarking would be a very costly exercise for councils.

A comprehensive benchmarking exercise was undertaken by the Independent Inquiry with nine NSW councils.³⁴ The exercise showed that Local Government in NSW is well placed within the world best practice model. Service performance and maturity of management practices were found to be above those of both the Local Government sector and service organisations generally in other parts of the world.³⁵

Another exercise undertaken by the Independent Inquiry assessed the managerial efficiency of 58 NSW councils by looking at the back office cost (corporate overheads) in relation to total expenditure. According to this exercise, NSW councils outperform NSW Government benchmarks and the results of most state government agencies.³⁶

The Associations question the value of other generic efficiency indicator, particularly where such measures would make judgements about the appropriateness of council policies. Output measures like the ones used in the Department of Local Government's annual publication *Comparative Information on NSW Local Government Councils* are misleading as they do not take account of different local circumstances and community preferences. They are also meaningless in the sense that they are not linked to community objectives agreed upon through proper community strategic service planning.

It is not desirable to compare measures of efficiency of service provision among councils where the range and level of service differs dependent on local preferences and priorities and the cost of service provision varies dependent on local circumstances.

Therefore, the Associations support the establishment of a performance measurement framework that is focused on outcomes agreed upon by individual communities and their council. It should be up to the community to determine and judge the policies of their council.

³⁴ QMI Solutions and Service Probe, *Service Practice and Performance in NSW Local Government*, (2005); for the Independent Inquiry; available at www.StrengtheningLG.lgsa.org.au; for a summary: Independent Inquiry, op cit 6, pages 245-249.

³⁵ Independent Inquiry, op cit 6, section 10.4, pages 245-249.

³⁶ DG&AB Maxwell, *Corporate Overheads of Local Governments*, (2006); for the Independent Inquiry; available at www.StrengtheningLG.lgsa.org.au; for a summary: Independent Inquiry, op cit 6, pages 250-252.

The Associations are thus fully supportive of the Department of Local Government's Integrated Planning and Reporting Reform. An essential part of this reform is for councils to be required to monitor and report on the achievement of long term community goals through performance indicators agreed upon by the community.³⁷

Efficiency improvements

The Independent Inquiry found that resource sharing and regionalised provision of services can enhance the efficiency of municipal service delivery if it is applied through specific and flexible structures which are able to determine delivery of which service would benefit from resource sharing in their particular circumstances and to implement such arrangements.³⁸ Ad-hoc resource sharing models and regional organisations of councils and other strategic alliances provide such structures.

In recent years, many councils have entered into shared service arrangement and strategic partnership either through their regional organisation of councils or other strategic alliances to capture economies of scale and enhance the efficiency and effectiveness of service provision.

A number of examples such arrangement are described in detail in the Independent Inquiry's Final Report (pages 262 to 264).

³⁷ See below, section 3.4, pages 27-28.

³⁸ Independent Inquiry, op cit 6, pages 262-266 and option 10.5.9.

3.4 Comments on alternative revenue frameworks

IPART questions and issues

- *How does the current regulatory framework for council revenue, or any alternative framework:*
 - *Promote the effective and efficient provision of services?*
 - *Enhance the financial sustainability of local government?*
 - *Meet the standard of principles for good regulation and taxation – efficiency, equity, simplicity, transparency?*
 - *Enhance the accountability of local government (question 4)?*
- *What alternative regulatory models could be used to regulate rates and charges in NSW (subsidiary issue 42)?*
- *How do the various alternatives rate against the criteria listed above i.e., financial accountability and governance, financial sustainability, comparative efficiency and effectiveness indicators including affordability and availability of local services and facilities (subsidiary issue 43)?*

The Associations have outlined the general principles for an improved Local Government revenue framework in their comments on the role of Local Government (see above).³⁹ In this section, the Associations will briefly comment on the options with respect to rate pegging proposed by IPART in section 7.4 of the Issues Paper.

The Associations support the complete removal of rate pegging (see above for a detailed discussion of the negative consequences of rate pegging)⁴⁰ and the introduction of a framework of enhanced accountability (Option 5 of Issues Paper).

The Associations note that the Department of Local Government, through its Integrated Planning and Reporting Reform, is in the process of introducing a framework that will enhance accountability and transparency of local decision making as well as financial governance.

According to the Department's reform proposal, councils will be required to undertake a long term strategic service and resource planning (10 years minimum) and prepare a community strategic plan based on community goals arrived at through extensive consultation and community engagement. The purpose of the plan is to identify the community's main priorities and expectations for the future and to plan strategies for achieving these goals.

Importantly, the community strategic plan is also to consider the level of resources that will realistically be available to achieve its goals and councils will have to prepare a resourcing strategy outlining how to utilise external and internal resources to achieve them. Internal resources will be identified and managed through long term financial planning and asset management. Long term financial planning should include a framework of financial sustainability indicators (see above)⁴¹ to ensure council and the community can keep track of council's financial situation and regularly assess the sustainability of its resourcing strategy.

Finally, to ensure a high degree of accountability and transparency, the achievement of community goals is to be measured through an outcomes focussed performance measurement framework agreed upon with the community during the consultation process and reported on in council's annual report.

³⁹ See above, section 3.1.

⁴⁰ See above, section 3.2, pages 14-17.

⁴¹ See above, section 3.3, pages 24-26.

The introduction of this new framework will enhance councils' accountability to their community, introduce forward-looking strategic service and resource planning, greatly improve financial governance and reporting, and so ensure financially sustainable policies. It will therefore eliminate any justification for the existence of rate pegging.

As an interim measure, the Associations support IPART's Option 4. Councils who will have fully implemented the integrated strategic planning and reporting framework should be exempted from rate pegging as they will have in place adequate financial accountability and governance mechanisms and performance measurement and reporting frameworks ensuring financially sustainable policies.

Councils who will not have implemented the new system should be subject to a more transparent rate pegging system where the rate pegging limit is calculated using a transparent methodology that takes account of the real cost pressures for groups of councils⁴² based on criteria specific to each grouping (Option 2 of Issues Paper).

IPART questions and issues

- *Is the Department of Local Government modification of the Australian Classification of Local Governments (ACLG) a suitable framework within which to consider the differences between councils (subsidiary issue 42)?*

Council groupings

The Associations support in principle the ACLG and the Department of Local Government's modification of it as an appropriate way of grouping councils.

However, it would be desirable to also include the following criteria:

- Population growth to capture the different challenges faced by growing and councils with declining populations (e.g. infrastructure enhancement, human services);
- Location in terms of coastal or inland to capture the different environmental challenges faced by councils in coastal areas to councils in inland areas (e.g. water availability, drought, impacts of climate change);
- Economic circumstances to generally capture different economic status and development opportunities; and
- Revenue raising capacity and grant dependency to capture any fiscal disabilities faced by different types of councils.

⁴² For a discussion of such a methodology see above, section 3.2, page 15.

3.5 Role of IPART in setting rate, charges and fees

IPART questions and issues

- *What role should IPART play in setting local government rates and charges, including charges for non-business activities (question 5)?*
- *Should IPART have a determinative role provided by legislation or should IPART's role be limited to making recommendations, if and when requested by the Minister (question 6)?*
- *What role should IPART play in setting local government rates and charges in future years (subsidiary issue 44)?*
- *How should IPART's role be implemented (for example, by a legislative amendment giving IPART a determinative role or by a terms of reference from the Minister requiring recommendations from IPART) (subsidiary issue 45)?*

The Associations have outlined their position on rate pegging and the issue of setting or regulating rates by another body. The Associations preferred rate pegging model (Option 5) does not require the involvement of IPART.

However, the Associations' submission points to a potential determinative role for IPART to undertake the annual determination of a default rate pegging limit (Option 4 in conjunction with Option 2) to apply to councils that have not implemented long term community strategic service and resource planning pursuant to the Department of Local Government's Integrated Planning and Reporting proposal. Apart from providing a default rate pegging limit, this would provide a benchmark for reviewing the community strategic plans of comparable councils.

Further, as set out above,⁴³ the Associations do not accept that there is a case for the imposition of a prescriptive regulatory framework for fees and charges that are currently unregulated.

In terms of large scale commercial service, the Associations recognise the benefit of a regulatory framework to ensure councils fully recover their economic costs, including cost of capital, but not exploit any monopoly powers. However, the Associations do not support a determinative role for IPART in the pricing determination for commercial activities for the following reasons and see IPART's role rather as one that provides consistent guidelines on the charging for commercial services:

- Pricing of commercial activities is an important consideration in the determination of whole-of-community outcomes and should be the responsibility of democratically elected councillors to ensure that pricing decisions are responsive to community needs, based on local circumstances, and integrate commercial service provision into broader whole-of-community outcomes;
- It would be highly impractical and costly from a regulatory perspective as well as for councils to enable IPART to collect information about and consider the diverse supply and demand profiles and community preferences in Local Government areas across NSW. Councillors, because of their local knowledge and supported by best practice pricing policies and other regulatory instruments, are better placed to make strategic decisions about pricing;
- The current system of price setting is transparent and cost-efficient; and
- Determination by a central agency such as IPART could result in significant inefficiencies caused by operational inflexibility (e.g. long periods between pricing determinations during which councils are unable to timely respond to changes in circumstances such as potential

⁴³ See above, section 3.2, page 18.

additional cost associated with required infrastructure spending due to drought or increased demand).

It also needs to be noted that significant commercial activities are already subject to (quasi-) price regulations.

Council owned and operated local water utilities are already subject to (quasi-) price regulations as part of the *Best-Practice Management of Water Supply and Sewerage Guidelines* produced by the NSW Department of Water and Energy. The guidelines set requirement for water charges and developer charges for water supply and sewerage infrastructure and require local water utilities to achieve full cost recovery. Local water utilities have continuously improved best practice management and made significant progress in their adoption of the criteria of best-practice management identified in the guidelines.

Councils' domestic waste management are regulated by the LG Act requiring charges not to exceed the "reasonable cost" to the council providing those services; section 504(3) LG Act.

Furthermore, water and sewerage services (38 per cent of total turnover of Local Government businesses) and waste collection and related services (8.8 per cent, *ibid*) are commercial businesses and as such expected to meet the requirements of National Competition Policy (NCP).

3.6 Framework for setting charges levied by other public authorities

IPART questions and issues

- *To what extent do government authorities - such as SHFA, SOPA, RWA and the GCCs - provide services that duplicate or overlap with those of local government? (question 7)?*
- *What are the implications for local government rates where these authorities provide services normally provided by local government (question 8)?*
- *Should a common regulatory framework be introduced for these authorities? (question 9)?*

- *Whether a common legislative or regulatory framework be introduced to improve consistency in the levying of charges by authorities (such as SHFA, SOPA, RWA and GCC) that provide services akin to those provided by local government (subsidiary issue 46)?*
- *The best form for this legislative or regulatory framework to take (subsidiary issue 47)?*
- *To the extent that these authorities provide services that overlap with or duplicate those of local government, what benefits and disadvantages arise from the duplication of service provision (subsidiary issue 48)?*
- *To the extent that these authorities provide local government services how should the costs of these services be recovered? To what extent would these arrangements promote: efficiency; equity; simplicity; and transparency (subsidiary issue 49)?*
- *Similarities and significant differences (in quantum, scope or standard of service) between SHFA, SOPA, RWA and neighbouring councils in regards to:*
 - *current regulatory frameworks including governance arrangements, accountability to the local community and the role of the State Government in setting fees and charges and determining revenue levels and/or mix*
 - *property related services including land use planning, the processing of development applications, development activities, the levying of developer contributions, conservation of natural and cultural heritage, management of public domain areas and provision of infrastructure 75*
 - *management of major events and regional promotions, and*
 - *responsibilities under the Roads Act 1993 (subsidiary issue 50)?*
- *The potential overlap between the Growth Centres Commission's development approval and infrastructure planning processes and those used by Growth Centres Councils (subsidiary issue 51)?*
- *The extent to which SHFA, SOPA, RWA and the GCC, respectively, impact upon the costs incurred and revenues generated by the corresponding councils (subsidiary issue 52)?*

The Associations would object to any proposal to share council rates with, or provide rate concessions to, property holding state owned corporations. The Associations would consider such proposals to be flawed in that they fail to comprehend the nature and purpose of council rates. Rates are a form of taxation, the only taxation instrument available to Local Government. There is no nexus between rates and a defined service level. Local Government rates are similar to land taxes and, like other State and Commonwealth taxes, they do not entitle the individual taxpayer to a specific range of goods and services.

“Municipal service” provision by state owned corporations is analogous to the type of “municipal services” provision by, for example, Westfield shopping centres in and around the shopping mall. This would not warrant any concessions or re-allocation of rates.

The Association note in this regards the following incorrect statements in the IPART Issues Paper:

- Domestic and trade waste/garbage services are not covered by council rates but are financed by separate and specific waste charges. Trade waste services as used by businesses are

generally competitive and businesses may opt to engage services directly from private providers rather than use and pay for the trade waste service provided by councils.

- Non-commercial properties on lands held by the Sydney Harbour Foreshores Authority and the Sydney Olympic Park Authority are not subject to rates.

The question of the payment of rates by state owned businesses has previously been reviewed at length by the former Reciprocal Charging Committee convened by NSW Treasury to develop policies and principles relating for achieving competitive neutrality under National Competition Policy. The Reciprocal Charging Committee provided its final report to Cabinet in December 2001. The report concluded that all land held by State Government businesses for commercial purposes should be fully rateable. This included bodies such as the Sydney Harbour Foreshores Authority. A relevant extract from the report can be found in the text box below.

Apart from the issues involving taxation principles, it is also questionable whether these authorities should continue to administer and service these land holdings in the long run. Once the areas have been fully developed for commercial and particularly residential purposes, it may be more appropriate that they either be absorbed into adjoining Local Government areas or be separately established as Local Government areas with their own democratically elected councils.

Box section - extract from the Reciprocal Charging Committee's Final Report to Cabinet in 2001

5.2 PAYMENT OF COUNCIL RATES

There is an argument for State Government businesses to pay Council rates simply from the perspective that the private sector businesses with which they compete are required to pay rates on all land. Government businesses should also be required to earn a commercial return on their assets to recover the opportunity cost of capital investments. The Commercial Policy Framework was developed in recognition that NSW Government businesses, like their private sector counterparts, should be exposed to the disciplines of the market.

As indicated in section 3.3, Government businesses lose their exemption from Council rates when they become corporatised. The complete implementation of competitive neutrality policy would require that Council rates be imposed on all Government businesses to remove any competitive advantage attributable to these exemptions.

In principle, there is no reason for a State Government business to be exempted from Council rates when they operate in potentially competitive markets and are subject to the financial requirements of the Commercial Policy Framework. To ensure consistent application of the policy framework, Government businesses should pay full Council rates on all landholdings currently (or potentially) used for commercial business purposes.

Policy Principle 1b:

State Government businesses to commence payment of full Council rates and charges on all commercial (or potentially commercial) landholdings from the scheduled commencement of the reciprocal charging policy (page 31).

The Working Group therefore considered that protection or exemption from Council rates should only be retained by 'non-commercial' or 'non-business' activities. For the purposes of this Review, the coverage of charging policy will include all land held for commercial, or potentially commercial, purposes by Government businesses.

To give effect to this policy, the principle has been established that all land owned by a Government business is deemed to be held for commercial purposes and therefore fully rateable under the charging policy, including all public recreation areas (see Box 1). This principle excludes land that is held for 'non-commercial' or 'non-business' purposes by virtue of the Government's social policy objectives.

The Working Group recognises that there is a much broader issue at stake, whether ownership of 'non-commercial' land should be retained by Government businesses.

Policy Principle 2a:

All land owned by a State Government business is deemed to be held for a commercial purpose and therefore fully rateable under the reciprocal charging policy. This principle excludes land that is held for 'non-commercial' purposes by virtue of the Government's social policy objectives (page 32).

This attachment refers to a Submission to the IPART Review of State Taxation and may be viewed on the IPART Website under Other Industries.

Local Government
Association of NSW



Shires Association
of NSW

**Local Government Association of NSW and
Shires Association of NSW**

Submission to

Productivity Commission Inquiry

**Assessing Local Government Revenue
Raising Capacity**

July 2007

Index

1. Introduction	2
2. Executive Summary/ Key Positions.....	2
3. Financial sustainability – identifying and responding to the challenge.....	4
3.1. The Independent Inquiry into the Financial Sustainability of Local Government in NSW	4
3.2. Strengthening Local Government Program.....	5
4. Issues and Questions.....	6
4.1. Revenue	6
4.1.1. Trends in Local Government Revenue	6
4.1.2. Capacity to Raise Own Source Revenues.....	9
4.2. State and Territory Government Regulatory Constraints	11
4.2.1. Land Rating and Valuation Methods	11
4.2.2. Rate Pegging	12
4.2.3. Concessions and Exemptions	15
4.2.4. Setting Fees and Charges.....	18
4.3. Impacts on individuals, organisations and businesses	22
4.3.1. Council Rates.....	22
4.3.2. Developer Charges and Contributions.....	24
4.3.3. Fines and Pecuniary Penalties	26
4.3.4. Interest income	26
4.4. Factors influencing expenditure and revenue raising.....	27
4.4.1. Operational Efficiency of Local Government.....	27
4.4.2. Service Levels and Pricing	28
4.4.3. Financial and Asset Management Skills	29
4.4.4. Incentive Effects of Grants and Subsidies	30

1. Introduction

The Local Government and Shires Associations of NSW (the Associations) are the peak bodies representing the interests of all 152 general purpose councils, the 9 divisional Aboriginal land councils and the majority of special purpose county councils in NSW.

The Associations welcome the opportunity to make a submission to the Productivity Commission's review of Local Government Revenue Raising Capacity. This is a timely review given the recent comprehensive reviews of the financial sustainability of Local Government in NSW and other states as well as a national review commissioned by the Australian Local Government Association.

While supportive of the terms of reference for the research study, the Associations are disappointed that the terms did not extend to include the adequacy of Commonwealth and State grant funding to Local Government. Grant funding is a major component of Local Government revenue and the adequacy of Local Government's revenue raising capacity cannot be roundly addressed without reference to it.

The submission provides a summary of the Associations' key positions and then proceeds to address most of the individual questions raised in the Productivity Commission's Issues Paper. We have also submitted the Final Report of the Independent Inquiry into the Financial Sustainability of Local Government in NSW entitled *Are Councils Sustainable? – Final Report: Findings and Recommendations*. This is a current, comprehensive and independent report that is referenced extensively in our submission.

2. Executive Summary/ Key Positions

NSW Local Government is under financial duress. This has been confirmed by the Independent Inquiry into the Financial Sustainability of NSW Local Government that found that around:

- 25% of NSW councils are not financially sustainable under current policy settings;
- 50% are potentially vulnerable; and only
- 25% are in a relatively strong financial position.

A key finding of the inquiry was that NSW Local Government has accumulated a huge infrastructure renewals backlog of \$6.3 billion that continues to grow by \$500 million per annum. This is considered by many to be a conservative estimate. The Inquiry estimated that Local Government would need to increase revenues by at least \$900 million per annum to deal with the backlog and ongoing renewals. This does not include the additional revenue required for growth infrastructure or to deal with demands for improved services.

There are several, sometimes interrelated reasons for this financial situation, including:

- Rate pegging and other legislative constraints on councils fees and charges;
- The decline in Commonwealth and State financial support for Local Government relative to economic growth (GDP, GSP) and the growth in national taxation revenues;
- The expanding roles and responsibilities of Local Government, a trend explicitly recognised by the Commonwealth Grants Commission, The Hawker Report and other reviews;
- Cost and responsibility shifting onto Local Government by the State and Commonwealth Government, again a trend recognised by the Hawker Inquiry and subsequently acknowledged by the national *Intergovernmental Agreement Establishing Principles Guiding Intergovernmental Relations on Local Government Matters*, (2006); and
- Deficiencies in Local Government financial and asset management practices.

The central issue is the inadequacy of Local Government's revenue base to meet the demands being placed on it.

Rate Pegging

NSW is the only jurisdiction to apply rate pegging to Local Government rates. As a result, rate growth in NSW has lagged all other jurisdictions over the last 10 years and NSW now has the lowest rates per capita. The Associations maintain that rate pegging is an unnecessary intervention that distorts the operation of the rating system and produces negative consequences. Not the least of which is the direct and indirect suppression of the rating effort.

The Associations advocate removal of rate pegging. However, as an interim measure the Associations have advocated the use of a Local Government specific cost index as the basis for determining the rate pegging limit. This would help ensure that the rate pegging limit more accurately reflects the real cost movements faced by councils. This would help provide certainty and as a published index, it would provide the transparency that is now lacking.

Fees and Charges

NSW councils are increasingly moving towards full cost recovery and commercial pricing policies where this is appropriate and where council has the discretion. This is at least partially in response to the financial constraints of rate pegging.

Many Local Government fees and charges remain regulated by NSW legislation. The Associations advocate the relaxation such regulations.

Exemptions and Concessions

The Associations are calling for a review of rate exemptions and concessions. The scope of exemptions in NSW is currently too wide and exemptions granted to charities, benevolent institutions, schools and churches need to be more accurately targeted. Many of the exemptions originated in the late nineteenth and early twentieth century and it is questionable whether they are appropriate under modern institutional arrangements.

Remaining exemptions to some of the commercial activities of the NSW Government should also be eliminated. This includes the commercial plantations of Forests NSW. National Parks should also be required to make contributions in lieu of rates to councils.

Pensioner rate concessions should be fully funded by the State or Commonwealth Government. We understand that NSW is the only jurisdiction that requires councils to fund nearly half the cost of these concessions. Welfare and income support are the province of the Commonwealth Government and state and territory governments who are able to spread the cost of such assistance more equitably over a broader revenue base.

Conclusion

The measures listed above will not fully alleviate the financial deficiencies of NSW Local Government.

Rating is the only taxation measure available to Local Government and accounts for approximately 36% of total revenue in NSW. This narrow taxation base places a severe restriction on a Local Governments capacity to raise revenue generally. Further, the rating base varies significantly between Local Government areas, an aspect only partially addressed by the horizontal fiscal equalisation principles of the Local Government grants process. Unlike the Commonwealth Government and state governments, Local Government does not have the flexibility to spread its taxation effort over a suite of taxation tools.

The restricted taxation base has led to a growing reliance on fees and charges but this avenue of recourse is reaching its limitations. User charges are the second largest source of revenue and already represent 34% of Local Government revenue in NSW. Local Government already achieves a much higher cost recovery ratio than other spheres of government from the application of user fees and charges. On a national basis, the cost recovery ratio for Local Government is 37% compared to ratios of 4.3% for the Commonwealth and 12.2% for the states. This partly reflects the type of services provided by Local Government. However, it also suggests that Local Government is already maximising its use of fees and charges and that there may be limits to the extent that Local Government can increase its cost recovery efforts. Apart from general community resistance to ever increasing fees and charges, there are important equity and governance considerations. Many council services, by their very nature, cannot be provided on a cost recovery basis. Further, the opportunities to raise revenue in this way vary significantly between councils. For example parking meters are an option restricted to high density commercial and tourist areas.

There needs to be a substantial increase in financial assistance from the Commonwealth and the states to Local Government.

Given the high degree of vertical fiscal imbalance in the Australian taxation, it is the responsibility of the Commonwealth Government to ensure that allocations to other spheres of government are commensurate with their roles and responsibilities.

The inquiry and other studies have demonstrated how grants have fallen well behind economic and national taxation growth. The Associations fully support the recommendation in the ALGA submission to this Inquiry that:

“The quantum of Commonwealth transfers should increase to at least 1% of total Commonwealth taxation revenue (excluding GST). This would ensure that councils gain access to a revenue stream that grows in line with the growth of the economy and therefore can keep pace with demand for service delivery and infrastructure provision.”

At the same time, the Associations recognise that there is a need for councils to improve their own performance. The Associations are currently working in partnership with the Department of Local Government, the Local Government Managers Association and the Institute of Public Works Engineers Australia on concerted programs to improve financial and asset management practices.

3. Financial sustainability – identifying and responding to the challenge

3.1. The Independent Inquiry into the Financial Sustainability of Local Government in NSW

In response to the widespread concerns about Local Government's financial capacity to meet the growing demand for infrastructure and services, the Associations commissioned the Independent Inquiry into the Financial Sustainability of Local Government in NSW in September 2005.

A panel consisting of three persons with extensive experience in public policy and management, but independent of Local Government or the Associations, was appointed to undertake the inquiry over a six-month period ending on 30 April 2006. The panel members were:

- Percy Allan AM (Chair & Research Director) – A public finance and management consultant and former head of NSW Treasury;
- Libby Darlison – A social policy and change consultant; and
- Diana Gibbs – A management and economic development consultant.

The inquiry's terms of reference included:

- To assess the current financial position and performance of the NSW Local Government sector and its individual councils;
- To assess the adequacy of existing NSW Local Government physical infrastructure and service delivery in terms of (i) its statutory obligations, (ii) community, State Government, and Commonwealth Government expectations of its role and functions, and (iii) challenges posed by changing demographic, economic, social, environmental, technical and governance trends;
- To assess the financial capacity of Local Government to meet its statutory obligations, expected functions and emerging challenges; and
- To identify possible financial, administrative, governance and intergovernmental reforms that could address any shortcomings and gaps uncovered by the above research.

The inquiry was a major undertaking provided with a budget of over \$600,000. Accordingly, the inquiry was able to undertake extensive consultations and investigations and commission major research assignments.

The inquiry conducted 12 stakeholder workshops with about 400 participants and surveyed over 250 participating councillors and council staff. It commissioned a professional poll of over 900 NSW residents to canvass community expectations on the role of Local Government and willingness to pay for services. It also met twice with the NSW Minister for Local Government and interviewed 26 senior officials in eleven State Government and two Commonwealth Government agencies.

The inquiry received and analysed over 170 written submissions to its *Background and Issues Paper* (October 2005) and *Interim Report: Findings and Options* (March 2006). Submissions came from councils and regional organisations of councils as well as other stakeholders including government agencies, professional associations, environmental groups, community groups, businesses, unions and interested members of the public.

The inquiry benchmarked the administrative capacity of nine councils and compared the back-office costs of 58 councils. With the help of 19 councils it measured the amount of cost shifting by other tiers of

government. The inquiry commissioned Access Economics to analyse the financial situation of all 152 councils and Jeff Roorda & Associates to undertake an extensive survey of over 100 councils on the condition and management of their infrastructure. Altogether, the inquiry commissioned more than 30 research papers and reports dealing with various issues affecting Local Government.

On 3 May 2006, the inquiry released its Final Report entitled *Are Councils Sustainable – Final Report: Findings and Recommendations* containing 49 firm recommendations as to how to improve the financial sustainability of NSW Local Government.

The major finding of the inquiry was that NSW Local Government faces an infrastructure renewal backlog of \$6.3 billion that is growing by about \$500 million annually and that Local Government has inadequate revenue to respond to this crisis. Principle reasons for this include insufficient intergovernmental grants and own source revenue restrictions imposed by the State Government. Twenty-five per cent of councils were identified as financially unsustainable because their current financial capacity was not sufficient to meet their expected financial requirements over the long term without having to introduce substantial or disruptive revenue and/or expenditure adjustments. The inquiry also found that councils need to improve their long term strategic and financial planning and asset management.

The inquiry made a range of recommendations which can be summarised as follows:

- Clarify Local Government's role relative to other spheres of government through an intergovernmental agreement;
- Boost revenues from rates, charges and grants (abolish rate pegging, increase FAGs);
- Renew infrastructure to overcome a growing backlog (requires \$900million in additional annual revenue to meet annual renewal gap and pay debt charges for borrowings to close the present backlog);
- Improve financial data and reporting;
- Save money through resource sharing and better prioritising services; and
- Improve long term strategic and financial planning, including asset management, based on community engagement.

All reports and papers produced by the inquiry as well as submissions and responses can be accessed on the inquiry website: www.lgi.org.au.

3.2. Strengthening Local Government Program

Following the release of the inquiry's final report, the Associations in August 2006 established the Strengthening Local Government program to facilitate a sectoral response to the findings and recommendations of the inquiry and strengthen the financial sustainability of Local Government to build a strong and sustainable Local Government sector that will contribute to fairer, more harmonious communities, a more productive economy, and environmentally sustainable development.

The program was led by the Strengthening Local Government Task Force which was made up of key Local Government stakeholders including the Associations, the Local Government Managers Australia (NSW Division), the Institute of Public Works Engineering Australia (NSW Division), and the NSW Department of Local Government (observer status). The task force was supported by specialist working groups which included a wide range of experts and professionals from the Local Government sector, social, environmental and community groups, government agencies and businesses.

Working groups were formed in the following areas:

- Intergovernmental Relations and Community Relations;
- Financial Management;
- Corporate Governance and Performance Measurement;
- Resource Optimising and Capacity Building; and
- Promoting Local Government Leadership.

In the area of asset management the task force contributed to and promoted the position paper on asset management and financial planning prepared by NSW Infrastructure Task Force. The task force also contributed to the Department of Local Government's integrated strategic planning and reporting project and the NSW Strategic Alliance Network.

The task force extensively consulted with councils and other stakeholders. It held 17 workshops throughout NSW as well as two roundtables for businesses, community and environmental groups in Sydney. Furthermore, a comprehensive website was established to inform about the program and provide resources (www.StrengtheningLG.lgsa.org.au).

In June 2007, the Strengthening Local Government Task Force endorsed and presented to the Associations its recommended positions and actions on the 49 recommendations of the inquiry with the recommendation that the Associations provide them to the NSW Government to facilitate a whole-of-government response. In July 2007, the Associations endorsed these positions and actions and provided them to the NSW Government. They will form the basis for continued work by Local Government sector in NSW.

4. Issues and Questions

The following section addresses most of the individual questions raised in the Productivity Commission's Issues Paper. The following acronyms are used in this section:

CPI	Consumer price index
DLG	NSW Department of Local Government
EPA Act	<i>Environmental Planning and Assessment Act (NSW) 1979</i>
FAGs	Commonwealth Financial Assistance Grants
GDP	Gross domestic product
GSP	Gross state product
ICV	Improved capital value
LGI	Local Government Inquiry - The Independent Inquiry into the Financial Sustainability of NSW Local Government
LG Act	<i>Local Government Act (NSW) 1993</i>
MP	Member of Parliament
SPPs	Commonwealth special purpose payments
UCV	Unimproved capital value

4.1. Revenue

4.1.1. Trends in Local Government Revenue

What are the principal factors explaining the trends in revenue from councils' various sources?

The Productivity Commission's Issues Paper indicates an upward trend in all categories of Local Government revenue.¹ This is consistent with the findings of the LGI, which found modest real growth in all categories of NSW Local Government revenue over the period 1995/96 to 2003/04. While maintaining real growth over this period of 21.6%, the LGI found that Local Government lagged NSW State Government revenue growth of 30.3%, Commonwealth revenue growth of 30.7% and NSW GSP growth of 31.3% over the same period.²

Like the Issues Paper, the LGI also demonstrated varying growth rates for different revenue categories over the period 1995/96 to 2003/04:

- The slowest growth was rate income with real growth of only 0.8% p.a;
- Grant income grew by only 1.0% p.a;
- User fees and charges grew by 2.4% p.a: and
- Contributions and donations growth most strongly at 5.4% p.a.

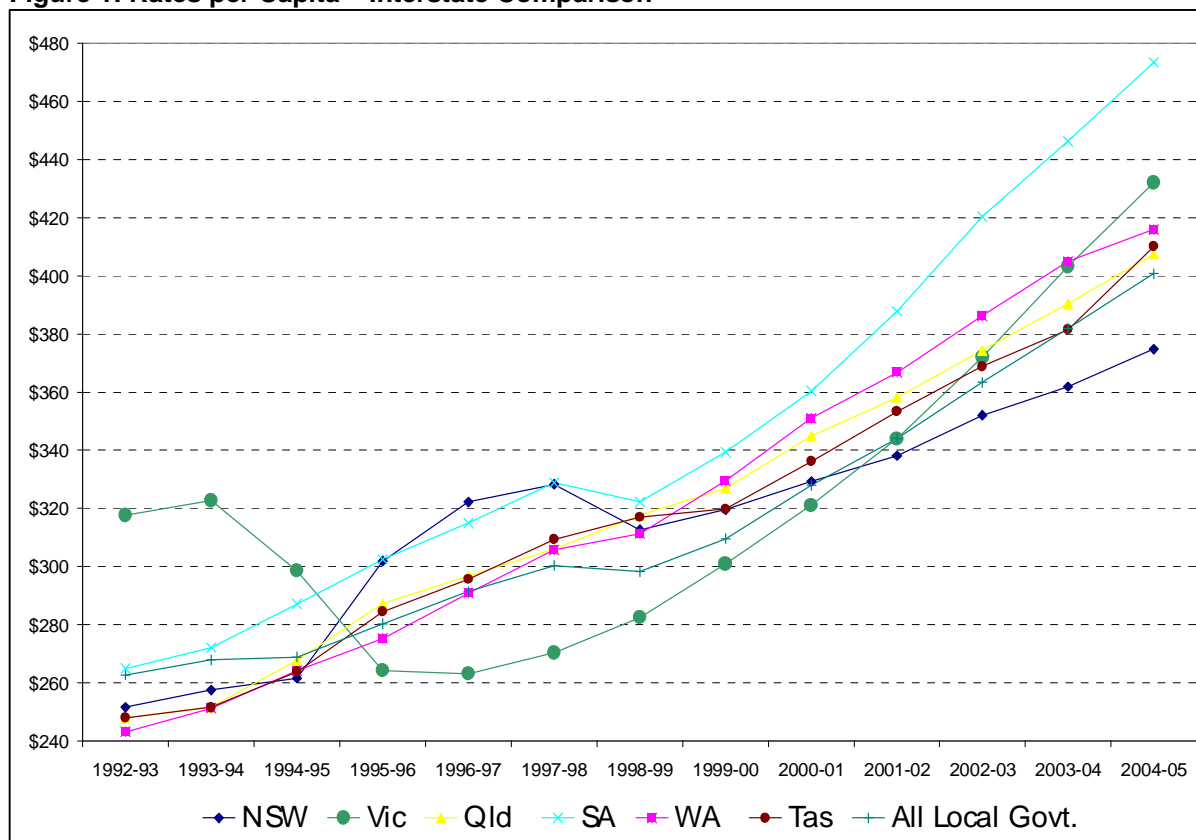
There are several reasons for the differing growth rates.

As illustrated in Figure 1, rates revenue growth in NSW has lagged that of all other states and the Northern Territory during the period and as a result NSW has the lowest rates per capita of any jurisdiction in Australia. This strongly suggests that rate pegging is a major revenue constraint on NSW councils. Given the size of the NSW economy, it is also likely that this has dampened national average growth in rate revenue.

¹ Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, May 2007, pp12-15.

² LGI, *Final Report*, Section 9.2, pp196-197.

Figure 1: Rates per Capita – Interstate Comparison



Source: MAV Viability Index, 2007.

The major component of grant income, FAGs, have grown at a similar rate to NSW rates, marginally exceeding CPI. This is because FAGs are only escalated in real terms per capita (CPI plus population growth) and are not linked to Commonwealth taxation growth or GDP growth.

User fees and charges, including annual charges, have been growing quite steadily in real terms. This suggests a growing reliance on user fees and charges for the provision of goods and services. It would also reflect the growing application of user pays and full cost recovery principles in pricing policies. This is particularly evident in the provision of water and sewerage services by councils, where full cost recovery is effectively mandated.

Contributions and donations largely consist of developer contributions and, paradoxically, block grants from the NSW Roads and Traffic Authority for regional and local road maintenance.³ Developer contributions for local infrastructure are collected under section 94 of the EPA Act or under section 64 of the LG Act where they relate to water and sewerage infrastructure. The relatively strong growth in contributions revenue is probably explained by two factors:

- The increasing application of user pays and full cost recovery principles; and
- The strong growth in the Australian economy over the last decade reflected in development.

Further information on this issue is available in Chapter 9 of the LGI's Final Report.

While the longer term data supports the trends discussed above, it should be noted that the DLG publication *Comparative Information on NSW Local Government Councils 2004/05* indicates the proportion of revenue derived from contributions and donations has declined from 12.7% to 10.8% between 2002/03 and 2004/05.⁴

Why has 'other income' been growing at a faster rate than council rate revenues and sales of goods and services?

³ Block grants from the NSW Roads and Traffic Authority, a NSW state agency, are classified as contributions and not as grants from the NSW State Government.

⁴ DLG, *Comparative Information on NSW Local Government Councils 2004/05*, 2006, p66.

The growth in 'other income' identified in the Issues Paper includes developer contributions. As noted above, developer contributions have been a strong area of growth over the past decade and are likely to be the main driver of growth in 'other income' as defined in the Issues Paper.

As noted above, rate revenues in NSW have been constrained by rate pegging.

Growth in revenue from sales of goods and services has growing steadily in real terms despite the fact that many fees and charges are regulated under NSW Government legislation. Regulations cover a range of fees including planning and building related fees, health inspections, dog registrations, rating certificates and so on. Regulated fees are only adjusted periodically (3-5 years) and adjustments are usually related to CPI only.

The Associations advocate greater freedom for councils in setting fees.

Do these trends differ between states and territories, and between urban, rural, remote, and indigenous local governments? If so, what are the primary factors explaining such differences?

Does the composition of council revenue (shares of each own-source revenue — rates, fees and charges, and 'other') differ between states and territories, and between urban, rural and remote local governments? If so, what are the primary factors explaining such differences? Do these factors have implications for the potential revenue raising capacity across different types of councils?

The Associations are not in a position to provide detailed comment on the difference in trends between states and territories other than to note that growth in rate revenue has been much slower in NSW as noted above.

The composition of revenue between metropolitan, regional, fringe and rural councils in NSW varies significantly. This is clearly demonstrated in Table 1 extracted from the LGI report.

Table 1: Composition of Local Government revenue by council category, 2003/04 (%)

Area	Rates and annual charges	User charges and fees	Interest revenue	Grants	Contributions and donations	Other revenue
Sydney City	53.7	17.7	4.6	1.8	4.8	17.5
Metropolitan developed	57.6	14.1	3.7	9.8	8.0	6.7
Regional town/city	43.4	19.4	4.0	16.3	14.6	2.3
Fringe	51.9	14.6	3.9	13.2	13.6	2.7
Rural	32.3	18.9	3.4	31.9	11.6	1.9
NSW total	47.6	16.8	3.8	16.0	11.5	4.2

Source: LGI, Final Report, Section 9.2, p196 (Table 9.2).

The differences in composition will affect the respective revenue trends to some extent. The major difference involves the proportion of revenue raised by rates compared to grants, with rural councils having a much higher degree of grant dependency.

Other differences include the proportion of contributions and donations, with the lower proportions recorded for Sydney and the metropolitan areas likely to be reflecting both a broader revenue base and the absence of development contributions for water and sewerage infrastructure. Councils are not responsible for water and sewerage within the Sydney and Hunter regions.

The higher proportion of 'Other Revenue' recorded in the Sydney and metropolitan areas is likely to be the result of broader revenue raising opportunities. This could include investment income, property rents, rental of outdoor space (e.g. footpath cafes) and infringement revenues among other items.

The Associations do not have revenue trend data for comparison of urban, regional, rural and remote areas.

4.1.2. Capacity to Raise Own Source Revenues

What are the principal factors that determine the magnitude of the various revenue raising bases available to local governments?

There are numerous factors that determine the revenue raising base available to councils. These include:

- Population and population density;
- Socio-economic profile of area;
- Disposable income/capacity to pay;
- Willingness to pay/ demand for infrastructure and services;
- Commonwealth and State Government grants policies and practices;
- Revenue options available to council (legislative or otherwise);
- Revenue constraints (such as rate pegging); and
- Land values (potentially, not necessarily).

What are the key determinants of the capacity and willingness of resident households, organisations and businesses to pay for services provided by their local governments?

The factors that determine the capacity and willingness to pay are likely to be similar for rates, fees and charges. In relation to rates the LGI found that:

“First, rates are not a large impost for most households. Rates are typically around \$600 [annually] per household in average income areas. These charges are in line with (or less than) typical utility bills such as annual electricity and telephone charges.

Second, the revenue that can be raised from the rate base is actually constrained by disposable household income, not by land values. Whether or not an average household can pay \$600 a year (or a low income household can typically pay \$400 to \$500 a year) depends on their income after Commonwealth taxes and transfers. Changing the revenue base will not change this fundamental fact.

Thirdly, as reported by IRIS Research (2005, p8), the community at large does not oppose rate increases when necessary: ‘About 70 per cent of surveyed residents provided a medium to high support rating for the statement ‘I would rather see council rates rise than see cuts in local services’.’ However, support for a rate rise rather than service cuts was stronger in wealthier households with incomes \$100,000 and above.”⁵

Other factors that could come into the question of willingness to pay rates, fees and charges include:

- The service expectations of the community;
- The quality and level of infrastructure and services provided by councils; and
- Community knowledge or recognition of what infrastructure and services councils are supplying.

In regards to the latter, community members often do not have an understanding of which sphere of government actually provides the infrastructure and services that they use and let alone the cost. Many assume that certain council infrastructure and services are provided and/or funded by the State Government when this is not the case. This is something councils need to address when seeking to increase rates, fees and charges.

What scope is there for local governments to augment their revenues with fees and charges collected from non-residents?

How and why might the scope to do so differ between local governments?

The scope varies widely between councils and, where opportunities exist, the overall scope is limited by the revenue options available to councils.

⁵ LGI, Final Report, Section 9.3, p203.

Councils with high visitation rates such as commercial, employment or tourist destinations have much greater opportunities than those that do not. For tourism destinations the opportunities will frequently be seasonal.

The direct options available to councils to raise fees from visitors are largely limited to parking fees, entry fees to council attractions or facilities, rental of council facilities (e.g. halls, sporting facilities, caravan park accommodation⁶) and usage fees for services and equipment (e.g. coin operated barbeques, laundry facilities in council operated caravan parks).

Indirectly, high non-resident visitor concentrations may lead to increased demand from businesses such as cafes or restaurants to rent public footpath space from councils for outdoor seating. Similarly, circuses, carnival operators, concert promoters and other outdoor entertainment businesses may also seek to rent public space from councils from time to time.

Under rate pegging, high non-resident visitation numbers do not provide an opportunity to generate increased overall rate revenue. While businesses may benefit from non-residents and this may ultimately be reflected in property values, rate pegging means that a council's total revenue from rates is capped. In this environment increased property values may only result in a redistribution of the rate burden between categories or by location.

Do local governments have policies, which in effect, limit their own-source revenue raising? If so, what are these policies and what might be factors holding back councils from increasing their own-source revenue? What might stand in the way of changing the policies to expand the ways, and extent to which local governments raise revenues?

The potential constraints on rate revenue are discussed in other sections of this submission. The response to the above question therefore only concerns the pricing policies of councils.

Recommendation 25 of the LGI proposes a review of current pricing policies of councils and suggests that the DLG issue best practice guidelines for pricing of council services. It is envisaged that, with consistent pricing guidelines, councils could raise more revenue, improve rationing of demand for council services and provide a more consistent framework for full or partial cost recovery. A review of Local Government pricing policy produced for the Strengthening Local Government Task Force is provided below.

Textbox 1: Local Government pricing policies for fees and charges

Local Government Pricing Policies

Overall there are 5 general cost treatments for fees and charges available to councils:

- **Legislative cost** – whereby prices are determined by legislation;
- **Zero cost** – whereby Council fully absorbs the cost of the service;
- **Partial cost recovery**- tied to a fee or charge to offset the cost of the service but which has some form of subsidy reflecting equity or public benefit objectives;
- **Full cost recovery** – tied to efficiency and revenue neutral objectives; and
- **Market or competitive pricing** – tied to council business operations and bound by competitive neutrality principles. Council business operations must have cost structures and pricing that does not use its public ownership status to generate a competitive advantage over private providers. For example competitive neutrality prohibits councils from cross subsidising their business services from non-business operations in order to offer discounted business services and undercut private sector competitors.

Fees and service revenues are the main areas where councils can apply varying cost treatments. Section 608 of the LG Act allows councils to charge or recover a fee for any service it provides such as:

- Supplying a service, product, or commodity;
- Giving information;
- Providing a service in relation to council's regulatory functions; or
- Allowing admission to a building or other council owned venue.

In determining which cost treatment is appropriate for each type of service, Councils are guided by principles of "fair imposition" and "user pays". *Fair imposition* principle is contained in Section 8 of LG Act which sets out the

⁶ Most caravan parks operated by councils in NSW are on Crown lands under the care control and management of councils. Revenue raised on these sites must be reinvested in the caravan park and surrounding Crown lands. They do not provide a source of general revenue.

council's charter and states that *councils may raise funds for local purposes by fair imposition of rates, charges and fees, by income earned from investments, and when appropriate by borrowings and grants*. The principle of *user pays* is attached to those council services that are made available to the public but not necessarily provided collectively and generically to all ratepayers. Hence payment is sought from the user or direct beneficiary of the service rather than imposing that cost on all ratepayers.

Mindful of these pricing principles, councils commonly split their services and fee treatments into the following categories:

- **Simple revenue services** – such as parking fees and specific “user pays” services
- **Non-business or “traditional” council services** – free or partial cost services associated with community service obligations such as public library services or community venue hire
- **Competitive or business services** – whereby Council services compete with the private sector providers such as building approval services or nursing homes or child care facilities
- **Legislated or exclusive services** – such as charges for council infrastructure access or planning approval lodgement fees tied to exclusive or monopoly service provision by councils

For some time councils have been exploring new revenue opportunities by breaking down their broad service categories into sub-categories with different cost treatments.

For example, a council may provide a free (zero cost) resident membership for local libraries but charge a partial cost for use of internet facilities and photocopying services, and apply full cost charges for lost or damaged books. Similarly a council may apply the prescribed legislative fee for the issue of a building certificate, a partial cost charge for variations or reissue of certificates, and full cost for the restoration work (ie guttering and paving) relating to the approved building work.

A council may also apply differential fees on the basis of the type of service user. For example councils may allow discount venue hire fees for not-for-profit organisations compared with hire rates for private or commercial operators.

While Councils have the discretion across these areas to set fees and charges, under section 610F of the LG Act, a council must not determine the amount of a fee until it has given public notice of the fee and considered any submissions. In addition there are transitional, disclosure and review requirements imposed on ongoing fees and charge arrangements. Through these mechanisms councils are implicitly required to assess their particular community's capacity to pay and set appropriate price policies.

Are there any untapped revenue sources that local governments could use to augment or change the mix of their revenue raising? Would any potential new revenue sources be stable or variable over time?

On a broader level, a major potential revenue source would be rents for the commercial placement of pipes, wires, poles and cables in public corridors. As noted elsewhere, section 611 of the LG Act provides a limited historical precedent for this. However, there would need to be legislative changes to enable the application of this practice to be expanded to include telecommunications, water and electricity.

In the absence of rate pegging, special rates, often referred to as levies, could be more effectively utilised to increase revenue. For example; special rates could be applied to raise additional revenues from tourism and entertainment precincts. At present, revenue from special rates forms part of general income which is pegged. Without a special rate variation, the targeted application of special rates only results in a redistribution of the rate burden not an increase in revenue.

4.2. State and Territory Government Regulatory Constraints

4.2.1. Land Rating and Valuation Methods

To what extent do limits on land categories that local governments can adopt for rating purposes restrict their capacity to raise rate revenues?

Limits on categorisation have not been generally recognised as a significant revenue raising constraint in NSW. As illustrated in Table 2, the LG Act provides considerable scope for categorisation with major four categories which may be further sub-categorised on various criteria.

Table 2: Land categories and sub-categories for rating purposes

Category	Sub-categorisation options
Farmland	Intensity of land use Economic factors Reduction in land value ⁷
Residential	Rural Centre of population
Mining	Kind of mining
Business	Centre of activity

Mixed Development Apportionment Factors provide a further rating option for mixed development lands. They allow councils to rate parcels of land with both residential and business uses proportionally according to those uses, based on these factors as determined by the Valuer General. NSW councils are also able to apply minimum rates and base rates in their rating policies; further expanding options to vary the rating mix. The base amount may yield up to 50% of income from the rate category or sub-category.

With a rate pegging system, further options to categorise would only result in a redistribution of the rate effort, not an increase in rate revenue.

What are the principal reasons why some local governments do not pursue differential rate setting even where they are free to categorise their own land?

The majority of NSW councils do apply differential rating, at least to the category level. Flat rating structures are rare in NSW. The decision not to further sub-categorise in some instances is primarily for reasons of administrative simplicity.

Do restrictions on land valuation methods affect the capacity of local governments to raise revenue? If so, how and to what extent?

In NSW, valuations for rating and land tax purposes are provided exclusively by the Valuer General. Valuations are provided on an UCV basis.

A change in the valuation methodology would have little direct effect on a council's revenue raising capacity in a rate pegging environment. However, it will potentially affect the distribution of the rate burden within a council area.

While it may be argued that UCV methodology theoretically promotes the highest and best use of land, many would argue that a ICV basis allows for more equitable outcomes. ICV provides a more accurate reflection of the market value of a property and the owner's capacity to pay.

ICV would help alleviate the apparent distortion where, for example, very high value home units pay significantly less rates than free standing homes (of comparable or lesser value) in the same council area. For example, many high value units in North Sydney City Council area pay minimum rates while other properties pay significantly more.

Outside a rate pegging environment, capital values could increase a council's rate revenue raising capacity by increasing the valuation base. Within a rate pegging environment, there may be indirect advantages via greater flexibility to maximise rate revenue through special rate variations; for example, better targeting of capacity to pay.

4.2.2. Rate Pegging

What are, or might be, the reasons for rate pegging?

⁷ The introduction of reduction in land value as a basis for sub-categorisation is a recently introduced transition criterion to help councils deal with the separation of land and water for land valuation purposes.

NSW is the only state that currently applies rate pegging. Rate pegging was introduced in response to the prevailing economic and political environment of the mid 1970s and it is doubtful that the concerns of the time are still relevant.

An interim form of rate pegging was reintroduced to NSW by the Wran Government in 1977. A revised system, much the same as is currently operating, was implemented in 1978. A form of rate pegging had previously operated in NSW between 1901 and 1952, after which it was discontinued because of its impracticality. The situation had been reached where the majority of councils were successfully applying for an exemption or variation in the limit. This situation was administratively cumbersome and ultimately self defeating.

The Labor Party committed itself to the introduction of rate controls during the 1976 state election campaign.

The justification and appeal of rate pegging needs to be considered against the backdrop of the time. The 1970s were a period of rapid social, political and economic change. The pertinent aspect in relation to rate pegging was that the roles of, and relationships between, spheres of government had changed substantially.

The Whitlam Government had established a more direct relationship between the Commonwealth and Local Government. While this involved substantial increases in direct financial assistance to Local Government it was also accompanied by an expanded range of roles and responsibilities. This expansion of the roles and responsibilities of Local Government were also driven by increased community demands and expectations.

To quote Independent State MP John Hatton during the debate on the rate pegging bill:

“The responsibilities of Local Government have grown so rapidly that they have completely outgrown the revenue base and, despite the impetus of money in the form of direct federal grants from the Whitlam Government, which have been carried forward by the Fraser Government, this is still the case.”

At the same time, public perceptions about government were changing, particularly in relation to perceived excesses. While this applied to all spheres, Local Government as the most accessible and familiar sphere of government was particularly vulnerable to criticism.

Most importantly, it was a period of high inflation that impacted on rates through both escalating property values and increasing council operating costs. It was also a period when many believed that wage and price freezes were an appropriate response to inflationary pressures. This view was promptly discredited, however, rate pegging, an analogous concept, is still maintained.

The impetus for the introduction of rate pegging was provided by the rapid escalation of rates in the early 1970s. In the four years, 1973 to 1976, rates increased by an average of 118% while average weekly earnings increased by only 75% and the consumer price index by 56%. Annual increases of between 30 to 40% had been applied in many areas. While this was largely the result of the factors such as expanded roles and responsibilities, it was easy for the public to perceive the increases as excessive.

Interestingly, the argument that rate increases were excessive is not supported by comparison with the revenue growth of other spheres of government. While Local Government general rate revenue increased by 148% between 1970 and 1976, NSW Government revenue increased by 212% and Commonwealth Government revenues increased by 167%. Clearly, Local Government rate increases were quite modest compared to the revenue increases of other spheres of government - a situation that persists today.

Rates are a highly visible form of taxation and because they are presented in the form of bill to be paid annually or quarterly, ratepayers are very conscious of the amount paid and changes from year to year. This is not true of many other major forms of taxation. Bracket creep allows income tax revenues to quietly escalate with little protest by taxpayers and GST revenues escalate in a like manner.

The introduction of rate pegging was also made easier by increases in the level of Financial Assistance Grants by the Commonwealth Government, which many perceived to be a substitute for rate revenue.

In brief, the rationale for the introduction of rate pegging is summarised in the following points:

- It was a period of high inflation and the public were demanding stringency measures;
- Grant funding was (wrongly) perceived as a substitute for rate revenue; and
- Rates increases, unlike many other tax increases, are highly visible.

More recent arguments for maintaining rate pegging include the view that Local Government should reduce its reliance on rate (tax) revenue in favour of user fees and charges for services. Further, the major political parties in NSW appear to believe it is popular and the relevant NSW bureaucracies appear to like to maintain the control mechanism.

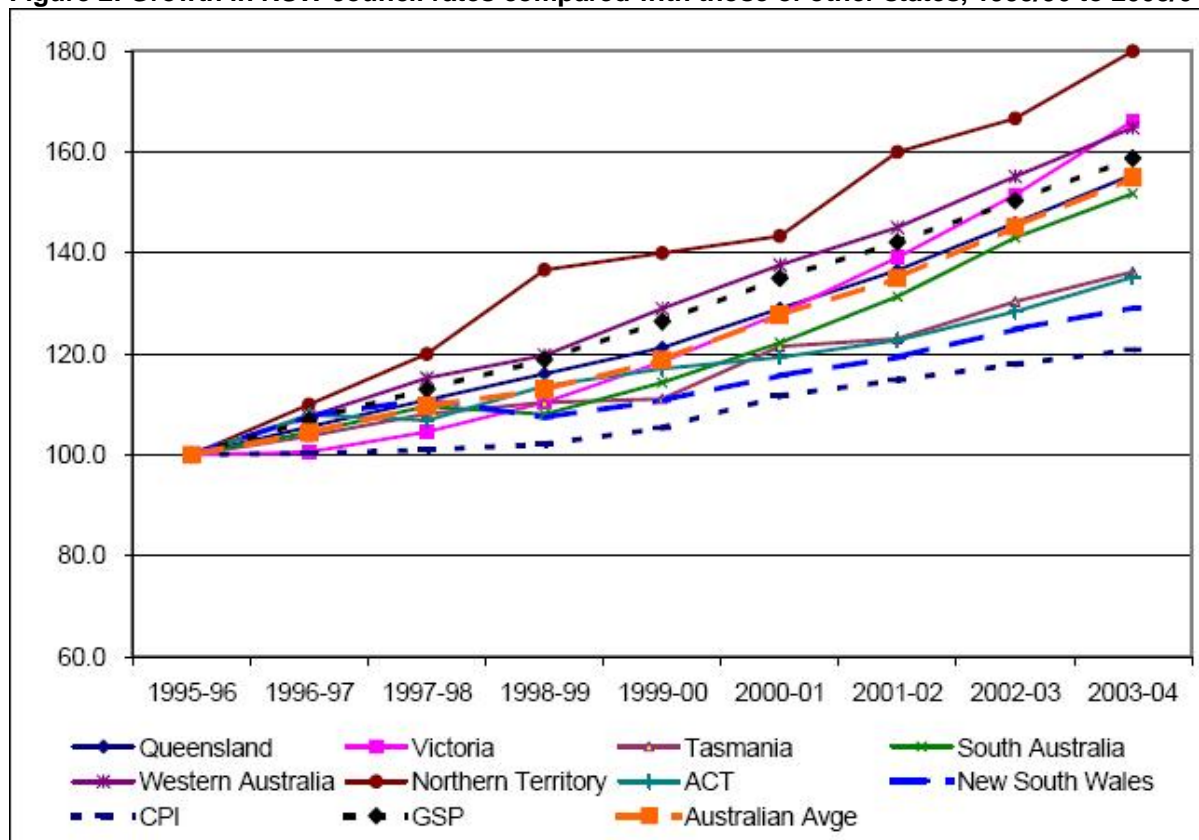
The experience of other states and territories supports the Associations position that rate pegging is an unnecessary intervention. While rates have grown more slowly in NSW than in other states in recent years, rates in other states have not increased excessively. This supports the Associations view that the political process holds councils accountable.

To what extent does rate pegging limit the ability of local governments to raise council rate revenues?

The available evidence indicates that rate pegging is a major revenue constraint on Local Government in NSW. As noted previously and illustrated in Figure 2 below, rate revenue growth in NSW has lagged that of all other jurisdictions and NSW now has the lowest rates per capita.

Even though NSW councils may apply for special variations to general income which allow for rate increases over and above that rate pegging limit, the LGI found that actual increases in average rate revenue only marginally exceeded the rate pegging limit for the period 1995/96 to 2003/04.⁸ This indicates that the rate pegging system has a broader dampening effect than the actual limit.

Figure 2: Growth in NSW council rates compared with those of other states, 1995/96 to 2003/04



Source: LGI, Final Report, Section 9.2, p198, (Figure 9.2).

A likely explanation for the dampening effect is that rate pegging provides a public benchmark and creates expectations about maximum rate increases, placing political pressure on councils to stay within the limit and not seek special variations.

This has negative consequences in the long run, these include:

- Depriving communities of infrastructure and services;
- The deferral of infrastructure maintenance and renewal expenditure; and

⁸ LGI, Final Report, Section 9.3, pp207-208.

- Undermining the financial sustainability of councils.

A further criticism of the rate pegging system is that it lacks transparency. There is no official or publicised methodology on which it is based and ultimately it is a political decision. While the rate pegging limit has tended to track CPI over the past 10 years, there have been exceptions and the system is vulnerable to political manipulation.

A major flaw of the rate pegging system is that it effectively breaks the traditional nexus with land valuation. As discussed earlier in this paper⁹, valuations do not drive revenue under rate pegging; they only serve to redistribute the rate burden within council areas.

It could also be considered hypocritical for rate pegging to be maintained on Local Government while NSW State Government land taxes remain uncapped.

The Associations have opposed rate pegging since it was introduced. However, while advocating removal of the system, the Associations have promoted the adoption of a Local Government cost index as an interim measure. The Associations developed an alternative model, the *NSW Local Government Rate Determination Model*¹⁰, and presented this to the NSW Government in 2003. The model provided a specific Local Government cost index as the basis for determining the rate pegging limit. This would help ensure that the rate pegging limit would more accurately reflect the actual cost pressures facing councils. As a public index, it would also overcome the lack of transparency associated with the current system.

Further information on the issue of rate pegging is available in Chapter 9, pages 207 to 211 of the LGI's Final Report.

Are local governments able to raise revenues from other sources to compensate for the potential revenue raising limits imposed by rate pegging? How, and with what consequences?

As noted above, NSW councils are increasing their reliance on 'fees and charges' and 'other income' to compensate for the constraints of rate pegging.¹¹ There is an increasing trend towards full cost recovery or commercial pricing policies where appropriate.

4.2.3. Concessions and Exemptions

To what extent do mandated exemptions and concessions limit the ability of local governments to raise council rate revenue?

The LG Act provides for a wide range of exemptions, many of which were carried over from the *Local Government Act (NSW) 1919* and which, in the Associations' view, are outdated and no longer appropriate.

The Associations are calling for a review of rate exemptions. This is consistent with LGI recommendation 23 which states:

“The State Government should review and remove rate exemptions for all land use for commercial or residential purposes regardless of ownership.

This includes State Government trading enterprises (e.g. NSW Forests landholdings used for commercial forestry) and benevolent organisations' commercial activities (e.g. retirement homes and business premises). Councils should also be allowed to apply Section 611 charges for all commercial use of public spaces (e.g. underground pipes and cables, street poles, overhead wires).¹²

The types of land exempt from all rates are included under section 555 of the LG Act:

- Land held by the Crown, not being leased for private purposes;
- Land within a national park, historic site, nature reserve or state game reserve;
- Land subject to a conservation agreement;

⁹ See above 4.2.1.

¹⁰ Local Government and Shires Associations of NSW, *NSW Local Government Rate Determination Model*, Prepared by the National Institute of Economics and Industry Research, 2003, Sydney, Melbourne.

¹¹ See above 4.1.1.

¹² LGI, Final Report, Section 12.6, p307.

- Land occupied by a church or another building used or occupied for public worship;
- Land occupied by a building used or occupied with religious teaching or training, or as a residence for a minister of religion;
- Land that belongs to and is occupied and used in connection with a school;
- Land that is within a special area for the Hunter Water Corporation or other water supply authority;
- Land that is vested in the NSW Aboriginal Land Council or a Local Aboriginal Land Council and is declared under Division 5 of Part 2 of the Aboriginal Land Rights Act 1983 (this may also exempt land from all charges in some circumstances);
- Land owned by the Rail Infrastructure Corporation; and
- Land below the high water mark and used for any aquaculture relating to the cultivation of oysters.

The types of land exempted from rates other than water supply and sewerage special rates are included under section 556 of the LG Act:

- Land that is a public place, common or public reserve;
- Land used as a public cemetery, public library, public hospital, college, university or mining rescue company;
- Land that belongs to and is used by a public benevolent institution or charity; and
- Land belonging to the Sydney Cricket and Sports Ground Trust or the Zoological Parks Board.

The Associations are not opposed to rate exemptions where they are justified; for example, genuine benevolent institutions and charities, public lands, schools and hospitals. The Associations concerns are that in modern times the distinction between public and private or commercial use is becoming blurred in many instances. This arises in areas such as seniors residential and aged care facilities. Many facilities operated under the banner of churches, charities and benevolent institutions bare little distinction from privately owned complexes and facilities. Similarly, many councils cannot see why rate exemptions apply to the large land holdings of many private schools, a large proportion of which is utilised for sporting, recreational, staff accommodation and other non-core educational uses.

Further we are concerned that some commercial uses of state owned lands remain exempt from rates. This includes commercial activities within national parks, unleased properties held by land holding agencies and the commercial forestry plantations of Forests NSW. The latter compete with private plantations which do pay rates, so there is also a competitive neutrality issue here.

The Associations have also called for new a new provision to be inserted in the LG Act to allow councils wider powers to charge for the commercial use of public spaces. This relates to cables, pipes and wires under or over public corridors. Limited provision is provided under section 611 of the LG Act to charge for such usage. However, this is not enforceable in most instances.

What are the existing arrangements in each State and Territory regarding the payment of council rates and rate-equivalents by Australian, State and Territory landholders?

NSW state owned corporations are generally required to pay rates under sections 9(b) and 20F(b) of the *State Owned Corporations Act (NSW) 1989*. Rates are paid directly to councils. This policy was adopted to apply competitive neutrality principles under National Competition Policy. However, as illustrated in Table 3, a number of other NSW Government businesses remain exempt.

Table 3: NSW Government businesses exempt from council rates

Business	Section 555(1) LG Act exemption
TransGrid	Pays no rates despite liability under s 20F(b) of the <i>State Owned Corporations Act (NSW) 1989</i>
Pacific Power	Pays rate equivalents despite being exempted under the <i>Electricity (Pacific Power) Act 1950</i>
Fish River Water Supply Auth.	Pays no rates on unleased land under section 555(1)(a)
Sydney Catchment Authority, Sydney Water & Hunter Water	'Special Areas' and 'Controlled Areas' exempted under section 555(1)(c) and 555(1)(c1)
Landcom	Pays no rates on unleased land under section 555(1)(a)
Department of Housing	" "

Business	Section 555(1) LG Act exemption
Crown Property Portfolio	" "
Department of Public Works	" "
Waterways Authority	" "
Sydney Harbour Foreshores Authority	" "
Honeysuckle Develop. Corp	" "
Land & Property Information	" "
State Forests of NSW	Pays no rates on unleased land under section 555(1)(a)
National Parks & Wildlife Services	Exempt from paying rates "whether or not the land is affected by a lease, license, occupancy or use" under section 555(1)(b)
State Transit Authority	Pays no rates on unleased land under section 555(1)(a)
Rail Infrastructure Corporation	Pays no rates on unleased land under section 555(1)(g1)
State Rail Authority	Pays no rates on unleased land under section 555(1)(a) and 555(1)(g1)
Sydney Cricket Ground Trust	Pays no rates on unleased land under section 556(1m)
Wollongong Sports Trust	Pays no rates on unleased land under section 555(1)(a)
State Sports Centre Trust	" "
Parramatta Stadium Trust	" "
Sydney Ports Corporation	Liable under <i>State Owned Corporation Act (NSW) 1989</i>
Newcastle Port Corporation	" "
Port Kembla Port Corporation	" "
Zoological Parks Board	Pays no rates on unleased land under section 556(1)(n)
Sydney Opera House Trust	Pays no rates on unleased land under section 555(1)(a)

Commercial/private leaseholds on Crown lands are subject to rates however, as noted above, commercial leaseholds in national parks are not subject to rates. This is an anomaly that needs to be addressed.

State and Commonwealth Government departments and agencies do not pay rates or rate equivalents on properties they own. Commercial leaseholds on Commonwealth lands typically pay a rate equivalent (e.g. Sydney Airport).

The Associations maintain that all government business or trading activities, particularly those that compete with private competitors should be subject to rates. This is based on the Associations' policy principle that all lands used for residential or commercial purposes should be subject to rates regardless of ownership and the principle of competitive neutrality.

What are the existing arrangements in each State and Territory regarding the provision of concessions, and the compensation by State and Territory governments for the loss of revenue by local governments from these concessions?

Pensioner rebates are the major concession available in NSW. While all states provide pensioner concessions, NSW is the only state that requires councils to fund approximately half the cost of the concession.

Eligible NSW pensioners are entitled to rebates on:

- All ordinary council rates and charges for domestic waste management services up to \$250;
- All water supply special rates or charges not to exceed \$87.50; and
- All sewerage special rates or charges not to exceed \$87.50.

The expense of the rebate is jointly funded by councils and the NSW Government on a 45:55 basis. The level of the compulsory rebate has been static since 1993. Similar pensioner rebates are provided in other states and territories but are fully funded by the respective state and territory governments.

Australia's population aged 65 and older is projected to increase from 2.5 million (12%) in 2002 to 4.2 million in 2021 (18%). Based on this figure, over a quarter of the population in most Local Government areas will be aged over 65.

Despite growing superannuation coverage, many of the retirees will still be pensioners or partially funded retirees who will become pensioners at some stage after retirement.

There are also mounting pressures to increase the levels of the rebates and extend them to self funded retirees. Of immediate concern are recent amendments to Commonwealth legislation whereby asset limits for Centrelink purposes are to increase from 20 September 2007. These trends will potentially swell the number people receiving concessions and dramatically increase the cost of concessions.

The cost of compulsory pensioner rate rebates is a rapidly growing burden for many councils and is affecting the level and range of services that councils are able to deliver. The scheme already costs some individual councils well in excess of \$1 million annually. The total cost to councils is now around \$76 million annually. This is the result of an ageing population. The impact on councils is uneven with higher concentration of pensioners in many coastal councils, regional centres and some older established suburbs. Many councils are advising that they will not be able to sustain the growing cost in the medium to long term.

It should also be recognised that the cost is inequitably distributed. Those who qualify for rebates are disproportionately represented in low income areas, areas that already have a high demand for council services but a limited revenue raising capacity. Given the limited revenue base of Local Government it is unfair that it should be required to fund this form of welfare assistance. This form of benefit should be funded by from the broader revenue base of the state or federal governments. As previously noted, the NSW Government is the only state government that does not fully fund pensioner rate concessions.

To what extent do exemptions and concessions limit the ability of local governments to raise revenues?

The impact of concessions and rebates varies widely between councils. As noted above, pensioner concentrations are higher in particular Local Government areas. The same is true of exemptions. For example, many councils have a large proportion of their land areas taken up by national parks or Forests NSW; others have concentrations of government offices, schools and hospitals.

Aggregate data on the cost of exemptions is not available.

Are local governments exempt from taxes and charges by other tiers of government? If so, what are they? Does any lack of reciprocity favour or disadvantage local governments?

Local Government is exempt from company tax and its core activities are exempt from NSW payroll tax and stamp duties. Certain prescribed activities are subject to payroll tax if they exceed the threshold (e.g. water, sewerage, cemeteries, abattoirs etc).

As part of the incomplete reciprocal charging regime, Local Government no longer receives exemptions or concessions from state owned water corporations or state owned electricity utilities.

4.2.4. Setting Fees and Charges

What are the regulatory requirements and guidelines applied to local governments for setting fees and charges?

To what extent are local governments constrained in setting fees and charges? To what extent are the requirements and guidelines followed by local governments?

To what extent do local governments under or over-recover the costs of supplying goods and services?

What scope would there be to raise additional revenue if the limits were removed?

To what extent does local government legislation or other relevant legislation explicitly provide the power to set fees and charges in excess of the cost of supply?

If powers are not explicitly provided, to what extent, if any, does this limit the ability of councils to raise revenue from introducing new fees and charges?

NSW Local Government can collect charges for service to properties which are levied on the parcel of land for which the service is provided and fees for supplying other services, a product or commodity, for giving information or for providing a service in relation to council's regulatory functions.

The following sections will deal with:

- The regulatory environment for the setting and pricing of charges;
- The regulatory environment for the setting and pricing of fees; and
- Scope for additional revenue.

Charges (annual charges and user charges)

Power to set charges

Legislation prescribes what property services councils can levy charges for. Pursuant to chapter 5, parts 1, 2, 4 and 5 of the LG Act councils can levy charges for the following services:

- Water supply services; section 501 LG Act;
- Sewerage services; section 501 LG Act;
- Drainage services; section 501 LG Act;
- Waste management services (other than domestic waste management services); section 501 LG Act;
- Any services prescribed by the regulations; section 501 LG Act;
- Domestic waste management services; section 496 LG Act; and
- Stormwater management services; section 496(a).

Charges can be levied either as an annual charge or as a charge for actual use (user charges, section 502 LG Act); apart from charges for stormwater management services which can only be levied as annual charges.

In addition, councils can levy an annual charge on the person for the time being in possession, occupation or enjoyment of a rail, pipe, wire, pole, cable, tunnel or structure laid, erected, suspended, constructed or placed on, under or over a public place (section 611 LG Act).

In practice, annual charges are mainly levied for domestic waste management services. User charges are commonly levied on water and sewerage services (outside the Sydney and Hunter regions), commercial waste and extra waste management services.

Regulatory restrictions and guidelines

General "capping" of income from charges

Similar to rate pegging, the Minister for Local Government has the power to specify the proportion by which income from certain charges can be varied in relation to previous year's income. However, in practice the Minister has not applied this power, apart from the fact that income from annual charges for drainage services and any charges councils levy for services as prescribed by the regulations are included under "general income" which is currently limited (rate pegging); section 505(a) LG Act.

Income limitation could be imposed on the following charges:

- Annual charges for domestic waste management services; sections 505(b) and 507 LG Act;
- Annual charges for stormwater management services; sections 505(c) and 510A LG Act;

Charges for water supply, sewerage and domestic waste management services are subject to mandatory rebates for pensioners; section 575 LG Act; which are only partly reimbursed by the NSW Government.¹³

General regulatory requirements on pricing

Generally, the amount of a charge need not be limited to recovering the cost of providing the service, except as provided by section 503(2) LG Act (limitation to cost recovery of a charge for a service if the land is not rateable by a special rate for that service) and section 504(3) LG Act (limitation to reasonable cost for domestic waste management services; see below).

The DLG in its *Rating and Revenue Raising Manual* advises that funds received as a result of levying a charge may not be used otherwise than for the purpose for which the charge was levied.¹⁴

Section 539 LG Act generally prescribes what criteria are relevant in determining the amount of a charge: councils may have regard to (but is not limited to) the following:

- The purpose for which the service is provided;
- The nature, extent and frequency of the service;
- The cost of providing the service;
- The categorisation for rating purposes of the land to which the service is provided;
- The nature and use of premises to which the service is provided;
- The area of land to which the service is provided; and
- In the case of water supply services—the quantity of water supplied.

The DLG in its *Rating and Revenue Raising Manual* recommends that while the amount of a charge need not be limited to recovering the cost of providing the service, the amount of a charge would still need to be "reasonable".¹⁵

However, the LGI found the DLG guidelines recommendations, as well as the provisions in the LG Act vague. They do not define or discuss the nature of costs, the treatment of sunk costs, pricing according to marginal cost principles where appropriate, the treatment of accrued versus cash costs, the allocation of joint overhead costs, the treatment of depreciation, or the appropriate real return on capital.¹⁶

Specific constraints and requirements

The following restraints and requirements apply to specific services:

- Water and sewerage and liquid trade waste management (water and sewerage services are provided by council businesses outside the Sydney and Hunter regions of NSW):
 - Pursuant to the 1994 Council of Australian Governments agreement on a strategic framework for the efficient and sustainable management of the Australian water industry, councils are required to adopt best practice pricing principles, full cost recovery and transparency as policy objectives for water supply and sewerage businesses and liquid trade waste services.
 - Best practice pricing for water supply includes an appropriate usage charge together with a cost reflective access charge. Best practice pricing for sewerage includes a two-part tariff for non-residential customers, a uniform sewerage bill for residential customers and appropriate trade waste fees and charges for all dischargers of liquid trade waste.¹⁷ The Department of Water and Energy provided guidelines for councils on best practice management and pricing guidelines.
 - Water and sewerage services (38 per cent of total turnover of Local Government businesses) and waste collection and related services (8.8 per cent, *ibid*) are commercial businesses and as such expected to meet the requirements of National Competition Policy (NCP) if their annual turnover is greater than \$2million (category 1 businesses). Requirements imposed by NCP are:¹⁸

¹³ See above 4.2.3.

¹⁴ DLG, *Councils Rating and Revenue Raising Manual*, (2007), p43.

¹⁵ *Ibid*, p43 and pp54-58.

¹⁶ LGI, *Final Report*, Section 9.4, p215.

¹⁷ DLG, *Councils Rating and Revenue Raising Manual*, (2007), p44.

¹⁸ See LGI, *Final Report*, Section 9.4, p214, 216. In 2003/04, the 126 local water utilities providing these services had a total turnover of \$806 million and total assets under management of \$10.6 billion. Of these LWUs, 51 were category 1 businesses and required to apply corporate principles to their operations

- Adoption of a corporate model;
 - Inclusion of debt guarantee fees;
 - Factoring into prices an appropriate return on capital invested;
 - Quantification of and making explicit community service obligations;
 - Operation in the same regulatory environment as other businesses;
 - Inclusion in costs the same taxes as faced by private businesses
 - Pay-for-use water supply pricing;
 - Full cost recovery;
 - Removal of cross subsidies;
 - Trade waste pricing;
 - Performance reporting and benchmarking; and
 - Payment of tax equivalents and the ability to pay dividends from water and sewerage businesses to councils' general funds.
- Domestic waste management charges:
 - Income to be applied to domestic waste management must be obtained from charges for this service; section 504(2) LG Act. Income from ordinary rates cannot be applied towards the cost of providing domestic waste management services; section 504(1) LG Act.
 - Domestic waste management charges must be calculated not to exceed the “reasonable cost” to the council providing those services; section 504(3) LG Act.
 - Pursuant to section 510 LG Act, the annual charge for domestic waste management services for a parcel of rateable land must not exceed the charge for the previous year as limited by general income restrictions for that charge, if imposed; section 507 LG Act.
 - Stormwater management charges:
 - Pursuant to clause 125A of the *Local Government (General) Regulation (NSW) 2005*:
 - An annual charge for stormwater management services may only be levied on land categorised for rating purposes as residential or business;
 - The charge cannot apply to vacant land;
 - The charge cannot be levied on a parcel of land subject to a special rate or charge for which the primary purpose is to provide a stormwater management service;
 - The charge cannot be levied by a council if it has received a special variation from the Minister for Local Government for which the primary purpose is to provide a stormwater management service;
 - The charge cannot exceed the anticipated cost (if less than maximum charge) or the maximum charge (if anticipated cost greater than maximum charge); and
 - Pursuant to clause 125AA of *Local Government (General) Regulation (NSW) 2005* the maximum charge that may be levied on rateable land is:
 - \$25 for land categorised as residential; and
 - \$25 per 350 square metres (or part thereof) for land categorised as business.
 - Charges pursuant to section 611LG Act:
 - The annual charge is to be based on the nature and extent of the benefit enjoyed by the person concerned.

Fees

Fees are the main areas where councils can apply varying cost treatments. Prices are determined by pricing guidelines and council policies.

Section 608 LG Act allows councils to charge or recover a fee for any service it provides such as:

- Supplying a service, product, or commodity;
- Giving information;
- Providing a service in relation to council's regulatory functions; or
- Allowing admission to a building or other council owned venue.

A review of Local Government pricing policies is provided above.¹⁹

Scope for additional revenue from charges and fees

¹⁹ See above 4.1.2, Textbox 1.

Full charging for the use of water and dividends from water and sewerage businesses

The LGI found that few if any councils charge for the water as a resource itself. In this, they are following common practice in NSW where the Independent Pricing and Regulatory Tribunal regularly sets water prices to reflect expenditures and makes no allowance for the scarcity value of water. Accordingly, the Inquiry suggests fully charging for water as a scarce resource.²⁰

Also, the rate of return on assets employed is low even by utility standards and does not reflect the rate of return available from alternative uses of scarce capital resources. This indicates that not only is there no scarcity charge for water itself, but that the charges for the use of capital and other resources are also too low.²¹

Pursuant to section 409(5) LG Act, councils with water supply and/or sewerage businesses are allowed to pay a dividend from any operating surplus of those funds to their general fund. The payment of dividends is subject to the council complying with best practice guidelines published by the Department of Water and Energy.

However, besides covering its accounting costs, water and sewerage businesses are not obliged to earn an economic rate of return on its equity so that its dividend payout can be truly commercial.²²

Parking fees

The LGI found that councils, particularly in metropolitan areas already collect parking fees but there might be scope for more effective use of this type of fee.

Where there is a shortage of parking facilities (on or off street), the principle of efficient allocation suggests charging at the market-clearing price. This ensures that scarce parking space is utilised most efficiently. Parking fees are also an effective way of ensuring that visitors pay for local services. While groups who lose free parking rights may resist the new charges and the fines that go with overstaying parking meters, councils have powers to exempt local residents from parking fees and often do so for short stays or in residential streets and popular local amenity areas.²³

Recently there has been concern about rising fines for parking. Parking fines rose from \$60 million in 2002/03 to \$95 million in 2004-05. However, this concern is largely misplaced. The key issue is not whether fines are charged, but whether parking fees are reasonable. Parking fees are an inevitable and necessary method for fairly and efficiently dealing with limited road space subject to excessive demand.²⁴

Road usage fees

Roads and open spaces are high value assets of local councils. They are also a source of long-run financial viability. It is important that use of roads and open spaces be appropriately rationed and used in the public interest and this is likely to involve charging commercial returns for the use of scarce resources.²⁵

4.3. Impacts on individuals, organisations and businesses

4.3.1. Council Rates

What would be the effects on individuals, organisations and businesses of local governments increasing council rates?

As noted previously, rates represent a small proportion of disposable income and, perhaps more significantly, a small proportion of the overall tax burden on individuals, organisations and businesses.²⁶

Rates represent only 3% of the tax revenue collected in Australia.

²⁰ LGI, Final Report, Section 9.4, pp216 and 220.

²¹ Ibid, p216.

²² Ibid, p216.

²³ Ibid, pp217-218.

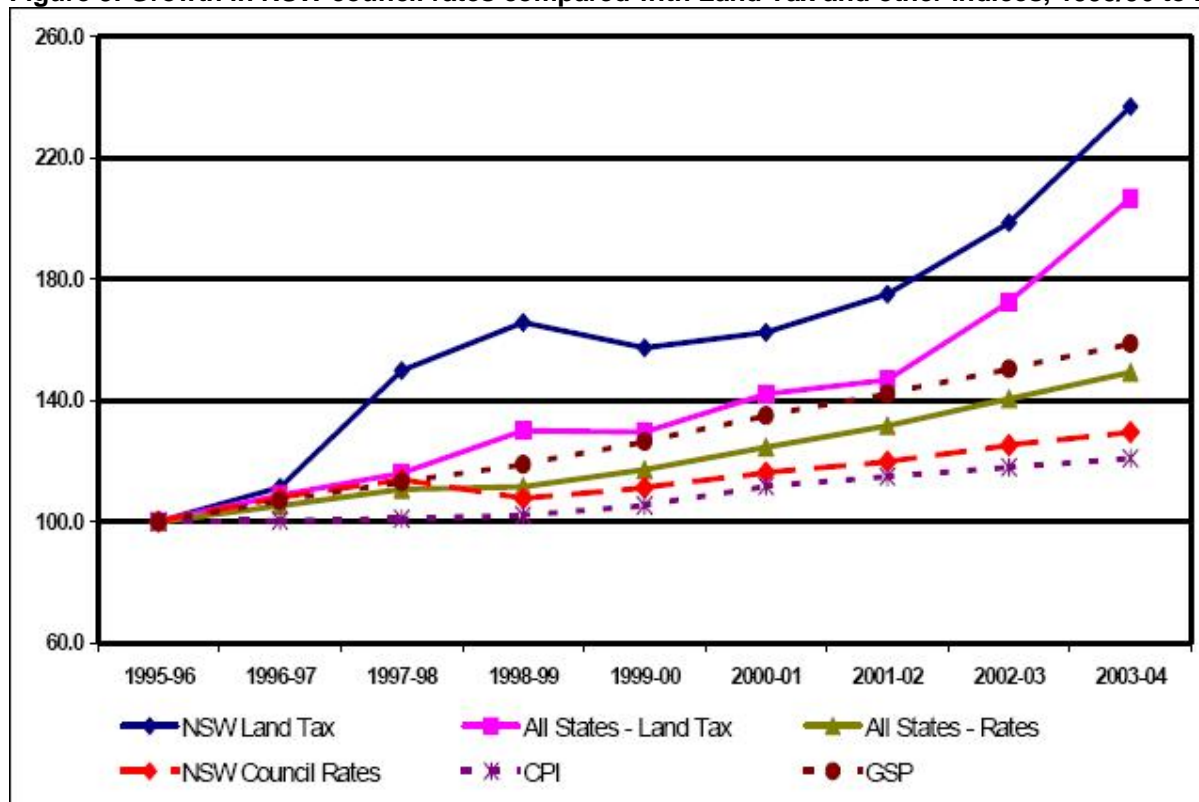
²⁴ Ibid, p218.

²⁵ Ibid, p217.

²⁶ See above 4.2.2.

However, this is not to say that rates represent a relatively underutilised form of taxation that is the panacea for Local Governments financial needs. Rates cannot be considered in isolation from the overall tax burden on the Australian public. Further, the potential to raise additional rates is becoming increasingly crowded out by the encroachment of state land taxes. Figure 3 below demonstrates the escalation of state land taxes compared to council rates.

Figure 3: Growth in NSW council rates compared with Land Tax and other indices, 1995/96 to 2003/04



Source: LGI, Final Report, Section 9.2, p198, (Figure 9.1).

Given the effects of rate pegging, there is the need and the scope for increased rates in NSW. However, given the vertical fiscal imbalance inherent in the Australian taxation system, a major part of the solution to the financial needs of Local Government lies in a fairer share of national taxation revenues.

To what extent are council rate revenues used to subsidise the delivery of goods and services for which fees and charges are collected? What are the consequences?

Once again the extent varies between councils and will depend on the composition of council revenue, community needs and council policies.

To what extent do efficiency and equity considerations contribute to the attractiveness of council rates as a source of local government income?

It is probably the inherent efficient and equitable basis of rating that has maintained it as the core revenue raising mechanism for Local Government. The NSW rating system, like most rating systems, is based on the principles of benefit (efficiency) and capacity to pay (equity).

The LGI determined that a sound Local Government rating system should exhibit four traits; financial adequacy, administrative simplicity, equity and efficiency.²⁷

It concluded:

- That rating was an adequate tax base for most metropolitan and large regional councils but noted that it was not so for many rural councils with small and/or declining rate bases;
- That the system is administratively cost efficient;

²⁷ LGI, Final Report, Section 9.3, p202.

- That rating was an equitable system overall, although with some deficiencies; and
- That it is efficient.²⁸

Further information on the issue of council rates is available in Chapter 9, pages 202 to 207 of the LGI's Final Report.

4.3.2. Developer Charges and Contributions

Information on the legislative and administrative framework for development contributions in NSW can be found in an extensive set of practice notes issued by the NSW Department of Planning.²⁹ The following notes draw on these practice notes and additional information can be found in the practice notes.

To what extent do local governments employ developer contributions and charges to finance investments in new and upgraded assets?

The provisions of section 94 and 94A of the LG Act and planning agreements under the EPA Act enable councils to obtain development contributions as a means of funding local infrastructure and services that are required as a result of new development. They may only be applied to capital costs.

The DLG publication *Comparative Information on NSW Local Government Councils 2004/05* provides statistics for each council and for all councils on contributions and donations. However, contributions pursuant to section 94 and 94A of the LG Act are not itemised separately. Each council reports on the level of contributions raised in any one year in their annual reports.

Are there legislated limits to contributions that can be required or charges that can be collected?

Councils are required to publish plan for contributions pursuant to section 94 LG Act which sets out the formula for determining the level of contributions.³⁰

Councils may also set a fixed rate development levy under section 94A of the Act. The *Local Government (General) Regulation (NSW) 2005* limit the maximum amount that can be levied to 1% of the cost of the development. Amendments to the legislation late last year also placed other limits on the levy, including:

- Levy cannot apply to developments valued at less than \$100,000;
- Maximum levy of 0.5% for developments valued at between \$100,001-\$200,000; and
- The levy cannot be applied to development for the purposes of disabled access, affordable housing and some other categories of development.³¹

Are there legislated constraints on the use of revenue raised from developer charges?

Under the legislation, section 94 of the LG Act can only be applied to the capital funding of facilities. The only recurrent funding permitted is the ongoing maintenance of roads where heavy vehicular traffic movements arise directly from specific development activity, such as mining. Planning agreements do, however, allow levies to be put towards recurrent funding.

What are the effects on individuals, organisations and businesses of the use of developer charges and contributions?

What is the most appropriate way to recover the costs of new and upgraded assets?

The LGI in its Interim Report found that:³²

²⁸ Ibid, Section 9.4, pp202-207.

²⁹ The practice notes can be accessed via the Department of Planning's website at http://www.planning.nsw.gov.au/planning_reforms/developmentcontributions.asp.

³⁰ Ibid, see practice note: "Determining rates for different types of development".

³¹ See Planning Circular - Changes to the application of section 94A of the EPA Act – ministerial direction (issued 6 December 2006) at http://www.planning.nsw.gov.au/planningsystem/pdf/circulars/ps06_020_s94a_am.pdf

³² LGI, Interim Report, Section 9.4, p177.

“The principle of developer contributions is a sound one. Developer contributions are efficient and equitable. They are efficient because they set charges that should reflect the real costs of local public infrastructure needed to support a private development and so ensure that such a development does not occur when its total costs exceed its total benefits in both a private and public sense. Also, they provide a mechanism for financing development.

They are equitable because the charges are borne by the beneficiary of the works. The major beneficiary is the owner of the land on which the development is made. As shown in Abelson³³, when the supply of land for urban housing is fixed and the price of housing land exceeds its value in alternative uses, as is usually the case in NSW, developer charges reduce the price of land. When the supply of housing land is fixed, the number of new houses supplied is independent of developer charge. The price of new houses is determined by the relative attractiveness of the new housing compared with the existing stock of housing. This relative attractiveness is not affected by charges that the developer has paid.

However, developer charges have to be paid from somewhere and, in general, development is a competitive business so the charges cannot come out of developer profits. Faced with developer charges, developers bid less for land. Of course, if developers already hold land, they pay the extra charge as the landowner. In the absence of developer charges, the land price would be substantially higher. This would be inequitable because the landowner has contributed nothing to this higher price.

In practice, there can be problems in the application of developer charges. There needs to be a nexus between the charges and the development and it can be hard to determine in advance exactly what costs will be involved. Special problems arise when development incurs ‘lumpy’ infrastructure. It can also be difficult to identify marginal incremental costs when development occurs in established areas. Many councils simplify administration of developer contributions by estimating an average rather than marginal or project specific cost for a new development. Dollery³⁴ argues that this is inappropriate because it sends the wrong price signals to developers and may encourage the wrong form of development.

In a working paper on developer charges for the Inquiry, Dollery³⁵ concludes that developer charges have worked well and that there is a strong case for expanding them.”

The proceeding discussion refutes the most common criticism that developer charges add to the cost of housing, particularly impacting on first home buyers. These arguments are supported by the Productivity Commission’s *Inquiry Report into First Home Ownership* (March 2004) which found:

While infrastructure charges, like other costs of bringing housing to the market, have increased over time, they cannot explain the surge in house prices since the mid-1990s. The claimed cost savings and improvements in affordability from reducing reliance on developer charges for infrastructure appear overstated:

- Most categories of charges are both justified and desirable on efficiency/equity grounds;
- Housing affordability should not be significantly affected by greater reliance on upfront charging as opposed to charging over time;
- Developer charges for those items of social or economic infrastructure that provide benefits in common across the wider community have generally been relatively small; though such infrastructure should desirably be funded out of general revenue sources; and
- Even if the cost of providing infrastructure to new developments were shifted onto the wider community, housing affordability might not be greatly enhanced.

Developer charges and contributions for infrastructure should be:

- *Necessary*, with the need for the infrastructure concerned clearly demonstrated;

³³ Abelson P, *The Real Incidence of Imposts on Residential Land Development and Building*, Economic Papers, 1999, Vol.18, 85-90 and Abelson P, *Taxation and Subsidies for Housing and Land: Market Impacts and Economic Efficiency Implications*, Paper presented to 34th Annual Conference of Economists, 2005, Melbourne.

³⁴ Dollery B, *Developer Contributions and Local Government Infrastructure*, For LGI Final Report, Sydney, 2006.

³⁵ Ibid.

- *Efficient*, justified on a whole-of-life cost basis; consistent with maintaining financial disciplines on service providers by precluding over-recovery of costs; and
- *Equitable*, with a clear nexus between benefits and costs, and only implemented after industry and public input.

Those imposing developer contributions and charges should:

- Follow guidelines based on these principles and be subject to independent regulatory scrutiny;
- Provide for 'out of sequence' development if developers are prepared to meet the cost consequences;
- Be open to proposals for alternative infrastructure arrangements that meet the needs of the households concerned;
- Allow appeals on the amounts charged, or their coverage; and
- Be accountable for how money raised from charges is spent.

The Associations support the conclusion that developer contributions are efficient and equitable means for funding infrastructure.

4.3.3. Fines and Pecuniary Penalties

What are the effects on individuals, businesses and organisations of fines and other pecuniary penalties and increases in them?

The purpose of fines and pecuniary penalties is to act as a deterrent from action that would otherwise be inappropriate and to encourage behaviour that is for the benefit of the whole society. The effect of the increase in the quantum of a fine may have different effects on individuals and businesses dependent on the size of the increase in the fine.

What measures are there in place to protect against the possibility that local governments might view fines as a revenue raising instrument more than as an appropriate deterrent?

There has been no evidence to indicate that councils use fines primarily as a source of revenue. Further, the level of fines for particular offences is prescribed under state legislation, not by council policy. When a council issues an infringement notice it can generally only issue the infringement at the amount set by legislation.

Recently there has been concern about rising fines for parking. Parking fines rose from \$60 million in 2002/03 to \$95 million in 2004/05. However, this concern is largely misplaced. The key issue is not whether fines are charged, but whether parking fees are reasonable. Parking fees are an inevitable and necessary method for fairly and efficiently dealing with limited road space subject to excessive demand.³⁶

If conflicts of interest arise between deterrence and revenue raising, is there any evidence of the effects on individuals, organisations and businesses?

Firstly, as noted above, there is no evidence that councils issue infringements primarily for the purpose of revenue raising. Secondly, deterrence is not the only reason that infringements are issued. There is also the public interest to be taken into consideration as a reason for issuing infringements; e.g. to recover some of the cost for damage caused by the actions of individuals or business under the environmental legislation.

4.3.4. Interest income

To what extent are local government cash reserves the result of State government imposed borrowing limits?

The Associations are not aware of any research that indicates that the level of Local Government cash reserves are the result of State Government imposed borrowing limits. The current levels of cash reserves are more likely to reflect the debt-averse policies and practices of councils.

Further information on the issue is available in Section 11.4 of the LGI's Final Report.

³⁶ LGI, Final Report, Section 9.4, p218.

4.4. Factors influencing expenditure and revenue raising

4.4.1. Operational Efficiency of Local Government

To what extent is there scope for local governments to reduce the unit costs of their operations? If so, how might they most effectively reduce their costs?

What effect would such cost reductions have upon their revenue raising requirements?

How and to what extent have structural reforms, such as boundary changes of local governments and service sharing arrangements, affected operational efficiency?

Economies of Scale

The LGI found that there is uncertainty as to whether the concept of larger councils actually produces significant economies of scale:

Firstly, a review of academic research concluded that no satisfactory Australian study has yet been conducted into economies of scale in municipal service provision, largely because most studies focused on total per capita costs of councils rather than the average cost of delivering a specific council service under different volume scenarios.³⁷

Secondly, the assumption that the number of council residents is an accurate indicator of total needs ignores the fact that population needs may be quite diverse across Local Government areas depending upon the demographics. Also, areas heavily frequented by non-residents such as shoppers, tourists and commuters also skew per capita expenditure as councils need to serve them too. For instance, the people who use the Sydney CBD far outnumber its permanent residents. Further, population size says little about the extent of various capital outputs being used to produce goods and services. For instance, a rural council with a small population but a large land area may have a huge road network that inflates its expenses because of high maintenance and depreciation.³⁸

Finally, the LGI did not find evidence that amalgamation reduce unit costs of services. Instead, it found that population density in any given area and not population size is the determining factor influencing unit costs. Negligible savings in administrative costs are offset by increased travel allowance and other support cost.³⁹

The LGI concluded that resource sharing and regionalised provision of services can enhance the efficiency of municipal service delivery if it is applied through more specific and flexible structures which are able to determine delivery of which service would benefit from resource sharing in their particular circumstances and to implement such arrangements.⁴⁰ Ad-hoc resource sharing models and regional organisations of councils and other strategic alliances provide such structures. A case study involving a study by Bombala Shire Councils supports this conclusion.⁴¹

Managerial efficiency

In terms of managerial and administrative efficiency, Local Government in NSW is well placed within the world best practice model applied by the LGI in a benchmarking exercise with nine NSW councils. Service performance and maturity of management practices were found to be above those of both the Local Government sector and service organisations generally in other parts of the world.⁴²

Furthermore, according to the results of a corporate overheads study undertaken with 58 NSW councils, which assessed the efficiency of corporate support services by looking at the back office cost in relation to total expenditure, NSW councils outperform NSW Government benchmarks and the results of most state government agencies.⁴³

³⁷ Ibid, Section 10.5, p258.

³⁸ Ibid, p258.

³⁹ Ibid, pp259-262.

⁴⁰ Ibid, pp262-266 and 10.5.9.

⁴¹ Ibid, p259.

⁴² Ibid, Section 10.4, pp245-249.

⁴³ Ibid, pp250-252.

4.4.2. Service Levels and Pricing

What guidelines and requirements are available to assist local governments to determine the appropriate range and standard of services, to measure and allocate their costs, to determine their revenue requirements, and to set rates, and fees and charges, accordingly?

Do guidelines properly take into account the allocation of infrastructure costs over the life of long-lived assets such as local roads, libraries and other facilities?

Strategic and service planning

There is currently no requirement for councils to undertake long term strategic (service) planning and reporting.

The main “planning and budgeting” instrument is the management plan. Pursuant to sections 402 to 407 of the LG Act, during each year, councils must prepare a management plan with respect to activities for at least the next 3 financial years and the revenue policy for the next financial year.

In terms of reporting, councils must prepare financial reports for each financial year (section 413 LG Act) and an annual report on their achievements with respect to the objectives and performance targets set out in their management plans (section 428 LG Act).

Apart from these reporting requirements, there are currently several unrelated requirements such as the state of the environment report or social reporting which are not integrated into the plans and reports mentioned above.

The LGI confirmed that there is no comprehensive and simple corporate planning framework for councils in NSW. The management plan merely reports on proposed ‘activities’ (outputs) and provides the basis for a one-year council budget. Although quarterly reporting on the achievement of activities is required in the management plan, and these reports are useful to see how budgets are being met, they do not really assist in measuring the effectiveness of activities in achieving outcomes.⁴⁴ The plan is operational in focus and does not look beyond 3 years.⁴⁵

The Inquiry concluded that councils need to introduce long term strategic service plans focussed on outcomes their communities need (recommendation 34). It also found that there is the need for improved coordination among levels of government via an intergovernmental agreement to avoid duplication of services.⁴⁶

The Associations are currently closely working with the DLG on the introduction of a mandatory integrated strategic planning and reporting framework underpinned by long term asset management and financial planning.⁴⁷

Asset management and reporting

Currently the biggest problem for NSW Local Government is asset management with only about 20 per cent of NSW councils managing their assets through adequate asset management policies and plans. Unlike the rest of the NSW public sector, there is no mandated requirement for total asset management principles and practices to be adopted by NSW councils.⁴⁸

Pursuant to section 428(d) of the LG Act, councils are required to report on asset condition in their annual reports; the “*Condition of Public Works*” report (Special Schedule 7). The condition report focuses on the estimate of the amount of money required to bring council infrastructure up to a “satisfactory” standard. Councils are also required to comply with AAS27 - *Accounting Standards for Government*.

AAS27 and the *Condition of Public Works* report are the only mandatory requirements. NSW councils are not required to apply specific asset management processes or standards such as AAS 4536 Life Cycle

⁴⁴ Ibid, Section 10.2, p236.

⁴⁵ Ibid, Section 7.5, pp172-173.

⁴⁶ Ibid, pp172-173.

⁴⁷ See DLG, *Planning a Sustainable Future – An Options Paper on Integrated Planning and Reporting for NSW Local Councils*, (2006) and DLG, *Asset Management Planning for NSW Local Government – A Position Paper* (2007)

⁴⁸ LGI, Final Report, Section 6.3, pp125 and 134.

Assessment or AAS4360 Risk Management. Nor are councils required to adopt any of the many existing infrastructure management processes such as *International Infrastructure Management Manual* (IIMM) or the NSW Government's *Total Asset Management* (TAM) system that applies to state agencies.⁴⁹

Furthermore, the current infrastructure accounting and reporting are regarded deficient in various aspects including:⁵⁰

- Lack of consistent recording, classification and valuation of assets;
- Meaningless *Condition of Public Works* report which does not provide a definition of what is "satisfactory" and is not linked to service levels required by the community;
- Inconsistent determination of depreciation data;
- Inadequate separation of maintenance expenditure, capital expenditure for renewal, and for enhancement or new assets;
- Inadequate of no identifications of the infrastructure renewal gap; and
- Inadequate asset management systems.

As noted above, the Associations are currently closely working with the DLG on the introduction of mandatory asset management policies and plans as part of the integrated strategic planning and reporting initiative.

The new framework will be guided by and consistent with the first national infrastructure financial management guidelines currently being developed by the National Asset Management Strategy (NAMS) Committee.

In a staged introduction process beginning with the financial year 2006/07 (water and sewerage assets) NSW councils are and will be required to value their non-current asset consistently according to the fair value methodology.

4.4.3. Financial and Asset Management Skills

What effect might the lack of financial and asset management skills of managers and lack of appreciation of the relevant issues by councillors have on the revenue raising capacity and effort of local governments?

To what extent do local governments find difficulty in attracting and retaining suitably qualified experts in financial and asset management?

What types of local governments experience the greatest difficulties?

General Comments

Any lack of financial and asset management skills significantly reduces the ability to strategically plan for the long term, set the right priorities and avoid wasteful short term decisions. In such a scenario, revenue and expenditure policies are likely to be sub-optimal.

Currently the biggest problem for NSW Local Government is asset management with only about 20 per cent of NSW councils managing their assets through adequate asset management policies and plans.⁵¹ Although there are councils who do asset management and financial planning well, many councils, particularly in regional and rural areas, struggle or will struggle to implement asset management and financial planning systems for a lack of strategic guidance, technical expertise and financial resources.

As discussed, the DLG in consultation with the Association is in the process of reshaping the strategic planning and reporting process and introduce a mandatory integrated framework of strategic planning based on community needs and priorities and underpinned by strategic financial and asset management. However, the Associations are concerned as to whether councils have the technical and financial resources to implement the new framework.

The shortage of strategic and technical capacity is mainly caused by a lack of financial flexibility and revenue limitations which make it difficult for councils to compete with the private sector and other government

⁴⁹ Ibid, pp125-126.

⁵⁰ Ibid, pp126-137.

⁵¹ Ibid, p 134.

instrumentalities and attract and retain professional staff. This is further exacerbated by the current skills shortages, particularly in regional and rural areas.⁵²

Skills shortages

Local Government is facing significant skills shortages. Strong economic growth, buoyant labour markets and demographic trends have created skills shortages throughout the Australian economy, including metropolitan areas. Nowhere is this shortage felt more acutely than in rural and regional areas, where Local Government is one of the single largest employers.⁵³

According to a recent survey of councils' skills shortages⁵⁴, 92 per cent of councils reported existing or emerging skill shortages with the greatest deficiency being in planning and engineering. Less severe shortages were evident in certain trades (e.g. mechanics and building), finance and other areas (e.g. environment, health and building inspectors and surveyors). Demand for certain council occupations related to aging populations, such as disability support workers, are also likely to increase.⁵⁵

4.4.4. Incentive Effects of Grants and Subsidies

What grants and subsidies are provided to local government by State and Territory governments? What is the value for each category of grant? Are there any terms and conditions attached to these grants? Do these terms and conditions distort the incentives of local governments to raise their own revenue? If so, how and why?

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The Associations are not aware of any evidence to indicate that council own source revenue raising efforts are generally distorted by state or Commonwealth grants. The upward trends in rate, goods and services and other income identified in the Productivity Commissions Issues Paper⁵⁶ support a conclusion that Local Government is maintaining or strengthening its revenue raising effort.

State and Commonwealth grants and subsidies are insufficient to alleviate a councils needs to raise own source revenue. Grants represent only around 15% of NSW Local Government revenue on average with 85% of revenues derived from own sources. Further, the LGI notes the ongoing decline to local Government as a proportion of GDP:

“The first and most important one [concern] is the ongoing decline in the allocation of grants from all sources (Commonwealth FAGs and SPPs and state grants) to Australian Local Government. These have declined from nearly 0.6 per cent of GDP in the mid-1980s to less than 0.4 per cent today.... In 2003/04 total FAGs to Australian Local Government (general purpose and local roads component) represented 0.18% of GDP.”⁵⁷

It is more likely that tied grants or SPPs will distort expenditure decisions rather than revenue raising decisions, particularly where they involve matching contributions from councils. The potential effect is to divert expenditure from higher local priorities to the Commonwealth or state priorities that are being funded.

Further information on the issue is available in Section 9.5 of the LGI's Final Report.

⁵² Ibid, Section 4.4, p80.

⁵³ Ibid, Section 3.3, p53.

⁵⁴ Redletterinformation, *Survey of Skills Shortages in NSW Local Government – A report prepared for the NSW Department of Local Government on behalf of the Training and Professional Skills Shortages Task Force*, Sydney, August 2005.

⁵⁵ LGI, Final Report, Section 3.3, p53.

⁵⁶ Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, May 2007, pp12-15.

⁵⁷ LGI, Final Report, Section 9.5, p226.