

RATE-PEGGING IN NEW SOUTH WALES LOCAL GOVERNMENT

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1. INTRODUCTION

New South Wales (NSW) is alone amongst Australian states and territories in employing a policy of rate-pegging designed to limit increases in property taxes that can be levied by local councils in that state¹. This longstanding policy has been an ongoing source of bitter controversy in NSW itself and the cause of much bemusement in the broader Australasian local government community (Dollery, Crase and Johnson, 2006). While NSW had employed a form of rate-pegging between 1901 and 1952, which was discontinued due to its 'impracticality' (NSW Local Government and Shires Association, 2008, p.16), the genesis of the modern method of rate-pegging may be found in the 1976 state election campaign. Under the Local Government (Rating) Further Amendment Bill, an interim type of rate-pegging was re-introduced by the victorious Wran Labor Government in 1977 and further refined into its contemporary form in 1978. The timing of the introduction of rate-pegging legislation into the NSW Parliament should be seen against the historical backdrop of economic developments in NSW in the 1970s; over the period 1973 to 1976, rates had increased on average by 188 per cent whereas average weekly earnings over the same

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¹ The Northern Territory will join NSW in imposing rate-pegging for a transitional three-year period beginning 2008 while extensive structural reform is put in place (Productivity Commission, 2008, p.97).

period rose by 75 per cent and the rate of inflation was 56 per cent (Johnson, 2001, p.5).

While the mechanics of the rate-pegging process have been adjusted periodically, the basic principle has remained unchanged to the present day. However, on 27 October 2008, NSW Premier Nathan Rees announced to the annual New South Wales Local Government Association conference that his government was giving serious thought to removing rate pegging. It thus seems an opportune time to consider the nature of rate-pegging, the arguments surrounding its desirability, and its economic effects on NSW local government. This forms the aim of the present submission.

This submission is divided into four main parts. Section 2 provides a synoptic description of the principles and practice of rate-pegging. Section 3 considers the rationale for rate-pegging and various arguments on this question. Section 4 seeks to evaluate the impact of rate-pegging on trends in rates in NSW relative to other Australian state local government jurisdictions. The submission ends with some brief concluding remarks in section 5.

2. PRINCIPLES AND PRACTICE OF NSW RATE-PEGGING

It terms of the Local Government Act 1993, NSW local authorities have six main sources of revenue: rates, charges, fees, grants, borrowings, and investments. With respect to income from property, under Section 493 of the Local Government Act 1993 local councils calculate and distribute rates among four defined categories of rateable properties in their respective local jurisdictions; farmland, residential, mining and business. Section 492 of the Act makes provision for two types of rates; ordinary rates and special rates. Section 494 of the Act stipulates that every council must strike

and levy an ordinary rate each year on all rateable land within its jurisdiction. By contrast, a local council can exercise discretion on whether or not to levy a special rate under Section 495 of the Act. Special rates are aimed at the finance of particular projects, such as specified local infrastructure, and must be applied to all ratepayers if the project will benefit the entire local government area (Department of Local Government, 2007).

For each category of property, rates can be calculated in one of three ways: Entirely on the land value of the property; on a combination of the land value of the property and a fixed amount per property; and entirely on the land value, but subject to a minimum amount. Land value in turn is periodically determined by the Land and Property Information Division of the NSW Department of Lands (Department of Local Government, 2007).

Part 2 of Chapter 15 of the Local Government Act 1993 allows the relevant Minister to impose limits *inter alia* on a council's 'general income'². With respect to the mechanics of rate-pegging, the NSW government sets a ceiling on the total amount of income that each council can raise from its rates and charges on land. This limit is termed the 'rate-peg percentage' and it is prescribed prior to each fiscal year by the Minister for Local Government. As a consequence of rate pegging, a given council's overall rates revenue cannot increase by more than the percentage increase approved by the Minister. Indeed, even if land values in a local government area rise in aggregate, local councils may have to reduce or otherwise adjust the amounts levied

² In addition to rate-pegging, other budgetary and legislative constraints operate on the ability of local councils to set rates in NSW, which also operate in other Australian local government jurisdictions. These include the land and property valuation methods stipulated by state governments, constraints on the ability of local authorities to impose differential rates on different categories of ratepayer, exemptions made for various classes of ratepayers (sometimes offset by reciprocal tax arrangements), and concessions that must be applied to certain categories of ratepayer (sometimes offset by reimbursements).

per dollar so that total revenue does not increase by more than the percentage increase stipulated by the Minister (Department of Local Government, 2007).

A simple example will serve to illustrate the operation of rate-pegging. Suppose the value of total rateable land in a given local council area is equal to \$250 million in year 1. If the rate is 10 cents in the dollar for all categories of property, then income would be equal to \$25 million. If total land value increased to \$300 million, due to a 'growth factor', such as land being sold to the public, then notional 'general income' from land would be \$30 million beginning year 2. But if the Minister set a rate-pegging limit at 2.5 percent for year 2, then the maximum permissible level of income in year 2 would be \$30,750,000 on a land base of \$300 million. Assuming a general revaluation of land occurred at the beginning of the fiscal year 2, which raised total land value to \$500 million in the local government area, with 'general income' limited to \$30,750,000, then the council would have to set its rate at 6.15 cents in the dollar to accrue the permitted maximum of \$30,750,000 from a land base of \$500 million. In other words, owing to a land valuation increase stemming from a 'growth factor' and a 'general valuation', the rate had to fall from 10 cents in the dollar for all categories of property to only 6.15 cents in the dollar (Department of Local Government, 2007, p.75).

In terms of the Local Government Act 1993, 'general income' does not include various rates and charges, including rates on water supply and sewerage, annual charges for waste management and stormwater management services. Other sources of revenue are also not covered under 'general income', such as user charges, interest, grants, developer contributions, donations, and other forms of revenue, like fines and business activities.

Under Section 208(2), Section 508A and Section 548(3) (a) and (b) of the Local Government Act 1993, councils can apply to the Minister for Local Government for permission to increase their general income by more than the rate-peg limit. This is called a special variation application. A council must include details of its intention to apply for a special variation in its draft management plan and consider any submissions received from the public. If approved, the Minister will specify the percentage by which the council may increase its general income as well as the period of time over which rates may exceed the rate-peg.

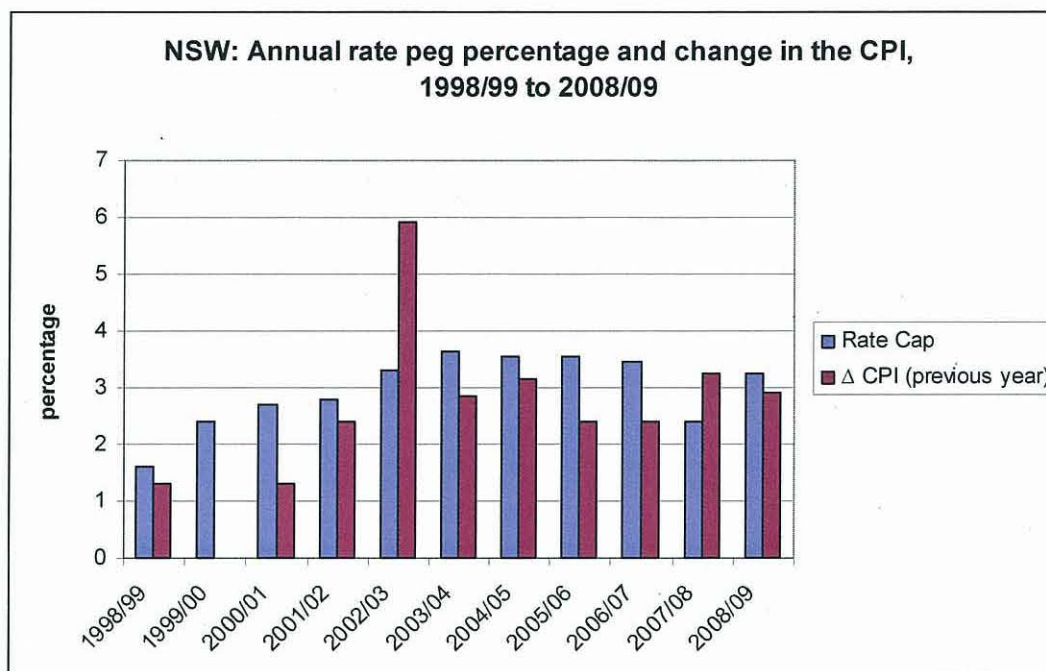
Grounds for an exemption under a special variation are spelt out in the Local Government Act 1993. For instance, under Section 208(2), the council in question must demonstrate that it meets one of three conditions: (a) additional funding is required for a project which has regional significance or a regional economic benefit; (b) additional funding is necessary to finance new or improved local government services or facilities specified in the council's management plan; and (c) additional funding is required to meet increases in state government charges (Department of Local Government, 2007).

With respect to the process involved in rate-pegging, the annual rate-peg percentage is typically set in March each year. In principle, 'this percentage reflects the projected annual increase in costs that a typical council delivering services at levels comparable to the previous year is likely to incur this year' (IPART, 2008, p.48). Following this announcement, individual councils can submit requests to the Minister for Local Government for a special variation to the rate-peg percentage. These submissions are considered by the Minister, who makes a final determination on each submission by

June. This enables affected local councils to strike their rates to take effect by 1 July of each financial year.

Given the proposition that the rate-peg percentage is supposed to reflect the 'projected annual increase in costs' faced by councils, it is interesting to compare the rate-peg with the Consumer Price Index (CPI) over the past ten years. Figure 1 compares the annual rate peg with the CPI over the fiscal years 1998/99 to 2008/09:

Figure 1: Annual Rate Peg Percentage and Change in CPI, 1998/99 to 2008/09



Source: Amended Table 7.1 (IPART, 2008, p.48).

The information contained in Table 1 indicates that, in general, the rate cap exceeded the change in the CPI over the previous financial year; this is true for all years, except 2002/03 and 2007/08. It should be noted that the CPI for 2001/02 contained in the 2002/03 column in Table 1 reflects the impact of the introduction of the GST, making it an unusual year. A second feature of the data contained in Table 1 is that, by way of a general trend, the rate cap and the CPI track each other closely. Finally, it should be stressed that the CPI is a measure of the rate of increase of a given basket of goods and services, weighted to reflect Australian consumption patterns, rather than a measure of production costs.

3. RATIONALE FOR RATE-PEGGING

The economic rationale for rate-pegging derives from the normative prescriptions of standard economic theory: Local government enjoys a monopoly in the provision of essential local services. Accordingly, like all other monopoly providers, it will provide these services at excessive prices and/or inefficiently and thus warrants regulation by higher tiers of government to ensure efficient and equitable outcomes (Bailey, 1999). However, it is important to immediately add the caveat that regulation must be carefully applied since bad regulation can make matters worse than no regulation at all (Hillman, 2005). The validity of this general proposition is recognised in the NSW debate over rate-pegging (see, for example, NSW Treasury, 2008).

With respect to economic efficiency, optimal regulation should seek to secure allocative efficiency, where the mix of local services provided must coincide with local community preferences, and productive efficiency, where local services must be produced in the most cost effective manner. In addition, regulation should also try to ensure that equity objectives are met. For example, essential local services should be provided to poor households by local councils at affordable prices. The effective application of regulation is difficult in all spheres of economic activity, including the operation of the local government sector (Bos, 1994). Moreover, regulation is further complicated in the local government sphere due to the fact that local councils possess the legal authority to tax; a monopoly power missing in both the private sector and in most other public utilities. Finally, in the special case of local council revenue regulation through rate-pegging, the regulatory agency faces additional problems

since it is not regulating the prices of particular local services but rather the 'tax-price' of a whole genre of local public goods and services that are mostly unpriced.

Against this background, IPART (2008, p.55) has summarised the arguments surrounding rate-pegging that have been employed in the NSW debate. In terms of the case for rate-pegging, four separate arguments are identified:

- (a) Revenue regulation through rate-pegging 'prevents the abuse of monopoly power' in the provision of basic local services;
- (b) Rate-pegging assists in controlling 'cross-subsidisation' and imposes restrictions on the 'provision of non-core services and infrastructure that might prove unsustainable to ratepayers';
- (c) Rate-pegging 'manages the risk of poor governance in the local government sector'; and
- (d) Rate-pegging 'limits the ability of councils to divert funds from essential infrastructure to other projects as well as expenditure on 'marginal services that are better provided by the private sector.

Some of these arguments are less than convincing. For example, it is not at all obvious that rate-pegging can have any positive influence on the supply of essential local services under argument (a); indeed it seems more likely to curtail their supply by restricting funding. Similarly, in terms of (b), it is hard to appreciate why rate-pegging will dampen cross-subsidisation. Quite the opposite may occur if fees and charges are increased to counteract the impact of rate-pegging. Along analogous lines, argument (b) does not meet with empirical reality regarding 'non-core' local services. For instance, Dollery, Wallis and Allan (2006) have demonstrated that an ongoing shift in

all Australian local government jurisdictions has taken place away from 'services to property' towards 'services to people', including NSW. Much the same objection can be levelled against argument (d). The NSW Treasury (2008, p.13/14) also found arguments (a) to (d) largely unconvincing.

An additional argument for rate-pegging is adduced later in *Revenue Framework for Local Government*: IPART (2008, p.63) contends that local government accountability is improved through rate-pegging because 'the process of assessing and making determinations on applications for special variation' ensures that the 'reasonableness of all applications is scrutinised' which may 'enhance councils' accountability'. But this argument is partly undermined by that fact that only a small proportion of NSW councils – only 26 councils in 2008/09 (IPART, 2008, Table 7.3, p.56)– actually apply for special variation.

Two further implied arguments for rate-pegging were put forward in the Independent Inquiry into the Financial Sustainability of NSW Local Government (Allan Report) (2006). Firstly, rate-pegging had worked well, compared with other Australian local government jurisdictions, if its primary aim was to constrain rises in council rates; an argument supported by both the Productivity Commission (2008) and the NSW Local Government and Shires Association (2008), which we will examine more closely in this paper. Secondly, rate-pegging may have forced NSW local government to become more efficient than it would otherwise have been in the absence of rate-pegging, especially in the domain of corporate overheads and administrative costs (Allan Report, 2006, pp. 245-257).

A final and much more convincing public choice argument for rate-pegging has been advanced by Dollery, Crase and Byrnes (2006). Invoking Wittman's (1995) model of democratic efficiency, they asserted that the pervasive nature of the phenomenon of 'local government failure' in Australian local government meant that electors had demanded state government oversight of local councils, especially in pecuniary affairs. Thus, in Australian states, "“watchdog” institutions will form an agency relationship with local government voters to demystify fiscal illusion by monitoring council revenue and expenditure decisions on behalf of voters' (Dollery, Crase and Byrnes, 2006, p.350). In NSW, this 'watchdog' role has occurred *inter alia* in the form of rate-pegging.

IPART (2008, p.55) put forward four separate arguments employed in the debate against the use of rate-pegging:

- (a) Rate-pegging 'limits councils' ability to provide local services';
- (b) Rate-pegging prevented 'infrastructure backlogs from being addressed';
- (c) Rate-pegging led councils to impose 'higher user pays charges which could result in pricing inequities'; and
- (d) Rate-pegging contradicts the 'principles of democracy and accountability of local government'.

Most of these arguments seem to carry weight. In particular, argument (c) appears especially convincing. In this regard, the NSW Treasury (2008, p.14) has noted that 'constraints on general revenue distort revenue raising sources and result in higher user charges'. Argument (a) also seems valid. After all, if the net effect of rate-pegging has indeed been to constrain total council income, then it follows that it must

have limited local services as well. Argument (d) rests on normative grounds rather than on economic observation; it would appear obvious that regulation of rate-setting must diminish local democratic autonomy since it arbitrarily limits local decision making.

However, argument (b) does not meet available empirical evidence. For instance, the recent PriceWaterhouseCoopers (2006) *National Financial Sustainability Study of Local Government* found that not only was a large number of local councils in all Australian local government jurisdictions financially unsustainable in the long run, but that most councils confronted a massive local infrastructure backlog. Moreover, Byrnes, Dollery, Crase and Simmons (2008), Dollery, Byrnes and Crase (2007), and others, have demonstrated that the magnitude of this backlog is so substantial that it is now beyond the present capacity of any Australian local government system to remedy without outside financial intervention. Since this problem is endemic to all Australian jurisdictions, and does not appear to be comparatively more acute in NSW, it would thus seem that the NSW local infrastructure backlog cannot be ascribed to rate-pegging.

The Local Government and Shires Association of NSW (2008) has developed a further and more general argument against rate-pegging couched in political economy terms. One aspect of this argument is that rate-pegging has an unintended and broader 'dampening' effect on rates than simply the pegged limit. In this vein, the Local Government and Shires Association of NSW (2008, p.14) contended that 'one likely explanation for the dampening effect is that rate-pegging provides a public framework and creates public expectations about maximum rate increases, placing political

pressure on councils to stay within the limit and not seek special variations'. A second dimension of this general argument is that rate-pegging provides a useful mechanism for local councils in NSW to engage in politically expedient 'blame shifting' onto the state government. The NSW Local Government and Shires Association (2008, p.15) has argued that rate-pegging 'provides an easy default option from both a political and managerial perspective' since (a) all rate increases can be attributed to the state government; (b) the need for community consultation to justify rate rises diminishes; c) sticking to the rate-peg limit avoids the problems contingent on special variation applications; (d) 'councils can blame the state government for their financial deficiencies'; and (e) the existence of rate-pegging enables councils to avoid long-term planning. The net result of these factors has been the 'under-provision of community infrastructure and services', the emergence of a local infrastructure backlog and 'undermining the financial sustainability of councils'.

4. IMPACT OF RATE-PEGGING

The impact of rate-pegging on the NSW local government sector is best assessed not in isolation, but rather in comparison with the experience of local government systems in other Australian state jurisdictions which do not have any regulatory ceiling imposed on rate increases. In other words, the unique use of rate-pegging in NSW allows analysts to treat it as a kind of 'natural experiment' in Australian local government. A comparative exercise of this kind faces several difficulties, quite apart from the ubiquitous problem of data comparability. The most important of these difficulties in the present context are twofold:

(a) There are substantial differences in relative significance of different sources of revenue in the different states (Worthington and Dollery, 2001; 2002). For example,

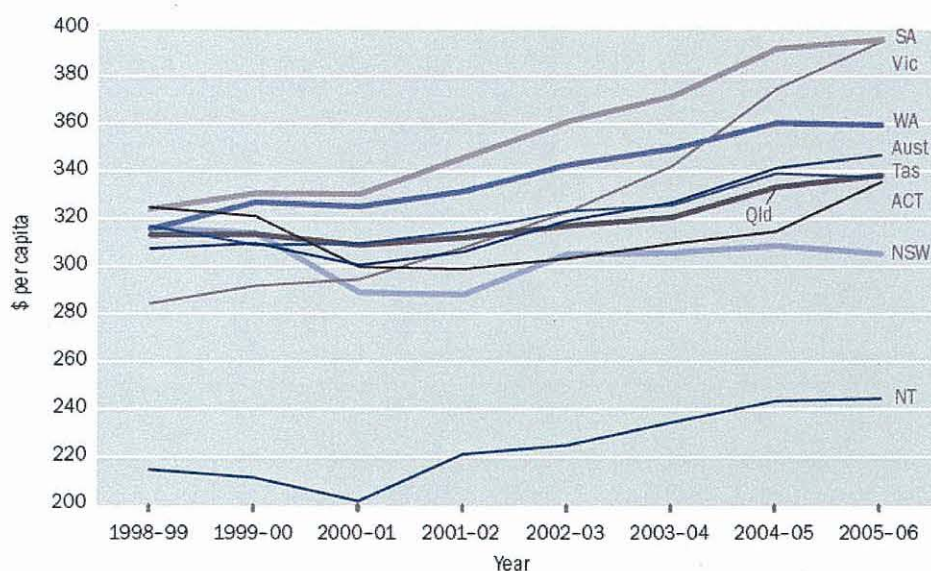
IPART (2008, p.25) has observed that 'there tends to be an inverse relationship between taxation revenue and revenue obtained from the sale of goods and services'. Thus 'states with greater reliance on taxation revenue (South Australia (57.9 per cent), Victoria (47.2 per cent), and Western Australia (43.5 per cent)) collected less revenue from the sale of goods and services, whereas states with less reliance on taxation revenue (Tasmania (32.2 per cent) and Queensland (26.0 per cent)) obtained greater revenue from the sale of goods and services'. By contrast, the NSW local government sector 'is close to average, with a relatively even split in terms of its reliance on either revenue source'. However, in the present context, this problem is ameliorated by the fact that we are not concerned with absolute differences in the level of rates between NSW and other state local government jurisdictions, but rather in the rates of change in property tax revenue through time.

(b) Considerable variation exists in the functions of local government in the different jurisdictions (Worthington and Dollery, 2001; 2002), which affect both expenditure and revenue patterns. For instance, in Queensland, Tasmania and non-metropolitan NSW (outside of the greater Newcastle-Sydney-Wollongong conurbation served by Sydney Water and Hunter Water), councils provide sewerage and water supply services, which earn an income, in contrast to the other state local government jurisdictions. In addition, as we have seen, there is an ongoing shift in local government function away from 'services to property' towards 'services to people' (Dollery, Wallis and Allan, 2006), which further distorts comparisons, unless it is heroically assumed that this shift has occurred in a uniform manner across all states. However, because we are chiefly concerned with trends through time in rate rises, both of these problems become less acute.

Difficulties (a) and (b) are compounded by the fact that large disparities in the capacities of individual local councils to raise rate revenues also exist within given state jurisdictions, which has been vividly illustrated in the Productivity Commission's (2008) *Assessing Local Government Revenue Raising Capacity*, especially Table 3.1 in this Report. While this is probably mostly attributable to the socio-economic characteristics of different local government areas, particularly local disposable incomes and their impact on the ability of householders to pay rates, numerous other influences are obviously at play, such as 'differences between urban, rural and remote councils, in population, rating base and the ability or willingness of councils to levy user charges' (DOTARS, 2007, p.12).

With these caveats in mind, we now seek to determine the impact of rate-pegging in NSW local government in the larger Australian local government context. Figure 1 illustrates trends in local government rate revenue per capita by state and territory jurisdiction over the period 1998/99 to 2005/06, expressed in constant 1998/99 dollars.

Figure 2: Local Government Rate Revenue per Capita, 1998/99 to 2005/06



Source: DOTARS, 2007, p. 15.

A glance at Figure 2 demonstrates that the average per capita rate revenue funding gap between NSW and the other Australian jurisdictions has grown over the period in question. Furthermore, it is noteworthy that NSW also has ‘the lowest council rates per capita of any jurisdiction in Australia other than the Northern Territory’ (Allan Report, 2006, p.207).

Similar insightful data have been assembled in the Allan Report (2006, Table 9.4, p.207), reproduced here in Table 1, which reinforce the information in Figure 2.

Table 1: Percentage Rate Increases by State Jurisdiction, 1995/96 to 2003/04

State or territory	Per cent increase
NSW	29.2%
ACT	35.2%
Tasmania	36.3%
South Australia	55.1%
Queensland	55.6%
Western Australia	64.8%
Victoria	66.1%
Gross domestic product	61.8%

Source: Allan Report (2006, p.207).

It is evident from Table 2 that that percentage increase in rates was substantially lower than in the other states; indeed, it amounted to less than half of the rate rises experienced in Western Australia and Victoria. From this and other data, the Allan Report (2006, p.2007) concluded that ‘rate-pegging has been a constraint on [NSW] councils’ revenue-raising capacity causing it to fall behind other states, notwithstanding NSW’s relatively strong property market over this period compared with Australia as a whole’. The Productivity Commission (2008, p.xxxiii/xxxiv) drew very similar conclusions from its deliberations. After stressing that ‘the rate of growth in rates revenue in NSW has been among the lowest of all jurisdictions over the past seven years’, NSW ‘also has rate revenue per person below that of most other jurisdictions’. It thus found that ‘rate-pegging in NSW appears to have been restricting revenue raised from rates, notwithstanding scope for councils to seek variations to mandated rate increases’. The Local Government and Shires Association of NSW (2008, p.14) reached an analogous conclusion: ‘If the objective of rate-pegging was simply to constrain council rate revenues, rate-pegging has been a success’ since ‘NSW rate revenue growth is lagging other jurisdictions’.

In addition, as we have seen, the NSW Local Government and Shires Association (2008, p.14) contended that rate-pegging had several other unintended effects. It has asserted that rate-pegging has reduced investment in infrastructure maintenance and renewal – an argument which does not accord with the evidence garnered by the PriceWaterhouseCoopers (2006) Report. A much more important argument in the present context resides in the NSW Local Government and Shires Association (2008, p.14) claim that the special variation option is under-utilised, which ‘shows that rate-pegging system has had a more general ‘dampening’ effect than the stipulated rate peg itself.

This proposition is worth considering in more detail. Table 2 provides information on the number of special variation applications submitted over the past seven years and the number of these applications that were approved by the Minister.

Table 2: Total Special Variation Applications Submitted and Approved, 2002/03 to 2008/09.

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Rate peg percentage	3.3	3.6	3.5	3.5	3.6	3.4	3.2
Number of applications for special variation received	30	23	25	42	46	34	26
Number of applications for special variation approved	23	23	22	30	39	30	24
Total number of Councils	172	172	152	152	152	152	152

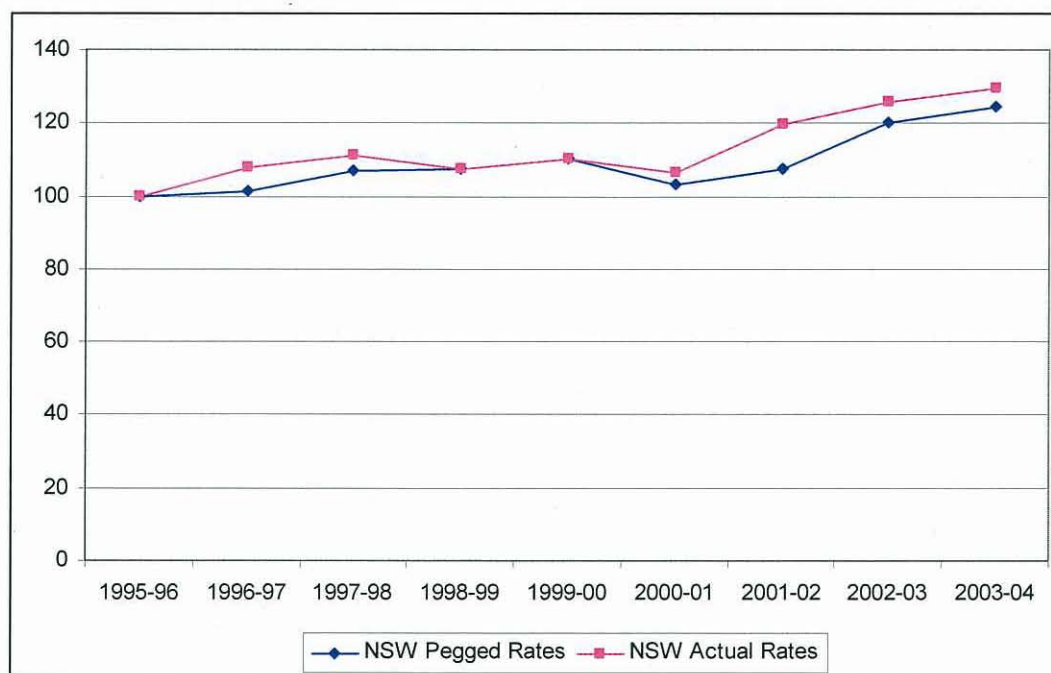
Source: IPART (2008, p.56) and Allan Report (2006, p.50).

The information contained in Table 2 seems to vindicate the observations made by the NSW Local Government and Shires Association (2008), considered earlier in this

paper, regarding the broader ‘dampening’ effects of rate-pegging. Thus in the 2008/09 special variation round, only 26 councils applied - a mere 17 per cent of all councils – of which 24 were successful. Put differently, while only a small proportion of councils actually apply under the special variation system, a very high fraction of these applications prove successful, ranging from a low of 71 per cent in the 2005/06 round to a high of 100 per cent in 2003/04. In other words, even though the great majority of special variation applications are approved by the Minister, comparatively few local authorities apply; a fact which thus must be ascribed to factors other than the prospects of success of an application.

A final aspect of special variations is their net effects on aggregate increases in rates in NSW local government through time. Figure 2 compares the long-term trends in the rate-peg with actual outcomes after special variations had been approved.

Figure 2: Growth in Actual Rates Relative to Pegged Rates, 1995/96 to 2003/04



Source: Amended Figure 9.7, Allan Report (2006, Figure 9.7, p.208)

The data contained in Figure 2 demonstrate that the impact of special variations on actual outcomes has little effect; the observed final growth of rates diverges minimally from the rate-pegged trend line. The Allan Report (2006, p.207) drew the same general conclusion; 'additional revenue allowed' as a consequence of the special variation system has 'not been large as a proportion of the total increase in the rate peg limit'.

5. CONCLUDING REMARKS

We have seen that the case for rate-pegging seems to hinge only on three convincing arguments. In the first place, as we have demonstrated in this paper, rate-pegging has achieved its basic objective of slowing increases in NSW council rates over time relative to other Australian jurisdictions (Allan Report, 2006). Secondly, a *prima facie* case exists which suggests that the constraints imposed on council revenue by rate-pegging may have enhanced the administrative efficiency of NSW councils and reduced their overheads, at least in comparison with the NSW state government departments (Allan Report, 2006). Finally, rate-pegging has enjoyed ongoing and strong public support (IRIS Research, 2005), which appears to demonstrate the operation of an efficient 'political market' in NSW (Dollery, Crase and Byrnes (2006) in the Wittman (1995) sense.

By contrast, several cogent arguments have been advanced against rate-pegging. Firstly, it has depressed the rating effort by NSW councils more than it intended since it has had a broader 'dampening' impact on rates in particular and local government finance more generally. Secondly, the existence of rate-pegging has partly absolved

local councils of full responsibility for their own financial affairs, with numerous deleterious consequences, not least a lack of long-term planning. Finally, rate-pegging has undermined the democratic bedrocks of 'local voice' and 'local choice' in local government and thereby reduced local autonomy.

Despite the announcement by NSW Premier Rees that his government is considering the abolition of rate-pegging, its continuing popularity seems to indicate that, at best, efforts will be made to improve the operation of rate-pegging and thereby at least ameliorate some of its harmful effects. If rate-pegging is indeed to be retained in NSW local government, over the years there has been no shortage of suggestions on how to improve its operation. For example, a Rate Pegging Taskforce, established by the NSW Local Government and Shires Association in 2001, called for a 'compromise' two-tiered rate-pegging system (Centennial Consultancy, 2004). Tier 1 would employ an annually determined index of local government costs, which would apply to all NSW councils, which would accurately reflect the real costs impinging on local councils much more precisely than the CPI used at present. Tier 2 would replace the current special variation system with a method that took the circumstances of individual councils into account and allow councils to make their own variations above Tier 1 levels up to some stipulated maximum.

The Allan Report (2006, p.210) also presented a 'compromise' proposal to revise the rate-pegging system. The Report argued that 'the view of this Inquiry is that the peg should be made less discretionary (i.e. not subject to Ministerial fiat), be based on explicit criteria (e.g. local government unit costs), and be made more transparent (i.e. be published in full)'. Moreover, 'any variations to the peg with respect to a particular

council should be more fully disclosed and explained in terms of rational criteria that are applied consistently across all councils and not subject to capricious change’.

At a more general level, in its *Revenue Framework for Local Government*, IPART (2008, pp.63/65) presented five alternative regulatory frameworks that could replace the current rate-pegging system. While a detailed evaluation of these options falls outside the scope of this paper, it is nonetheless worth briefly outlining these possibilities. Option 1 would retain existing rate-pegging arrangements, but publish the economic basis for the peg, modify the special variations process, and leave all other charges unregulated. Option 2 would develop a more ‘disaggregated form of rate-pegging’ using specific pegs for specific categories of council. Option 3 would ‘reduce the scope of rate-pegging to cover only local government revenue needed to fund operating expenditure’, thereby excluding capital expenditure and all other charges unregulated. Option 4 would retain rate-pegging but exempt individual councils, provided they could demonstrate financial prudence and operational efficiency in various stipulated ways. Finally, Option 5 would remove mandatory rate-pegging and simultaneously ‘enhance accountability to the local community’ using several criteria and the threat of a ‘default rate cap’.

A detailed analysis of the characteristics of these five options has been conducted by the NSW Treasury (2008). It has also suggested several additional feasible approaches to NSW council rates regulation. Amongst all these alternative regulatory methods, the NSW Treasury (2008, p.27) argued that the objectives of the current NSW rate-pegging regime could best be achieved at the least cost by retaining the existing rate-pegging system, but with ‘improved criteria’.

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