WALGA

15 February 2008

Local Government Study
Productivity Commission
LB2 Collins Street East
MELBOURNE Victoria 8003

Dear Sir

Re: Draft Report – Assessing Local Government Revenue Raising Capacity

The draft research report Assessing Local Government Revenue Raising Capacity provides a comprehensive description of the local government sector in Australia, and a thorough analysis of the observed mix and intensity of revenue raising efforts by the diverse range of local governments across the country.

WALGA values the opportunity to provide comments on the draft Report. It is noted that the economic modelling is subject to external peer review, and hence these comments are focussed on practical issues associated with the deliverable outcomes from this study. In order to maximise the value of this study in policy development by all three spheres of government it is suggested that the findings of this report may be strengthened by additional focus on the following areas.

Local Government Revenue Relative to Service Delivery Cost

Section 2.3 provides data to illustrate that over the seven years to 2005/06, real per person local government revenue has increased at an average annual growth rate of 2.3 per cent, using the ABS Non-farm GDP deflator to adjust all data to 2005-06 dollars.

However, it would be valuable to add some assessment as to what this means in terms of the capacity for local government to deliver a given level of service. Between 1998/99 and 2005/06 the ABS Implicit Non-farm GDP deflator increased 27.4%. However, over the same period the ABS indices for the major items of local government expenditure increased at a higher rate. For illustration:

- Labour Price Index (Aust; Public sector) 30.0%
- Road & Bridge Construction Cost Index (Aust) 33.2%
- Non-residential Building Construction Cost Index (Aust) 38.2%

There have also been marked differences in the cost increases of key activities between jurisdictions depending on the performance of the various state and regional economies. This is worthy of further consideration and analysis.

Distributional Impacts of Local Government Revenue Raising Efforts

In most states, and particularly in Western Australia, local government is heavily reliant on property rates to fund activities. It is noted that property based taxes are generally regressive, and in the case of particular sectors of the community such young home buyers and superannuants, can be particularly so.

It would be valuable to add an analysis (by jurisdiction) of trends in total property based taxes levied, including items such as land tax, metropolitan region improvement tax, sewerage, drainage and property based fixed water rates as well as local government rates. It is ultimately this total property based tax burden that local government councillors are cognisant of when determining appropriate levels for local government rates, fees and charges.

Grants and Subsidies from Other Spheres of Government

The data provided (Section 2.3) indicates that nationally Grants and Subsidies provided by other spheres of government have maintained a consistent share of total real revenue over time.

It is recognised elsewhere in the report that over time, local government have accepted responsibility for delivery of various services, some of which are funded by grants from other spheres of government.

In order to better understand the effect that this is having it is useful to illustrate the extent to which the Grants and Subsidies provided by other spheres of government are tied to, or linked with the transfer of responsibility for provision of services such as Home and Community Care. Local Governments report that while the community values these services and that local governments operate at the best scale to deliver them, the funding arrangements do not provide for replacement of the assets required to deliver these services or contribute to the overhead costs of delivery.

It would also be particularly powerful to separate capital grants from operating grants and subsidies as capital grants (typically for specific community infrastructure) have life-cycle costs normally exceeding the capital cost several times over. Thus although making an initial contribution to local government revenue, in the medium term they equate to a draw on local government financial resources.

Mix of Ratepayer Types

The contribution to local government own-source revenue from private individuals, tax-paying businesses and non-taxpaying businesses varies enormously from area to area as like sectors are typically geographically co-located.

Property taxes, fees and charges are deductible expenses from a business perspective and consequently a higher proportion of tax-paying businesses in an area allows transfer of some of the burden to the Federal Government.

Most Australian capital cities derive a much higher proportion of their own-source revenue from business and non-residents. Consequently they represent a special case amongst the broad spectrum of local governments.

However, amongst the various categories of local government described as Urban, some derive significant income from commercial businesses and others are almost totally dependent on private residents. It would be useful to disaggregate the data in this way to determine the impact on local government revenue raising capacity. Although Table C.5 shows that for each of the Urban categories of local government, Business Income is a similar (21 – 23%) proportion of Total Income, the range of Business Income percentage within each of these categories may be significant in looking at the capacity of a local government to raise revenue. (The inherent limitations in the methodology used to derive estimated business income within each local government area still needs to be recognised).

Other Limitations on Revenue Raising

<u>Autonomy of Local Government Revenue Decision making</u>

There are a number of examples of Regulations introduced by the State Government which prevent local governments implementing innovative solutions to revenue raising within their jurisdictions. Examples include:

Preventing Concessions Based on Owner Occupation

In responding to difficult financial circumstances resulting from rapid growth in a popular tourist area, the Shire of Augusta – Margaret River sought to offer rates concessions to owner occupiers on the premise that they are the only landowners unable to generate income from their property. It was argued that the implementation of land tax by the State Government and providing reduced fees for licensing vehicles for private use was based around a similar philosophy.

However, in response, in 2005 the State Government inserted Regulation 69A in the Local Government (Financial Management) Regulations 1996 Part 5, to prohibit local governments granting a concession in relation to a rate or service charge on the basis of whether the land is occupied by the owner of the land.

Parking

Regulations under the Local Government Act 1995 continue to be used in some circumstances to prohibit a local government from imposing or limit the amount of a fee or charge. For example, although capital cities and regional centres receive a significant contribution to their own source revenue from parking fees and fines, the State Government responded to a proposal from the Town of Cottesloe to impose parking fees in a popular beachside location by inserting Regulation 2A in the Local Government (Functions and General) Regulations 1996 which states "Local laws are not to be made requiring the payment of fees or charges for the parking of vehicles on any land under the care, control or management of a local government in any part of the district of Cottesloe west of Broome Street."

While the revenue forgone in this case is small relative to the aggregate rates raised across all local governments in Western Australia, it serves as an example of simple changes to Regulations that can and have been used to limit revenue raising by Local Governments.

<u>Interest</u>

The maximum interest component in instalments for rate payments is prescribed as 5.5% (Regulation 68; Local Government (Financial Management) Regulations 1996) and the maximum rate of interest on overdue rates and service charges is prescribed as 11%. These rates have not been varied since 1999, and as written into the Regulations are unlikely to be varied in response to conditions in financial markets. Consequently there are situations when it is financially advantageous to effectively use the local government as a source of low cost funding to the disadvantage of the Local Government and other ratepayers in the area.

Rates Exemptions

Previous submissions from WALGA and others highlight that exemptions from rating land used for charitable purposes impacts on the revenue raising capacity and strategy of local government. The draft Productivity Commission Report sets aside this issue on the basis that it is not material (less than 1% of rates revenue), and that it does not limit overall rates revenue as the revenue forgone can be made up by increased rates from other ratepayers.

These arguments fail to recognise the key issues:

1. Independent Living Units (ILU's) in lifestyle villages are a rapidly growing choice of living arrangement for Western Australians and could be reasonably expected to continue to grow in popularity as a result of the well documented aging profile of the population. The not-for-profit sector is an important, although not the only, developer of lifestyle village accommodation. Consequently the revenue forgone from conversion of existing rate paying land to ILU accommodation is expected to grow and place an increasing burden on the smaller proportion of the population who do pay rates. In many cases the residents of these villages need not be retired, or of limited means but simply over a certain age. The fact that residents in a particular village do not need to pay rates is promoted by developers, and may lead to other participants in the sector structuring their businesses to match this in a competitive market.
2. Independent Living Units where the land is owned by a charitable organisation and hence eligible for rating exemption is not evenly distributed among all local government areas and for individual local governments, significantly more than 1% of revenue is forgone as a result of these exemptions. As previously submitted, the Shire of Dardanup estimates that the loss of rate revenue from one retirement village alone represents 4.2% of the shire's potential rate revenue. In areas that have a significant number of independent living retirement villages, making up the shortfall in funding resulting from the rating exemption provided to charities, by increasing rates for other property owners (including retirement villages not owned by charities), exacerbates the perceived lack of equity between residents in potentially adjoining retirement villages.
3. It is neither politically nor practically simple for local governments to argue that ratepayers must pay higher rates on the basis that a number of properties in the shire have changed from being rateable to exempt and at the same time the services requirements have increased because of the increase in population.
4. Welfare programs are the responsibility of Federal and State governments, rather than local governments. This is recognised to an extent by the arrangements funded by the State to provide rates concessions to pensioners. Support from the State of the current rates exemption for Independent Living Units developed by the not-for-profit sector serves to reduce the State contribution to pensioner concessions (as they are not payable) and shifts responsibility for providing community services to residents of these facilities to local government.

State Agreements

The details regarding the impact of State Agreements in Western Australia on the capacity of local governments to raise revenue (p 173) does not adequately reflect the operation of these Agreements and their impact on the ability of local governments to raise revenue.

The West Australian Local Government Act (Clause 6.30) determines the value per square metre of land covered by State Agreements for the purposes of imposing rates. As these values are defined in the Regulations they are not reflective of dynamic markets and limit the range of revenue raising strategies available to the local governments concerned.

Efficiency, Equity and Appropriateness of Local Government Revenue Sources

If the reader is encouraged to draw the conclusion that local governments can (have the capacity to) raise additional revenue should they so choose, they miss the point of examining the impacts of the revenue raising efforts of local government.

All spheres of government consider the efficiency and equity implications of the mix of taxes used. The appropriateness of raising additional revenue to fund services directed at populations or segments of populations using a property based funding regime should be examined in detail.

Categorising Local Governments According to Services Provided

The range of services provided by local governments varies significantly, particularly the provision of water, sewerage and drainage services in some jurisdictions. These services are separately charged (often as a property based rate rather than a user pays service) in other areas. Summary statistics of local government revenue raised across this significant difference in service provision makes it more difficult to draw strong conclusions from the data and modelling.

It is suggested a methodology be developed to adjust for these significant service differences (and associated revenue differences) or that the local governments be separately grouped with others providing a similar suite of services in order to provide a comparable data set across jurisdictions. For example, the classifications of Urban Developed, Urban Fringe, Rural etc could be further divided into those providing water and drainage services and those not providing these services. For context, total revenue for the Water Corporation in Western Australia was $1.6 billion in 2006/07, which is similar in magnitude to the total revenue of all local governments in Western Australia.

Achieving Autonomy of Local Government Funding

This draft report concludes that even after a 10% increase in local government own-source revenue 73% of rural and 91% of remote local governments would remain dependent on grants from other spheres of government. Amalgamations of local governments, such as is occurring in Queensland, would apparently change the absolute number of rural and remote local governments, but there is no evidence provided that this will significantly change the population or area dependent on grants. Given that rural and remote local governments already impose higher than average rates, fees and charges per person and already receive higher than average subsidies and grants, what does the Commission believe is the most efficient solution to delivering services in these areas?

Actual versus Required Local Government Expenditure

The nexus between service need (as measured by proxies such as population distribution) and revenue raised by the local government can be obscured by the opportunity to defer maintenance and renewal of capital assets such as roads, bridges and buildings. While there is no simple measure of this, an estimate of the gap between actual renewal expenditure and that required to maintain service deliver from the portfolio of assets could be used to add a further dimension to the model.

We look forward to discussing these and other matters further when we meet later this month.

Yours faithfully

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Economist