



MUNICIPAL ASSOCIATION OF VICTORIA

Municipal Association of Victoria

**Submission to the Productivity
Commission review of disability care
and support**

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Submission to the PC's draft Disability Care and Support report*

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1 Introduction

The Municipal Association of Victoria (MAV) welcomes the opportunity to respond to the proposals and recommendations outlined in the Productivity Commission's Draft Report *"Disability Care and Support"*.

The MAV commends the Commission for its very comprehensive and coherent proposals for designing a national disability service system, and supports the principles upon which it is based and a number of the specific recommendations, particularly those in relation to the creation of the National Disability Insurance Scheme (NDIS) and the entitlement to individually tailored service which is comprehensive and portable. Specifically, the MAV supports the Commission in their recommendations relating to:

- the need for adequate care for people with a disability, however acquired, and a simplified way of accessing the needed service provision
- the general direction of one national funding scheme, i.e. the NDIS, funded from general revenue or a levy
- the proposal for a new central agency with multi-jurisdictional roles in appointments to the board and the advisory council
- the proposal for individualised support care packages based on assessment, and
- the proposal for a no fault national injury insurance scheme (NIIS), but not the proposal for funding from council rates.

There has been a considerable involvement with the work of the Commission by individual councils and their disability committees. As these submissions will be comprehensive and detailed involving significant consultation at the local level, this submission focuses on the area of most consternation to the sector namely the model of funding for the NIIS.

The MAV argues that the proposed funding arrangements should be reconsidered. This is based on the following:

- There is little potential benefit to Victorian councils through the imposition of a no-fault injury scheme as catastrophic injuries where a council is deemed at fault are highly infrequent and would only form a very small proportion of the costs not currently covered by TAC, WorkCover or medical indemnity insurance.
- Given the above, the MAV contends that far from presenting an incentive for councils to manage risks and hence reduce injuries over time, the removal of the alignment between the parties responsible for catastrophic injury and the schemes funding will introduce moral hazard that could erode current mitigation efforts, potentially increasing accidents.
- There are serious deficiencies in the argument for the introduction of a rates based mechanism as an administratively simple and efficient mechanism. This argument relies on analysis undertaken which does not accurately reflect the rating system in Victoria. As will be argued below, the efficiency of any levy placed on council rates will be lower than is estimated by the report.
- There is no consideration of the equity of the effect of a levy on councils. Research undertaken by the MAV has suggested that rates are regressive,

which would lead to a reduction in the overall progressiveness of the taxation system in Australia.

Based on the above points, the MAV argues that an alternative funding model — either a model which is more able to accurately connect the risk of injuries to the contributors or a tax which also fulfils criteria related to equity and distributional impacts — would be a more appropriate method of collecting revenue for the NIIS.

2 Local Government Insurance Arrangements

The MAV provides public liability and professional indemnity insurance through Civic Mutual Plus (CMP), a mutual scheme for Victorian and Tasmanian councils, water authorities and associated local government bodies (such as regional library corporations). One Victorian council is not a member of CMP, meaning the scheme caters for almost all potential local government public liability claims for both states.

As part of this submission, the MAV has included data on the performance of the public liability and professional indemnity insurance policies through the CMP scheme. As a scheme that operates in a competitive market, these data are commercially sensitive and are not publicly available. As such, the MAV provides section 3.1, which deals with the performance of the CMP scheme relating to injury claims, in confidence.

While most claims involving catastrophic injury relate to the public liability component of the scheme, injury claims can trigger the professional indemnity policy. An example of a professional indemnity insurance claim involving catastrophic risk include trip and falls relating to infrastructure design rather than maintenance.

3 The PC's Recommended Revenue Raising Model for the NIIS

The draft report recommends that the 'residual' costs of the no-fault insurance scheme should be collected through municipal rates. The scheme would retain current no-fault insurance arrangements for motor vehicle, medical indemnity and workplace injuries. The Victorian share of the 'residual' costs is estimated at \$60 million per annum in the draft report.

The PC presents a case for the use of local government rates (or land taxes) to fund a no-fault injury insurance scheme based on the following:

1. The collection of revenue through local government rates would be administratively simple.
2. Council rates are an efficient tax insofar as it has fewer distortionary effects than other taxes.
3. Local government would face reduced public liability premium costs due to the transfer of lifetime care costs currently borne by councils through insurance premiums to the NIIS.
4. Placing responsibility on councils for funding injuries would provide incentives for them to manage risks associated with catastrophic injuries, including crime.

All of these propositions are contestable. The MAV is concerned that the Commission has reached these conclusions with reference to little, if any, data and

analysis. For example, the MAV notes that the draft report does not quantify the administrative costs of collecting rates; has relied on a single study into the excess burden of Australian taxes without a broader discussion of aims of any funding mechanism (or acknowledged the limitations of this study as it relates to actual rating systems); does not quantify the current costs incurred by councils relating to catastrophic injuries; and makes recommendations about the capacity of local government to manage the risks of injuries that make only a cursory attempt, at best, to understand the responsibilities of the sector relative to other parties in managing these risks.

The first two matters pertain to the characteristics of a 'good' tax and are considered together, while third and fourth matters are considered separately below.

3.1 Public Liability Insurance

The PC's proposal argues that councils are likely to bear the responsibility of a large portion of catastrophic injuries not caused through motor vehicle accidents, medical incidents or workplace accidents through their public liability insurance policies, or at the least, that many of these accidents occur on council managed land. As the insurer for 78 of the 79 Victorian councils and all Tasmanian councils through the Civic Mutual Plus (CMP) scheme, the MAV is well placed to provide further information about this position.¹

In its draft report, the Commission contended that a proposed NIIS levy on rates would reflect a partial transfer of current insurance costs to the NIIS. The Commission argued:

...local councils would be relieved of some of the costs of their public liability premiums, as the lifetime care costs of high costs claims would now be covered under the NIIS. As such, some of the proposed NIIS levy on rate payers is already factored into rates charges to cover the costs of a local councils' public liability premiums and, hence, a proportion of the new levy is simply a transfer within local government (p. 16.25).

This argument can only be sustained with some reference to the size of the transfer that would occur. The MAV contend that the PC has reached this conclusion without adequate reference to the costs of catastrophic injuries currently borne by councils — even basic information such as the total quantum of insurance premiums paid by local government, which is publicly available.

In respect to the CMP scheme (including both professional indemnity and public liability products), the MAV submits that on average, there are very few claims related to these injuries. While public liability insurance is long tailed and it is likely that there will be incurred but not reported claims on existing fund years, the CMP scheme has been in existence since 1993 and claims of this size have remained low. <paragraph deleted as it contains confidential data>

As the report recommends retaining the common law rights to sue for economic loss and pain and suffering, the proposed no-fault insurance scheme will continue to

¹ Further, CMP also has Victorian and Tasmanian water authority members, along with various government bodies, such as regional library corporations, markets, cemetery trusts, etc. Unless otherwise stated, the data on the claims experience of CMP includes all its members.

exhibit frictional costs associated with legal processes, reducing the potential benefits of the scheme to local government. This feature also means that only a portion of the current costs provided by councils for catastrophic injuries relates to their care, further limiting the extent to which public liability insurance premiums could be expected to fall to offset even a portion of the increase in costs under the NIIS.

Based on the design of the NIIS proposed by the Productivity Commission and the experience of Victoria and Tasmania's public liability insurance scheme to date, the MAV strongly argues that the potential savings from reduced claims costs under the NIIS is extremely limited.

3.2 Incentives for councils to manage risks

The Commission makes an interesting and counter intuitive argument that introducing on a levy on rates would increase the incentives for local government to manage the risks of catastrophic injuries, including those that occur on private and crown land.

In making this recommendation, the Commission appears to overestimate the number of catastrophic injuries which occur on council land or assets. As the limited claims associated with catastrophic injury attest, councils have very limited involvement in catastrophic injuries as canvassed in the draft report. This implies that very few of the currently occurring catastrophic injuries are related to the risks managed by councils. Even taking into account those incidents where the injury occurs on a council managed asset but where the injured individual is deemed to be at fault, it is difficult to comprehend the risk management exercises that could be introduced to limit the risk of injury further.

Further research is required to identify where these catastrophic injuries occur, including those that occur on private land, state managed land or as a consequence of a crime (where it is assumed that the remainder of catastrophic injuries occur). This research should also examine the drivers for these risks and examine a more appropriate party to manage or mitigate these risks.

The Commission provides little evidence that local government has the capacity or responsibility to manage risks associated with non-council parties.

An example of the serious deficiencies in this argument can be seen in an example provided in the report. The report contended that:

A council would have incentives to either encourage or discourage certain activities, taking account of the full social and economic costs and benefits within their local area. Local governments would also have incentives to address some sources of violent crime, such as through alcohol free zones, community outreach centres and women's refuges, as gains in crime prevention and other characteristics of local government policies would affect the premium for an area... (PC 2011, p16.25).

The Commission further quotes a National Committee on Violence report which contended that 'local governments...are in an important position to **contribute** to the prevention and control of violence within their respective communities' [emphasis added].

The MAV argues that the Commission is mistaken in placing the primary responsibility on the management of the risks of crime on local government. The PC's proposed approach seemingly implies that councils have more influence on crime than other factors and bodies — such as overarching economic conditions (particularly the level of unemployment), the effectiveness of the state's police force in identifying, locating and preventing crimes, or the liquor licensing and enforcement provisions in place in that jurisdiction. At no stage does the report examine the efficacy of the proposed solutions in reducing violence that leads to catastrophic injuries and nor does it present a realistic examination of the role of a council in mitigating these risks. It is noteworthy that councils' roles will vary across jurisdictions and the proposed solutions may not be available to all councils. A significant body of research indicates that local government does not have a principal or major responsibility for crime prevention, particularly as it relates to serious assaults. This is reflected in the statutory framework in Victoria, where councils have no general responsibilities for the prevention of crime.

From a different perspective, the proposal to place risk at the hands of councils for responsibilities outside of their legislative responsibilities implies that the Commission is making responsibilities without reference to the capacity of a council to introduce these reforms, or with due recognition of the independence of the sector. The recommendation implies that council should have a role in crime control — despite the fact that the State Government has the primary responsibility for this function. This recommendation can also be criticised as it does not respect the autonomy of local government or its mandate under the Victorian Constitution.

Similar arguments could be provided about why councils have a limited capacity to influence risks on private properties, such as retail premises, shopping centres, private dwellings, or recreational activities, or state-owned land, including beaches and other high risk areas. The MAV is not aware of any current legislative responsibility for the management of these risks to fall on councils, nor can it identify effective strategies to minimise the risk of these injuries that are available to councils.

On the contrary, there is an argument that the removal of the liability for those parties with responsibilities for managing the risks of injuries creates a moral hazard and will lead to an underinvestment in risk mitigation and management by those parties currently at risk, particularly if a 2020 review expands the no-fault scheme to include economic loss and pain and suffering.

As such, placing the burden of funding the residual catastrophic injuries on councils is likely to increase, rather than decrease, the risks associated with these injuries and lead to the diminution of risk management. The contention that councils have the ability to manage these risks is highly questionable and the draft report does not provide evidence that the sector should be burdened with this responsibility. The Commission must undertake further research to better identify where catastrophic injuries occur: if the estimate of \$60 million in care costs for 'residual' catastrophic injuries is accurate, a vast majority — in the vicinity of \$59 million — is occurring on private and state land, or on council land where it is deemed council is not responsible. Given this, the capacity of councils to manage other risks is vastly overstated and should not be considered as a basis for establishing a levy on rates.

3.3 'Good' tax design

Given the limited potential public liability insurance premium reductions available to councils through the introduction of a no fault scheme, and the limited capacity of the sector to influence risk management practices in areas outside of its responsibility, the PC's argument for local rates to be used to fund the residual care costs appears to rely principally on the contention that rates are considered by the Commission as a 'good' tax — in that rates are considered to be both efficient and administratively simple. To reach this conclusion, the Commission referenced work undertaken by KPMG-Econtech (K-E) as part of the Henry Tax Review which assessed the efficiency of various Australian taxes (PC p.16.21). The MAV believes that it is worth testing these contentions further.

3.3.1 Administrative simplicity

The Commission's argument that there is likely to be low costs associated with the collection of levies through rates depends on the exact model used to apportion the burden of the tax across the community. Where levies are placed on the council and will result in a direct increase in rates, it is unlikely that there will be significant (marginal) administrative costs associated with the task. Where there is a different base applied to apportion the burden across ratepayers, such as an attempt to align risk to contributions, the rating system will present a less administratively simple mechanism. Further, the report did not specify how the burden will be apportioned, whether councils should bear the cost of non-payment, or whether the any costing methodology should be based on the marginal cost of introducing the system or a direct apportionment of the total costs of the rating system. The latter mechanism will present a more significant cost to the scheme.

Apportioning this between ratepayers with any nexus to risk is likely to be problematic, yet potentially important in driving risk mitigation strategies. It is not clear that the Commission has an accurate idea of the bodies to which risk can be attached (other than through public liability insurance premiums, which have already been rejected based on concerns about the excess burden associated with taxes on insurance). Any attempt to attach the funding model to an assessment of risk could therefore be considered to introduce a less administratively simple model, since there are no existing systems in place to achieve this aim.

Further, it is telling that the draft report does not consider if other taxes would be similarly simple to administer, such as increases to personal income taxes, payroll and land taxes. All of these taxes are likely to have low marginal costs associated with their extension to cover an injury insurance scheme and it is therefore unlikely that administrative simplicity is a unique benefit of rates.

3.3.2 Economic efficiency

The draft report argues that a major attraction of local government rates is its largely neutral impact on economic activity. That is, it is seen as being non-distortionary because the supply of land is a fixed and taxes on land will not distort activity. However, this view does not consider the complexity of the local government rating system. Council rates systems are generally complex, with differing valuation bases, the use of differential rates across properties, and set charges, such as municipal and garbage charges. The end effect of these characteristics is that the rating system does not reflect the stylised model used by K-E in its attempt to quantify the excess burden of taxes. This is likely to result in an underestimation of the excess burden of council rates.

The current rating system in Victoria is governed by the Local Government Act 1989 (Vic). The Act provides councils with the capacity to:

- Use one of three valuation methodologies as the basis for levying rates — capital improved value (CIV), which values the land and permanent improvements, site value (SV) which values the land only, and net annual value (NAV), which provides a net rental return on the property (inclusive of improvements).
- For councils using CIV, the Act provides that they can introduce:
 - A flat municipal charge of up to 20 per cent of total rates and charges.
 - Differential rates for various classes of property, with the highest rate no more than four times the lowest rate. The Act also provides that councils using NAV can introduce a limited set of differential rates.
- Service charges, to fully or partially offset the cost of services. Charges for waste management are frequently used by councils.

These attributes mean that council rates vary by across municipalities. Revenue requirements will also differ between councils, as will industry structures, settlement patterns and communities. As such, each rating system is unique. Rates may also vary within a municipality, depending on the rating structure adopted. Variation may be across property type (due to differential rates) or across property values (due to municipal charges). This means that a similar property will face different tax rates and potentially a different tax base, depending on where it is located.

Given these characteristics, the K-E study on the excess burden of various taxes has limitations that materially influence its conclusions. The study recognises that different industries can face different rates of municipal taxes. However, the model applies these differences at the industry level, rather than a geographic level: 'the model identifies differences in effective rates between industries' (KPMG 2010 p88). As such, this assumption does not reflect the variation in rating structures within Victoria, let alone in other states. This effectively assumes that the rates paid by each of the model's industries are the rate faced by the whole of those industries, which is not likely to be the case except in extreme cases where an industry is located in a single council area and cannot relocate to another area. This is likely to result in an underestimation of the excess burden of rates.

A further limitation is acknowledged by the paper:

The data used to construct land use, land tax and municipal rates by industry in MM900 was at an aggregated level. This means that a number of the more detailed industries in MM900 will have the same effective rates of land tax and municipal rates. This will work to lower the excess burden results obtained from the model, and understate the actual excess burden of land tax and municipal rates (KPMG 2010, 88).

That is, not only are the tax rates averaged for each industry, they are also the same for similar or related industries. This implies that given individual rating structures at the municipal level, the model does not adequately capture substantial variations in the tax rates likely to increase the excess burden of rates. The consequence is that the model does not capture incentives for the movement of households and businesses, from areas of higher rates to areas of lower rates. Since each council sets their own rates, depending on their non-rate revenue and expenditure requirements, the effective tax rates that apply to properties vary both across and

within councils. According to the principles articulated in the K-E study, these characteristics would tend to increase the excess burden associated with rates.

The K-E paper also acknowledges that the potential to rezone land means that there would be greater potential to substitute land between the property classes used in their model, which would tend to increase the excess burden (KPMG 2010 p88).

It is notable that SV is not used in Victoria, which implies that no council uses a pure land tax. The differing valuation bases used by local government in Victoria (and indeed, across Australia) do not appear to be recognised in the model. Land value is considered the most economically efficient method of collected taxes placed on property, since the supply of land is fixed. Since CIV is used by 73 Victorian councils and the remaining six use NAV, the value of permanent improvements is captured by the rating system across Victoria. This moves the rating system away from a land tax towards a tax on land and structures. The inclusion of structures is likely to distort investment decisions and lead to a reduction in the equilibrium level of building construction.

Taken together, there is substantial evidence that the K-E report has underestimated the economic efficiency loss from the implementation of rates.

3.3.3 Equity

The MAV also argues that while the PC is concerned with the administrative simplicity of a tax and its efficiency, there are serious limitations in not considering the equity and incidence of additional tax burdens associated with the injury scheme levy.

Equity considerations should explicitly consider the incidence of a tax, contributors' capacity to pay, and the extent to which it increases or decreases income inequality in the economy. There is no consideration of these issues within the draft Commission report.

Research undertaken by the MAV based on the ABS Household Expenditure CURF has found that council rates tend to be regressive — as a proportion of household disposable income, they reduce as incomes rise (MAV unpublished). The expansion of the rates base to cover the injury scheme will therefore tend towards decreasing the overall progressiveness of the Australian taxation system, even if the effect is marginal.

The question of whether councils rates are attractive when both efficiency and equity are explicitly considered across the full suite of taxes in Australia may result in a different conclusion. The MAV argues that the desire to implement a state-based tax as a means of financing a scheme is unreasonable if there are alternative Commonwealth taxes which meet the criteria of a good tax, including equity considerations.

3.4 **Capacity of local government to raise revenue**

An important element in considering the appropriate funding model for the NIIS is the current capacity of councils to raise additional revenue. The MAV has previously argued that there are major limitations in the capacity of local government to raise revenue in its submission to the Productivity Commission's research on the revenue

raising capacity of local government. It is recommended that the Commission examines the MAV's submission to the issues paper and the draft report on the study on local government's revenue raising capacity. The Association has argued:

- The capacity of councils to raise revenue varies by council type, based on their local population, service demands and inherent cost disabilities in providing services required under state legislation.
- Councils with the greatest (per head) expenditure requirements also have the least capacity to raise revenue through non-rate revenue. For example, these councils have limited capacity to increase revenue through fees, fines and charges generally due to low local incomes and/or statutory prohibitions on these income sources.
- The burden of rates is generally regressive, and varies substantially across households. As the tax is based solely on one element of wealth (property values), there is limited capacity to adjust the quantum of tax to take account of differences in total wealth or income. The major area of concern for councils is the ability to manage large rates bills for 'asset rich, income poor' households and businesses.
- For a small number of councils, rates and charges are already high relative to local incomes and there is very limited capacity for these councils to increase rates further. These councils are typically rural, with small and declining populations and a heavy reliance on agriculture and related industries.

Based on the above, the MAV has significant concerns about the capacity of some councils to bear an increase in rates due to a state-based insurance program. The draft report has failed to examine the capacity of councils to increase rates to provide adequate funding to the NIIS and has failed to consider how some of the small and rural councils would be able to cope with any substantial increase in rates without an accompanying deterioration in services and infrastructure or through the imposition of increased hardship from rate payments on the community.

For those 15 to 18 Victorian councils facing financial sustainability concerns, the proposal would introduce a new challenge to their financial stability.

4 Conclusion

This paper has demonstrated that there is little nexus between catastrophic injuries that will be covered by the NIIS and councils' public liability risks. The MAV argues that this lack of connection implies that the primary purpose of the proposed funding model is to collect revenue in the most economically efficient manner. The proposed model is sub-optimal because it does not consider all the characteristics of an effective tax (notably, it does not consider the distributional implications of the proposed funding mechanism), but also fails to produce incentives for bodies with risks to manage them appropriately (e.g. state and Commonwealth land, private land, crime). The model actually does the opposite — it perversely argues that councils can influence the risks involved for the vast majority of 'residual' costs associated with the scheme that are not its current responsibility.

The funding model should therefore be selected as either a model aimed at introducing a 'good' tax or as a means of apportioning the funding across those parties that would benefit from a no-fault insurance scheme. The current proposal attempts to identify a good tax without reference to any notions of equity and also

presents fallacious arguments about the benefits likely to accrue to local government through a no-fault scheme.

Given these significant limitations in councils' capacity to influence risks, the MAV contends that the Commission should re-evaluate the potential funding options for an injury-based scheme. With limited taxes at the disposal of states, and even fewer that have the characteristics of good taxes — such as efficiency, equity and administrative simplicity — the Commission may have more success in locating a source of revenue that is a 'good' tax or better aligns risks to contributors for the NIIS if it broadens its scope beyond state based mechanism.

5 References

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