Interim Submission to the Productivity Commission

Draft Report on Public Infrastructure

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1. Introduction

The Western Australian Local Government Association (WALGA) is the united voice of Local Government in Western Australia. The Association is an independent, membership-based group representing and supporting the work and interests of all 140 Local Governments in Western Australia.

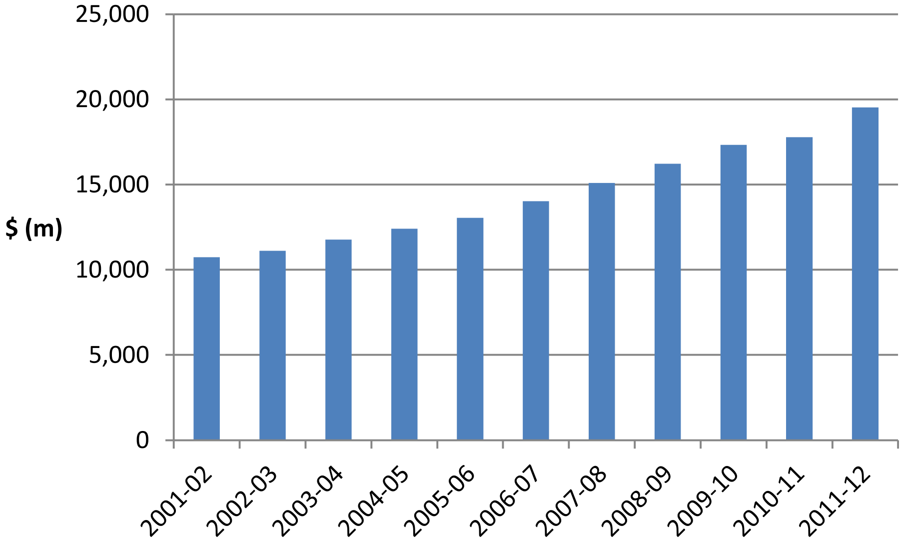
The Association provides an essential voice for 1,249 elected members and approximately 23,400 Local Government employees as well as over 2 million constituents of Local Governments in Western Australia. The Association also provides professional advice and offers services that provide financial benefits to the Local Governments and the communities they serve.

The Association appreciates the opportunity to provide a submission in response to the Productivity Commission's Draft Report on Public Infrastructure. Due to meeting schedules this submission has not yet been endorsed by the Association's State Council. The Productivity Commission will be informed of any changes to the Association's submission following consideration by the Council.

2. Local Government Infrastructure in WA

In the 2011-12 financial year, Local Governments in WA were responsible for $19.5 billion in non-financial assets. The value of this stock of non-financial assets has grown at a rate of 6.2% per annum over the last ten years:

Figure 2.1 WA Local Government non-financial assets



Source: Australian Bureau of Statistics, *Government Finance Statistics, Australia, 2011-12* (Cat. No. 5512.0)

While Local Governments have significant infrastructure responsibilities, they have limited capacity to raise own-source revenue. For example, the only form of taxation employed by Local Governments is property rates, whereas the State and Commonwealth Governments are able to use a range of taxes. The following table contrasts WA Local Government expenditure on non-financial assets with other levels of Government:

Table 2.1 Comparison of expenditure on non-financial assets, 2011-12

Revenue/Expenditure item	WA Local Governments		WA State Government		Commonwealth Government	
	$(m)	% of own source revenue	$(m)	% of own source revenue	$(m)	% of own source revenue
Own Source Revenue	3,908		16,416		339,451	
Depreciation	647	16.6	990	6.0	5,522	1.6
Net acquisition of non-financial assets	355	9.1	2230	13.6	5,173	1.5

Source: Australian Bureau of Statistics, *Government Finance Statistics, Australia, 2011-12* (Cat. No. 5512.0)

Local Governments have a high level of depreciation expenditure because local road networks represent a high proportion of non-financial assets. For example, in WA, roads make up approximately 67% of the sector's non-financial assets[1]. Although the structure and pavement have a long service life, the seal has a comparatively short 15-20 year life which is reflected in the high depreciation costs.

In recognition of Local Government's relatively lower fiscal capacity and substantial infrastructure responsibilities due to local road networks, the Commonwealth and State Governments provide significant levels of road funding to Councils. However, despite this assistance, WA's local road network has an estimated maintenance backlog of $102.7 million[2]. This backlog is particularly problematic in rural WA, where Local Governments often have low capacity to raise own source revenue and face the high costs of servicing a vast, and often very remote, local road network.

3. Commonwealth funding for Local Government infrastructure

The Association agrees with the Commission's main finding that there needs to be major changes to existing assessment and development processes for public infrastructure projects.

The Commission suggested that without reform, more spending will simply lead to the provision of poor value-for-money infrastructure. The Association suggests Commonwealth funding for Local Government infrastructure is a key area for reform. While the Commonwealth Government provides a number of infrastructure grant programs to Local Governments, there is often little certainty attached to this funding; programs often only run for a short period and eligibility for grants may be limited. Even the long running Roads to Recovery program is only guaranteed until 2018-19.

A 2012 report by Ernst and Young on Local Government infrastructure outlined the difficulties that result from this uncertainty:

- It is difficult to appropriately budget for grant revenue, since assumptions need to be made about the probability, level and timing of receipts.
- Some otherwise lower priority projects may end up being pursued ahead of others due to the availability of grant funding.

[1] Ernst and Young 2012, *Strong Foundations for Sustainable Local Infrastructure*
[2] Western Australian Local Government Association 2012, *Report on Local Government Road Expenditure 11/12*.

- Some grants are only made available for projects which are 'shovel ready' – this can result in Local Governments investing in significant pre-construction work without the guarantee of funding[3].

Most Commonwealth infrastructure funding for Local Governments is in the form of 'tied' grants, i.e., the funding is provided for a specific purpose and the recipient of the funding is accountable to the provider. The Commonwealth also provides Local Governments with untied general funding in the form of Financial Assistance Grants (FAGs). Although FAGs funding comes from the Commonwealth, the payments are made 'through' the States via Local Government Grants Commissions (LGGCs).

Financial Assistance Grants consist of two components: General Purpose Grants (GPGs) and Identified Local Road Grants (ILRGs). ILRGs are provided to Local Governments according to their road network's relative needs, as assessed by their jurisdiction's LGGC. Although ILRGs are provided for road infrastructure, the untied nature of the grants means that Local Governments can allocate the funds to any purpose.

Looking at the overall pool of Commonwealth payments to Local Governments, the Association believes there is a case for increasing the proportion of untied funding. Indeed, Local Governments and their Associations across Australia have long argued for an increase in general funding in the form of FAGs. The provision of more untied funding will be a more cost-effective method for the Commonwealth Government to assist Local Governments in providing infrastructure for the following reasons:

- Increased general revenue and greater certainty of funding would improve Local Governments ability to prioritise and select projects.
- Projects would be more likely to be selected based on community preferences and priorities, rather than the availability of grant funding.
- Rationalising the number of grants schemes would lead to administrative savings for Local Governments and the Commonwealth.

The Association agrees with the Commission's lack of support for institutions such as an infrastructure bank or a national infrastructure fund. Similarly, the Association also disagreed with a recent suggestion from Ernst and Young that a national financing authority should be set up to aggregate Local Government borrowing and offer products such as infrastructure bonds to private investors[4].

Ernst and Young argued that a national financing authority would assist Local Governments in overcoming their apparent reluctance to use debt to finance infrastructure. Looking across the sector in WA and Australia, debt levels are generally very low considering that Local Government's asset holdings consist of a large proportion of non-financial assets. Indeed, a recent report on the extent of Local Government borrowing suggested the sector was under-utilising debt[5].

Although Local Governments may need to make greater use of debt in financing infrastructure, it has not been demonstrated that a national financing authority is necessary to achieve this. While Ernst and Young recommended such an authority be established, they also acknowledged that most Local Government representatives they consulted with were satisfied with their current arrangements and conditions for securing debt (generally, Local Governments source debt finance from their State Government treasury). Furthermore, there may be potential constitutional barriers to the Commonwealth lending money to Local

[3] Ernst and Young 2012, *Strong Foundations for Sustainable Local Infrastructure*
[4] Ibid.
[5] Comrie, J. 2014, *Debt is not a Dirty Word: The Role and Use of Debt in Local Government*.

Governments. It is also important to note that funding, rather than financing, is the barrier to the provision of Local Government infrastructure. Effectively this leaves only taxes, user charges or transfers from other levels of Government as the issues to be considered.

4. Road funding models

The Draft Report's discussion of road funding models presents a number of options for improving investment and governance in the roads sector. This includes the institutional reform model recently proposed by the Heavy Vehicle Charging and Investment Reform (HVCI) project.

A common feature of the HVCI road funding model and the Commission's suggested models is the need to group Local Governments into regional entities. In WA, Regional Road Groups are responsible for providing recommendations concerning funding priority for various projects and identifying strategic regional issues. However, they are not legal entities and cannot receive or administer funding. While a group of Local Governments can form a Regional Council, it is important to note this is not a simple or a costless exercise, since an onerous regulatory regime applies to such bodies. There are also a number of other practical and political limitations on the formation and operation of Regional Councils.

A further consideration is that regional groups should not be the only mechanism for Local Government's involvement in the heavy vehicle planning process. There will often be specific local heavy vehicle issues, particularly first/last mile access issues, where individual Local Governments will need their own direct relationship with the body responsible for coordinating road investment.

Where regulatory models have been suggested, the Association's preference is for a decentralised, rather than national, regulatory and investment structure. The regulatory structure should consist of a national regulatory framework with pricing oversight and efficiency reviews performed by state economic regulators.

The Association believes that regulation and investment coordination at the state level should be preferred to a national approach because of the complexity and jurisdiction based nature of the national road network. This is particularly relevant to WA's roads, which could almost be considered a network in itself. For example, of the 28.96 billion tonne kilometres of road freight in WA in 2007, only 3.27 billion tonne kilometres (11.3 per cent) could be attributed to interstate freight[6].

The existing state road management agencies would be able to coordinate investment more effectively than a national body due to their knowledge of local conditions and priorities. It then follows that a state based regulatory regime will be best placed to oversee the conduct of this investment role.

The Association also believes, regardless of the funding model used, there is a need to take a more long term view of road investment. In some remote areas of WA, such as the Pilbara and Kimberley regions, wet season rains regularly cause damage to roads and this results in substantial annual maintenance costs. While upgrading these roads to withstand such conditions would require significant upfront investment, this would probably lead to overall savings in the long run due to greatly reduced maintenance requirements.

[6] Bureau of Infrastructure, Transport and Regional Economics 2010, *Road freight estimates and forecasts in Australia: interstate, capital cities and rest of state*.

5. Last mile access problems

The Association notes the issues raised in the Draft Report regarding access to smaller local roads. These 'last mile' (or 'first mile') access problems often occur because planning and approval processes only consider the national or state road component of a transport route. The Association believes these issues could be addressed if these processes used a more holistic approach and included access to local roads in planning transport routes. In other words, the whole route should be considered and not just segments controlled by particular levels of Government. This is particularly important when local roads are needed for access to sites such as ports and distribution centres.

6. Development near major infrastructure facilities

The Association agrees with the Commission's statement that the 'incentives around infrastructure construction and usage can differ between local councils and state governments' (p.509). The Association also notes the issues surrounding the incentives Local Governments may have to allow development near facilities they do not control. The Association appreciates the potential impact that nearby development could have on owners of such facilities.

However, there is often considerable pressure applied by owners of adjacent property, seeking to maximise the value of their investment through re-zoning and development appeals. In many instances these matters are resolved in state-based administrative tribunals and courts. Early planning is critical to avoiding and minimising these costs. For example, owners of major infrastructure facilities can control and mitigate such impacts through either outright purchase of adjacent land when projects are planned and initiated, or by entering an option to purchase agreement with neighbouring land owners.

7. User charges

The Commission states that 'well-designed user charges should be used to the fullest extent that can be justified' (p.2). However, the Commission also notes that 'government funding for infrastructure can be appropriate due to public good characteristics, positive externalities and equity goals' (p.152).

Such arguments can be applied to much of the infrastructure provided by Local Governments. It is therefore appropriate that most Local Government infrastructure is funded through taxation (i.e., property rates) rather than user charges.

The provision of social infrastructure by Local Governments can also lead to cost savings for other levels of Government. For example, provision of recreational facilities leads to better health outcomes for the community and reduces costs associated with Government-provided healthcare. Similarly, libraries help to improve literacy and raise education levels and infrastructure such as streetlighting reduces the incidence of crime and accidents.