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Your ref:

GUYRA
SHIRE COUNCIL
TOP OF THE RANGE

Civic Centre
158 Bradley Street
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6 July, 2007

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

Email: localgov@pc.gov.au

Dear Sir/Madam,

RE: SUBMISSION TO INQUIRY INTO ASSESSING LOCAL GOVERNMENT REVENUE RAISING CAPACITY

I refer to the Productivity Commission's circular dated 18 May, 2007 inviting submissions to your Inquiry into assessing Local Government revenue raising capacity. I wish to commend the Australian Government for undertaking vital research into this important area that underpins the long term sustainability of Australian local government.

Please find attached Guyra Shires submission to your Inquiry into assessing Local Government revenue raising capacity.

If you require further information regarding this matter please do not hesitate to contact me on (02) 6770 7103; 042 779 1869 or ajohnson@guyra.nsw.gov.au .

Yours sincerely,

ANDREW K JOHNSON B.EC(ACC) CPA MBA JP
GENERAL MANAGER

INTRODUCTION

A large number of independent reports including: PricewaterhouseCoopers - *National Financial Sustainability Study of Local Government*; the New South Wales - Are *Councils Sustainable?;* the Australian Government's - *Rates and Taxes: A fair Share for Responsible Local Government;* and the South Australian - Rising *to the Challenge: Towards Financial Sustainable Local Government in South Australian* have all found that Australian local government is currently under intense financial pressure. Councils face rising expectations from their communities to deliver both more and better quality services, including those beyond the traditional focus of local Government. State and Federal governments' expectations of Local Government have also never been greater, with municipal authorities increasingly relied upon to implement the policy objectives of these higher tiers of government. At the same time as councils are grappling with these increased expectations, they are finding that they have limited means of raising sufficient revenue to meet the higher expectations and they are struggling to maintain sustainability in their operations (Johnson 2007).

In essence, Local Government is currently facing intense financial pressures and it is unable to meet the increasing needs of the communities it serves. It has the additional problem of controlling large amounts of infrastructure that will need replacing or renewing in the near future. The gap between what the community and other levels of government demand from Councils, together with the assets renewal requirements confronting many Councils, and the funds that local government can raise to meet these demands, is growing at an alarming rate (Johnson 2007).

A significant proportion of Council-controlled infrastructure was constructed by Local Government in the post-World War II era from grants provided by State and Federal governments. Very little of this infrastructure was developed from Council-generated funds. At present many of these assets, including swimming pools, bridges, halls, roads, etc., are in poor condition and require replacement at cost to Councils' existing revenue stream. However, Local Government does not have the financial capacity to replace these assets or bring them up to a satisfactory standard, without the sustained assistance of state and Federal governments.

PricewaterhouseCooper (2006) as part of their review into the sustainability of Local Government throughout Australia also reviewed the many reports into the assets renewal challenge facing the local sector. They found that a sizable proportion of Councils face long-term financial sustainability problems. Councils in this situation have had a strong, tendency to defer or scale back asset renewals expenditure to upgrade existing infrastructure (PWC 2006:6). PricewaterhouseCooper (2006:11) conclude that the asset renal crisis varied between states and estimated the funding gap to clear both the estimated backlog and to cover the annual under-spend on renewals is $3.1 million per Council per annum or $2.16 billion nationally.

Community expectations of Local Government are increasing at an exponential rate. Communities are increasingly looking towards municipalities to meet their expectations of government, even in areas that Councils have traditionally not tackled. This may be a result of a widespread view that Local Government is the best vehicle to implement community requirements and the most accessible form of government for the community to voice concerns over the services provided and to have more of a 'say' in how things are run in their area. It may also be a result of the centralisation policies of most State and Federal government agencies that have seen many public agencies leave rural regions altogether to be consolidated in metropolitan areas.

Local government is in the unique position of being located in over 700 communities throughout Australia. It is the level of government that is the 'closest to the people' and it is most directly influenced by, and has the most interaction with, its constituents. As State and Federal agencies have become more centralised, these higher levels of government have regarded Councils as the most efficacious vehicle for implementing their policies, especially when 'on the ground' implementation is required. In particular, there has been a myriad of legislation deriving from state and federal parliaments that has required local government to implement it. Generally, no additional funds have been provided by the higher levels of government to assist Councils with implementing this legislation.

Local Government is struggling to fund its basic services, let alone implement the policies of other levels of government and is thus increasingly examining cost reduction measures.

REVENUE RASING CONSTRAINTS

Australian Local Government is also feeling pressure on its revenue streams. In essence, there are two broad revenue pressures facing the sector: legislative restrictions over its ability to raise revenue in certain areas; and limited access to a broad enough range of revenue, including a 'growth tax'. Any restriction on local government's revenue raising capabilities will have an impact on its ability to meet the growing expectations and needs of the community. Moreover, external restrictions on municipal authorities' ability to raise funds also limits their local autonomy and diminishes the accountability of those directly elected to serve the needs of the local community.

In addition to the restrictions on grants and rates, Local Government also has other limitations imposed on its revenue raising ability by the state government. State Government restricts local government's revenue by setting the amount that can be appropriated for a range of fees charged by Councils. Some examples of these fees in New South Wales include:

- Development and building application fees;
- Animal registration fees under the Companion Animal Act;
- Section 149 fees (request for planning information relating to property on transfer) set under the Environment Planning and Assessment Act;
- Section 603 fees (for statement of outstanding rates on property transfers) set under the Local Government Act; and
- Amount of interest payable for overdue rates.

Not surprisingly, given the diversity within local government, since the cost of providing these services vary from Council to Council, so too should the policies on determining the setting of these fees. This further highlights the disadvantages of setting a 'one size fits all' policy on fees for all municipalities. For example, a Council may choose to set its development application fees on a cost recovery basis to ensure that it is not subsidising commercial operations. Alternatively, the Council may choose to do the reverse (i.e. provide a subsidy) in order to attract industry into the area and thus encourage development in general. At present neither of these two options is available in New South Wales since the State Government typically sets the amount that can be charged for these services. In this regard, the Woollahra Municipal Council argued that 'we do need to address far more the user-pays issue because a lot of what we do is for a small sector of the community. We are limited by statutory fees. Development applications and building applications are a prime example of the community actually subsidising developers. One of the first things I would like to see addressed is the deregulation of fees so that each Council can properly charge developers for their activities within any Council area' (IPART 1998:42).

The New South Wales Government also restrict the amount of borrowings that can be undertaken by Local Government. All borrowings carried out by Councils must first be approved by the State Minister for Local Government, thus providing a potential barrier to funding infrastructure and a further opportunity for political interference in the operations of Councils. In reality, due to the conservative nature of many local authorities, the level of reliance on loan funding is low and therefore this has not presented a problem to most Councils when they have requested loan funds to finance their activities.

It should also be noted that the State Governments (including some of their commercial enterprises) are exempt from the payment of rates. In a world where cost recovery and the user pays principle are part of the standard procedural routine in the public sector, and given the existence of National Competition Policy, it seems reasonable that State Government agencies should pay rates for services provided to them by Local Government. The fact that other levels of government are not liable for these fees further limits the revenue-raising powers of Local Government, and leads to local communities further subsidising the activities of State Governments. It should be stressed that some of these State Government agencies that are exempt from local government rates also charge Councils considerable sums of money for their services, such as the Environment Protection Authority levies fees from local government for landfill and sewerage operation. This seems to be a contradiction in public policy.

Local government provides many services on behalf of state and Federal governments, like community housing, aged units and aged hostels. The fees a Council is able to charge those who benefit from these services is set by the other tiers of government and usually do not reflect the costs of providing the service in question. The net result is that Local Government is obliged to use its general revenue to provide these services on behalf of other governments.

All of these factors serve to limit the ability of Local Government to control its own revenue. These limitations have reduced the capacity of municipalities to meet community expectations; maintain the level of services provided; and undertake necessary measures to prevent further deterioration in their infrastructure. Councils need more flexible revenue-raising capabilities.

RATE PEGGING

A particularly acute example of State Government restriction on the revenue-raising ability of Local Government is the ongoing policy of 'rate pegging' in New South Wales. This policy has operated in New South Wales since 1977 and has greatly exacerbated the fiscal stress of the local sector in that jurisdiction. Ernst and Young (1990:37-38) contend that the main disadvantages of rate pegging are that it:

- Erodes differences in capacity to pay since it applies a uniform rate increase on individual assessments;
- Provides subsidies to commercial users, particularly where land use changes;
- Allows properties with a relatively high increase in value to pay the same rate increase as those experiencing smaller or no increases; and
- Restricts flexibility in rural areas, where capacity to pay is affected by seasonal conditions.

Several submissions to the Independent Pricing and Regulatory Tribunal (IPART 1998) maintained that rate pegging reduces incentives for efficiency and blurs accountability between state and local government. This is at odds with the current New South Wales State Government philosophy that rate pegging promotes efficiencies because municipalities are obliged to operate effectively. This view ignores various aspects of rate pegging; it permits Councils to increase rates to the full limit of the pegged increase with political impunity; to attain higher service quality, communities may be willing to pay rates higher than those permitted by the limit; and by not differentiating between Councils, rate pegging can lead to undesirable consequences because it does not sufficiently take into account the varying circumstances of Councils (IPART 1998:39-40).

Ernst and Young (1990:47) argue that because individual Councils believe that they enjoy a State Government sanction to increase rates by a given percentage, this serves to inhibit the quest for efficiency-enhancing processes, and thus retards the overall improvement in municipal operational efficiency. Furthermore, if Councils had to justify any increase in rates to their ratepayers, there would be a greater incentive to look carefully at administrative practices and the need for sustaining the current level of services. An additional argument was presented by the Woollahra Municipal Council in its submission to IPART (1998:40): '[Rate pegging] assumes that the community does not wish to pay for its present and future needs...Rate pegging does not allow for any relationship between the needs of the locality, the age of its infrastructure and the specific growth pattern or needs of a community'. Moreover, the same arguments in favour of rate pegging could be made for restricting the revenue-raising capacities of State and Federal governments.

The New South Wales Department of Local Government has tried to justify its stand on rate pegging by contending that 'rate pegging embraces accountability by forcing Councils to set priorities and explain the reasons for making decisions...the rationale for rate pegging is that it requires Councils to monitor their expenditure and helps limit the overall level of government spending' (IPART 1998:40).

It might be argued that Councils should have the necessary discretion to make their own judgments about the expenditures they undertake, and the way they raise revenues, since they are directly accountable to the ratepayers for their actions. After all, in other Australian states, Council rates are kept in check by the ballot box. As a democratically elected sphere of government, Local Government is accountable principally to the electorate, not to another sphere of government. No state other than New South Wales has found the need for similar heavy-handed intervention by the government (Torbay 2001).

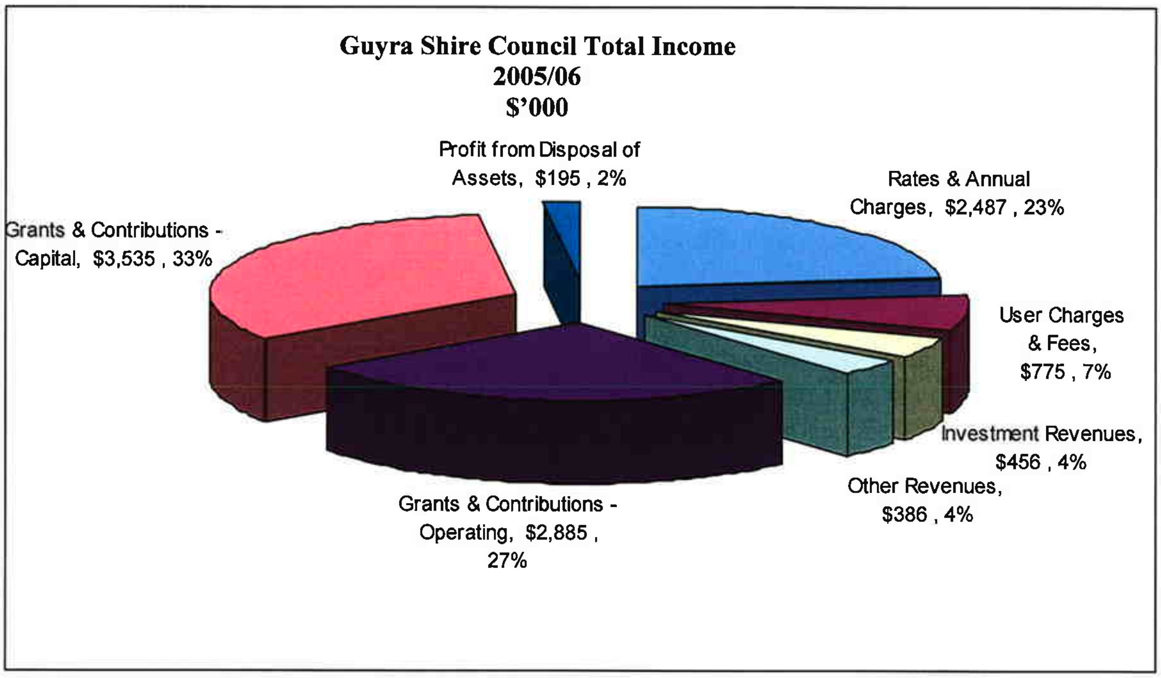
Rates are one of the most highly visible forms of taxation because they are presented in the form of a bill to be paid annually or quarterly. Consequently, ratepayers are very conscious of the amount paid and changes from year to year. This is not true of most other major forms of taxation (HRSC 2003a)

In their report into Local Government rating, Ernst and Young (1990:8) contend that, in New South Wales it has been possible for Local Government to 'make room' for the state government through the rate pegging arrangements. However, they also argued that the reluctance of the local government sector to increase rates (in the long term) provides a greater opportunity for State Governments to exploit what has traditionally been seen as a local government tax base. It has been argued that there is considerable scope for upward adjustment in the rating system itself. However, this is not the reaction of rate payers, nor apparently that of the State Government which applied the rate pegging limitations (ACIR1981).

GUYRA SHIRE COUNCIL'S EXPERIENCE

Guyra Shire is located on the top of the Northern Tablelands in the New England region of NSW. The Council services a rapidly growing population of 4,800 people and an area of 4,369km^2. The Council is based in Guyra, situated on the New England Highway approximately half way between Sydney (650km) and Brisbane (450km). The Council is also a short two hour drive to the mid north coast and Coffs Harbour. The Council is a general purpose Council which supplies a large range of services to the towns of Guyra, Tingha, the villages of Black Mountain, Ben Lomond, Ebor and Wandsworth.

Guyra Shire's revenue is primary derived from grants and subsidies ($6.42m; 60%); followed by rates and annual charges ($2.49m; 23%). User charges and fees only represent 7 per cent of total revenues at $0.78m; followed by investment returns ($0.46m) and other revenues $0.39m, both representing 4 per cent of totals revenues. Council's rates are extremely low by industry standards, with the average residential rate being $271; average farmland rate being $1,368; and the average business rate being only $340.



The key issue facing Guyra Shire is that it is experienceing unprecendented growth and prosperity within the community. New businesses and industry are opening at a rate of one a month with some $76 million in development being carried out over the last two years and property prices have increased by 400 per cent over the last four years. The future looks extremely positive for the community. The challenge for Council is to manage this growth in a coordinated and sustainable manner and ensure it has the capacity to meet the increasing community demands and the growth in infrastructure requirements that will result from the expected significant increase in population.

In addition, Council has been faced with significant increases in its expenditure in recent years and has found many of its costs have exceeded the state's rate pegging limit. For example, rural fire service contributions have increased significantly; wages have increased by 6 per cent; and resealing costs increasing by 17 per cent, just to name a few.

In recent years, Council has reviewed its section 94 developer charges, and moved from a flat rate per new allotment to charging a 1 per cent levy on most development. This has increased Council's ability to provide additional or improved infrastructure that will result from the increased development activity in the Shire. This is expected to generate, on average around $50,000 to $100,000 per annum.

Council has also reviewed its user charges and consider options to expand this source of income. One of the issues that Council has encountered in this area, is that it does not have the critical mass to be able it to generate significant income streams or to ensure cost recovery on its services. For instance, the Guyra pool requires a $100,000 subsidy from Council to operate each year, and has required significant capital investment to undertake essential renewal works to ensure its ongoing operations. The pool's admittance fee only contributes some 12 per cent to the operating cost of this valuable social infrastructure. This situation is replicated many times over, for two community halls; a library suffering from declining state funding; parks and gardens and sports fields etc.

Council has also considered the levying of special rates for particular projects. This has resulted in Council adopting the maximum allowable $25 per occupied allotment, storm water levy charge for 2007/08. This will generate around $25,000 p.a. towards addressing storm water issues in Guyra. At this rate, the projects identified in Council's storm water management plan will be completed in around 100 years.

Borrowing funds has also been identified by Council as another possible source of funds and one that should be used to address its infrastructure back log. Guyra Shire has limited debt exposure, with loan repayments accounting for less than 5 per cent of its income. Most of the loans that Council has outstanding are for income producing assets, such as water and sewer infrastructure. Council's loan exposure to its general revenue is therefore almost nil. What has prevented Council from undertaking a more robust borrowing program, is that while it has a good balance sheet and is able to easily secure new loan funds, it does not, however have the recurrent revenue available to make the required loan repayments. The lifting of restrictions over Council's rate revenue would enable Council to tackle head on its infrastructure back log and maximize the use of grant funding, such as Road to Recovery, to improve infrastructure and thus improve the economic efficiency of the transport sector in the economy.

Guyra Shire strongly objects to the state imposed rate pegging restrictions. Council believes that rate-pegging limits the services available to the community and is an anti-growth policy of the state government. Council's are discouraged from achieving population growth, as this leads to additional cost burden on Council with no additional income. Council believes that it should be able to capitalize on the growth being experienced in the Shire and the increases in property valuations, to generate additional rate revenue to enable it to reinvest this revenue into additional growth and infrastructure to ensure the sustainability of the area in the long term.

The Minister for local government would argue that Guyra Shire should submit a rate variation to gain additional rate increase. While Council intends to do this within the next twelve months, it would be Council's view that it should be able to set modest rate increases itself each year; rather than have a significantly large rate increase every few years obtained via Ministerial approval. That is the modest rate increase would smooth these increases out over a number of years.

Council has therefore explored all revenue raising options available to it, but has come to the same conclusion, the draconion rate pegging restrictions imposed by the state government has limited Council's growth potentional and its ability to be sustainable in the long term.

CAPACITY BUILDING

Local government's capacity is the single critical ingredient to overcoming the current fiscal stress that the sector is experiencing (Johnson 2007). The local sector needs to improve and build its capacity at all levels. The Financial Sustainable Review Board in South Australia highlighted the importance of strengthening the capacity of local government for the state government. It observed (FSRB 2005b:12) that a local sector provided with greater capacity will be in a better position to assist the state government in meeting its strategic direction, plans, and programs.

A complicating factor is the public perception that Local Government has considerably more capacity than it has in reality (LGI 2006:9). The survey undertaken by the LGI (2006:9) found that the public believed local government expenditure accounted for between 10 to 30 per cent of total government expenditure rather than the actual level of 5 per cent. The Inquiry also observed that different Councils with have differing levels of capacity (LGI 2006:89) to respond to mandates, to other changes in expectations, and to accept additional responsibilities (LGI 2006:91).

There are a number of ways to improve the capacity of local government, including measures such as: removing current restrictions over the local sector's revenue raising capacity (such as rate pegging and statutorily set fees); providing access to alternative revenue streams, or providing the sector a share of a growth tax, by guaranteeing a fixed percentage of income or goods and services tax revenue. Strong arguments could be mounted for better tax sharing arrangements in the Australian federal system. This would alleviate the current mandate dilemma that indicates that, in many cases, the local sector is the best avenue to implementing government policy and overcoming some of the previously identified inefficiencies that fully funding a mandate can cause. Australia has seen the Federal Government providing the states with access to its growth revenue stream (the Goods and Services Tax) in order to ensure their sustainability and to reduce their reliance on higher levels of government for fiscal assistance. However, it is now considered timely to implement the same for Local Government.

CONCLUDING COMMENTS

Local government is far from perfect. Sometimes wrong decisions are taken, inefficiencies are allowed to persist, customer service falls short of the standards required, and so on. Shortcomings are well documented: operating under legislation requiring highly transparent procedures and vigorous public perusal, local Councils are subject to intense scrutiny. They are also liable to the pitfalls facing any democratic institution (LGSA 2001:27). Local government requires autonomy in its revenue raising activities in order to meet the needs of its community.

Community demands are likely to increase over time. People will always strive to increase their quality of life, thus will always expect more from governments. State and Federal governments will also continue to use local government as a vehicle to implement their own policy objectives. The result of all of these factors is that Councils should be proactive and anticipate changing and heightened demands from their respective communities and be in a position to provide for these needs as and when required.

The increased resources now required to meet these responsibilities, as a result of increased expectation from the states, are affecting local government's ability to provide other services to its community. The combination of increased resources required to implement the growing legislative requirements of the state, and severe restrictions over local government's revenue-raising ability, has led to a reduction in services being provided in other areas. Few of the additional responsibilities conferred on local government over the past few decades have been matched by adequate, ongoing funding, or new sources of revenue (LGSA 2001:14).

Local government resources can only be stretched so far before a crisis point is reached. There is already evidence of this with the deterioration in local infrastructure, particularly roads, the running down of reserve funds, the lack of provisions being made for future assets replacement, and a reduction in the provisions made for major maintenance items. Local government is under considerable pressure to change its traditional character and procedures in many ways. It faces the prospect of financial cuts in both state and Federal grants and is expected to 'do more with less' by improving its managerial and economic efficiency (Self 1997:297).

Rate pegging and the imposition of limits on statutory fees and charges dramatically constrains council's ability to meet their escalating fiscal responsibilities. As a result, Guyra Shire strongly supports the following recommendations that were made as part of the LGI (2006:31) to improve Council's revenue raising ability:

Recommendation 1	The State Government free Councils to determine their own income by removing statutory limitations on their rates (i.e. rate pegging) and certain fees (e.g. development application processing fees) in return for Councils adopting longer term strategic and financial planning with outcome targets.
Recommendation 2	The Commonwealth Government increase its financial assistance grants (FAGs) to Local Government by 20 per cent ($300 million in 2003/04 values) and then set them at a fixed percentage of: • Gross domestic product (0.22 per cent); or • Total Commonwealth collected taxes, including GST (0.86 per cent); or • Total income taxes (0.22 per cent).

Council would urge the Productivity Commission to also support these recommendations.

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GENERAL MANAGER
GUYRA SHIRE COUNCIL

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