Local Government Study
Productivity Commission
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Assessing Local Government Revenue Raising Capacity
Draft Research Report

The Draft Research Report has provided a better structure for understanding the way in which the Commission wishes to formulate its final report. Some of the statements in the report are at variance with the content of submissions by those based on the Agriculture Industry and therefore the ultimate requirements to provide rural and remote local government with the capacity to revenue raise equitably and with the same equal effort of urban developed and urban fringe local government.

In this submission where contrary views are held by the Agriculture Industry explanations are given at some risk of repertition with the content in the original submissions.

It is disappointing to see from Table A1 List of submissions the lack of involvement of farming organizations in this study because their members occupy over 70% of the Nation's land mass in Rural and Remote shires and the financial health of those shires is of critical importance to them and vice versa.

Page XXVII Impacts of local government revenue raising. The content of this statement is agreed with but Agriculture is not a normal business and is severely disadvantaged when treated as such.

The terms of reference is for "the impacts on businesses" but those in Rural and Remote local government should realize that while Agriculture is a business, it is a very different business, so much so that it needs to be treated differently in the same way that Rural and Remote local governments are with higher inputs from grants.

Further to this p 145 of the report states "The terms of reference for this study requires the Commission to focus on assessing the revenue-raising capacity of councils". In agreeing with this a rider must be added that the revenue-raising capacity of city, urban developed, urban fringe is derived from the earning capacity of the citizens therein, while in rural and remote the earning capacity is reliant on the wellbeing of the Agriculture, Forestry, Mining and Fishing industries, with Agriculture being predominant in more local government areas than the other industries.

There are sociological and psychological reasons why Agriculture, represented as it has been by Prime Ministers, Premiers and Members from either side of politics, has not established its unique position in any official status other than being one of the primary industries. It is of no wonder that in the Report it is only treated obliquely in Rural and Remote shires on the same grounds as banks and merchandizing with one acknowledgment p63 that Agriculture has a cyclical level of income.

It is noted that the Report states the lack of data within or between councils that would substantiate such empirical evidence as presented by myself and others, is not available.

The trouble and cost of collecting such data may not be necessary if a better system can be devised.

Page 14 of the report "International comparisons with Australian local government" and page 127 "International studies of rate incidence" are deemed "Less relevant".

The limiting factor to moving away to a *unitary* system in Australia is distance, population densities and water availability over long periods of time; factors that those advocating abolishing states have not considered and factors for the retention of the present system suitably adjusted.

From conversations with the Victorian Farmers Federation (VFF) circa 2004 there was agreement that what Agriculture generally needed was a change away from UCV or ICV base of *ad valorem* rates to dwellings based on their size and location with Rural land not rateable; dedicated for agriculture or forestry use only. The view seeker is not excluded provided agricultural pursuits are maintained. (The cost of no rates on farmland see p 3 Option9:Local Government Revenue)

The VFF mention curtilage but on a farm the size of the surrounding garden of the homestead is immaterial to local government because they are not providing water or sewage. Where accommodation is provided on farm for employees a case for partial rate exemption could be legitimised on the basis that it is the landholder who provides all the infrastructure but the employee has a responsibility to local government for the services provided off farm when in town.

Curtilage is a consideration for legitimate revenue raising capacity when potable water and/or sewage is provided on rural lifestyle development blocks in Rural shires or where the frontage in Urban shires is over a certain length.

The desire to move to a dwellings base with rural land not rated is to obtain relief from the undesirable side effects of the present system. Such a change does involve moving to an holistic system but in doing so yields a fairer system with the burden of financing local government equally shared across all communities.

Federal and State Grants, subject as they are to formulae for distribution, is an holistic approach. The fact that any increase is based on CPI and does not cover increased wage rates is a detraction from their usefulness.

This would be counteracted by taking an holistic approach to all 700 local governing bodies, combining their desired funding level (under certain rules and limitations) divided by their total number of dwellings and their area to give a rate per square metre with location and ability to pay factored in.

Defining revenue- raising capacity p45 Key points

The revenue-raising capacity of local governments depends largely on the ability of their communities to pay.

There is no argument about paying for local government rates and services provided it is within the ability of the community to pay. Rural and Remote local governments have two communities in one. The town content and the Agriculture content with further complications due to Managed Investment Schemes MIS, new intensive farming industries on the increase. Population drift to cities and the coast now counteracted to a degree by the influx of lifestyle and view seekers.

The fluctuations of mines opening and closing due to commodity prices etc with the life of the mine an unknown, would have an effect on the revenue-raising capacity of the council. Surrounding farms need to be insulated from such fluctuations.

The net result is for Rural and Remote local government to have the town community generally able to pay if not too dependent on Agriculture, while the Agriculture community's ability to pay is dependent on circumstances beyond their control.

The distribution of grants on a per capita basis throughout the Report is an indication of the inability of the Agriculture population's ability to pay.

A comprehensive measure of the after-tax aggregate disposable income of the community is the most appropriate indicator of ability to pay of the community and hence the fiscal capacity of local governments

Because the Agricultural community have a fluctuating income varying from feast to famine governed by drought, fire, flood, commodity prices etc making income over a local government area an unreliable indicator of fiscal capacity.

Empirical evidence is with 60% of farms dependent on off farm income, income derived by shearing, fruit picking, nursing, off farm investments etc is used to buy food, holidays, schooling etc that the farm can not generate from capital invested in land.

Many farms would not be paying the principal labour source, the farmer, a wage. The farmer's effort is discounted. Only the Tax Office or farm consultancies can verify this statement, I rely on questions asked of family and friends. This is the basis of one of the sociological- psychological problems facing the industry.

When off farm income is being earned by the principal labour force on the farm then work and opportunity is being neglected on farm.

From Box 4.1

Property values effect both wealth and income of residents and are therefore a better indicator of ability to pay.

This is not so for Rural Agriculture as distinct from Rural Urban because of the distortions of the views and tree change seekers, plus MIS.

economic theory suggests that in an efficient property market at least in the long run, property values should be correlated with the expected return on holding the asset. Therefore higher property values would imply higher returns and ability to pay.

Again this does not hold good for Rural Agriculture as distinct from MIS. The view seekers are not interested in making an income from land. Their ability to buy and maintain comes from cities and /or investments, what the farm produces is considered a bonus albeit an expensive one. The only hope of redemption for the neighbouring traditional farmer is in capital gain, which may or may not eventuate. In the mean time under *ad valorem* his rates will rise and the land will produce at the same rate as it always has and with the same cash flow.

Using the dwelling and its position as basis for revenue raising capacity relieves the neighbouring farm of a rate rise. With Rural land not rateable the investor in an MIS would escape contributions to the local government, (they do remove existing dwellings further reducing liability to the local authority) if dwellings become the base but under an holistic scheme there is no escape because the investor would pay more on his dwelling and or dwellings with the surplus redistributed to rural and remote councils.

Box 4.1
using property values to assess ability to pay overcomes some of the practical difficulties in obtaining suitable measures of income.
The case of the City of Horsham cited in VFF sub 31 where 8000 residents pay $46.00 each while 500 rural holdings pay $640.00 each goes to show that while aggregate income is an appropriate indicator of fiscal capacity it is not being used fairly, in fact discriminatorily, and the value of the indicator of effort is abysmal.

If applied to all, $81.53 would be the per dwelling increase but using vertical fiscal imbalance some would pay more, some less. It is reasonable to believe that executives in the City will have far greater disposable income than any of the 500 rural properties even allowing that 300 of those have off farm income coming from the city. Using the 640:46 ratio no farm is going to be 13.9 times better off than any city based activity.

Suggestion

Explore the possibility of using dwellings and their location for the Tax office to provide a number of disposable income brackets to provide rate differentials while still keeping individuals privacy sacrosanct.

5 Comparisons of revenue-raising capacity

Revenue-raising effort, a measure of the extent to which a council draws on its fiscal capacity, also differs across classes of local governments. Urban developed and urban fringe councils tend to draw lightly on their fiscal capacity. On the other hand, rural and remote councils draw heavily on their fiscal capacity.

Reasons why urban developed and urban fringe can draw lightly on their fiscal capacity is because:

> they do not have to provide for the infrastructure that allows them to consume cheap housing materials, furnishings, food, some clothing and recreation in National Parks. The feeder roads as distinct from National and State highways are all in rural and remote shires.

transport in many of these shires is subsidised by the State while rural commuters pay 10 cent a litre more for fuel although the cost of delivery is 3 cents. This is over and above any cyclical daily fluctuations imposed by oil companies. The net result is rural and remote draw more on their fiscal capacity.

in rural and remote where there are a number of towns requiring sewage and water (costs recovered by fees) the multiplicity of units make for higher unit cost that detract from disposable income. One town of 39 houses in NSW with some Indigenous occupants have a 3 million dollar water treatment plant where the shortfall in fees is paid by rates.

The majority of rural and remote local governments would remain highly dependent on Australian and State government grants.

The converse to this statement is that City, urban developed and urban fringe remain highly dependent on the unpaid services provided by rural and remote local governments where grants do not balance the debt.

Incidence of rates and their shifting p 125

An assessment of the distributional impacts of rates is about who ultimately bears the burden of rates, that is, who in the community ends up paying the council rates. --- Rates paid by business, for example, may be "shifted forward" (to consumers) through higher prices of goods and services and/or "shifted backward" (to suppliers of services such as tradesman, contractors and others) by offering lower input prices.

This statement is an erroneous conception of the majority of farming businesses. It would only be true for very large farms over an extended period of time because of the cyclical nature of the industry.

For all farms shifting forward is not a possibility because:

all sales are made at auction
sold on commodity markets
sale prices are dictated by market dominance.

Shifting backwards is only a dangerous option and is more likely on farms to result in operations not being done and/or not being done efficiently or to the bare minimum. Insurance is a casualty with consequential backlash for fire fighting funds from insurance companies.

The extent to which ratepayers are able to shift the rates burden forwards or backwards depends on the market and institutional circumstances they face. In the case of businesses, the tax deductibility of rates enables the rates expense incurred by business to be shifted in part, to taxpayers more generally.

The ability of farms to use rates as a tax deductible item to shift to taxpayers is dependent on making a profit. Farm consultancies like Homes and Sackett advise clients to factor in a realistic wage for all operations that are performed on the farm by family and friends even if there is no physical payment to reveal if there is true profitability.

The reality is that if these farms show a small profit because of discounted wages the owners do not want the extra bookwork, tax liability, labour oncost; only to show a loss, with or without local government rates deducted, capped off with financing problems.

ABC-Radio Country Hour 15 Jan 2008 ran a segment on research done by mango growers confirming the above.

The above also confirms the earlier statement that Agriculture in this context is a very different business not only affected by the commercial considerations of whether to show a profit or loss but in which local government area the business is located.

P 134

In fact, the total rates incidence in rural and remote councils is almost twice as high as the total rates incidence in urbane councils. One reason for this is the relatively lower average incomes and higher per person expenditure in rural and remote councils on infrastructure services such as provision of local roads.

The outdated convention on local roads is covered in sub 9 p 3 but there is a need to show that there is an additional burden being put on rural and remote local government principally and farmers and truck drivers to a secondary degree.

State governments have been closing or not operating branch rail lines, leaving local government to cope with the thousands of extra truck movements on inadequate country roads. It is inevitable that more truck drivers and road users will be killed or hospitalised.

With relevance to a matter raised below under Principles for revenue-raising; where farmers are being hurt is having State run bodies promoting closed branch lines as a tourist attraction in direct conflict with the efficient running of the farms they traverse. Add to that, portion of the rates paid by these farms is used by local government to promote this form of tourism regardless of any consideration as to the farms ability to recover the extra costs and therefore be less able to contribute to the revenue-raising capacity of their local government. The tourism industry escapes paying for their benefit because there is not a satisfactory method available to local government of determining who is benefiting and by how much.

This is cost shifting by stealth and another reason why revenue-raising effort in urban developed and urban fringe does not have to be as rigorous as rural and remote. The savings made by letting branch lines fall into terminal disrepair can be spent on subsidising transport in metropolitan areas.

8 Principles for revenue-raising

Key points

Through open and transparent processes, local governments can improve the well-being of their communities by:

ensuring financial sustainability

This goal of "ensuring financial sustainability" is made more difficult for the rural councils going through a transitional stage with the aim of developing new industries with greater revenue-raising capacities than the traditional Agriculture base to tourism and/or Forestry. It must be noted that in going through this transition Agriculture is still the biggest contributor while Tourism and Forestry are providing no relief to Agriculture.

Page153 This does not sit well with "Generally, cost recovery can be regarded as an attempt to charge users more directly for the local government services they consume." Clearly not all consumers are treated the same as the rail trail and City of Horsham examples demonstrate.

P 155

Rates

Rates on land are generally considered to be an efficient form of taxation in that they do not significantly distort economic activity and resource allocation. Even though rates can be levied on the capital improved value of land in some jurisdictions, and are therefore a tax (in part) on capital, the general consensus is that the distortions and efficiency costs are small.

For rural and remote local governments this paragraph is of crucial importance, possibly not realised by the staff and councillors (see below), but for Agriculture the party creating the wealth to finance them, the following contrary views needs the Commission's adjudication.

There are two points to be made on this statement re rates on land.

(1) Rates on land do distort economic activity severely in rural and remote local government areas as strongly implied in the VFF submission 31, sub 9, and the actions of the NSW Farmers' Association's conversations with the VFF circa 2004 (see attached memorandum of meeting with the Federal Minister for Local Government 22 May 2007).

(2) The possible origin of the statement comes from a Federal Government classification of councils into groups of similar characteristics from which the Dept of Local Government publishes annually, a document "Comparative Information on NSW Local Government Councils".

The basis of this document is an average of rate assessments and is quite misleading. It is based on assessments taking no consideration of the type of land and its capability to produce wealth. Council officials quote from it saying the average assessment is $1280 but individuals are paying $6000 up to $18000 for rates on rural land in Tumut Shire. Government departments, agricultural consultants and financial advisors all use a per hectare and land type basis for benchmarking with the results showing anything from 6:3:1 dollars payable on a per area basis in three local government areas within 200 Ks of one another in NSW.

This could be why on p XXVII it is stated "Developing indicators that can be used to provide insights into the impacts of rates, and fees and charges on individuals, businesses and organizations has been difficult, given the limitations of the data sources available at the local government level."

Rates levied on UCV rural land is a tax on capital made worse if levied on ICV rural land because the capital is income producing.

This fact is the major reason why Agriculture is not like other businesses and the imbalance is multiplied depending on which shire farming operations are being conducted in. The farm in the highest rate bracket paying $6000 after 10 years has had $30,000 less to spend in its local shire on improving productivity, with less produce to be sold at the local saleyards (a source of fee income) than a similar sized farm in the neighbouring shire where the rates are $3000. A sure method of strangling the goose that laid the golden egg.

Rates should be paid but never be assessed on working capital. Applying the revenue raising principals of benefits and ability to pay local government rates there needs to be consideration of the ability to recover other taxes levied by government instrumentalities that have a flow on effect to the ability of Agriculture to pay local government rates.

They are for irrigation infrastructure, with or without delivery of water, Rural Land Protection Boards and potentially Catchment Management Authorities in the offing. The principal should be that if the cost can not be recovered in the price of goods sold the tax should not be levied in the first place.

A case of the direct user being disconnected from the next user, the public; therefore the public pays.

Ultimately everyone will receive greater benefit as Agriculture recovers its prosperity.

For those who subscribe to the general consensus believing "that the distortion and efficiency costs are small" are clearly not looking at Agriculture and the root cause of the over stretching of revenue raising ability in rural and remote local government areas.

As to achieving equity objectives: how do the cognoscenti reconcile such distortions as Gannawarra Shire, City of Horsham and from the LGSA in NSW report "Are councils Sustainable"? Statistics showing such an imbalance in NSW. (p 196 attached to NSW Farmers' Association Gundagai DC submission; Option 9: Local Government revenue, Chapter 9 "Are Councils Sustainable) Urban councils levied an average residential rate of $624; rural councils levied an average residential rate of $400. In 2003/4, councils received 26 per cent of their rate revenue (573 million) from business rates. The average rate per business assessment was $3,499. Councils received eight per cent of their rate revenue ($179 million) from farmland rates. The average rate per farmland assessment was $1,471.

The earning capacity of executives and many of the operatives employed by the timber and pulp industries in the Tumut Shire far exceeds the earning capacity of farms: a repetition of the City of Horsham. When representation has been made by farmers for rate relief, the reaction is that all rates will have to go up. No consideration of fairness, equity and certainly no thought that in the long term there are substantial benefits to the economy in building up farm capacity.

The truth is, benefits and ability to pay principles do not apply. Political consideration rules. There are the tools to give equity through differential rates but they are ignored and unless it is made mandatory to provide equity, political consideration will prevail.

The most vociferous group with the most time and money to spend lobbying, but none to be extracted in rates(mainly because there are no lines of demarcation to apply differential rating); they get what they want but Agriculture is the one who pays.

The Research Report proves that there is capacity for revenue raising; it also shows that effort is unbalanced across the spectrum. The old view that local government must be "local" denies the reality that time and technology has changed our World.

With the advent of capital gains being the driving force for determining wealth and not the inherent ability of land to produce wealth, but expected to produce ecological and environmental benefits as well; rural and remote local governments are left exposed to the fluctuations in wealth creation elsewhere.

Therefore it is timely to adopt a new base that will counteract the capital gains phenomena and the purely political obstructionism that is in vogue today. The proposition is not a new tax, just a new way of collecting the tax from all of the beneficiaries and sharing the effort of revenue raising.

For the 700 local government entities, they need to be kept local with all the social benefits such an organization can bring but their lifeblood, finance needs to be shared and their revenue raising effort made equitable.

Enclosures. Memorandum of meeting with Hon Jim Lloyd, MP

Option 9: Local Government Revenue sent to LGSA

Growing the Business of Farming | NSW Farmers Association

Meeting with The Hon Jim Lloyd, MP
Federal Minister for Local Government, Territories and Roads
Tuesday 22 May 2007

Issue

Local Governments have varying abilities to raise funds in order to provide benefits for all ratepayers at an even level.

Background

- Local Government has the ability to deliver a range of key services provided that adequate finance is available.
- Adequate finance is not available because many of the beneficiaries of individual shire's productivity are located outside the shire with no commercial link to recover costs and indefinable social benefits demanded by society.
- For example National Parks are located on crown land and are therefore not required to pay rates, however the Local Government in which the Park is located, provides the infrastructure and amenities for staff and visitors to the Park. The landholders in that Local Government area provide the funding through rates for the maintenance of these services.
- The overall ability of Local Government to raise funds requires immediate attention because many Local Governments are in serious financial difficulty.
- Currently in Queensland there is discussion occurring about the possible amalgamation of Local Governments in order to ensure the ongoing delivery of key services.
- Differing land uses and thus differences in the ability to generate rates exists between rural Local Governments.
- The independent inquiry into the financial sustainability of NSW Local Government found that although the general public has significant expectations about the ability of Local Government to meet their needs, Local Government has a limited ability to raise funds.
- In the United Kingdom, rural land is for rural use only and rates do not apply to the land, however rates do apply to the living area of the residence.
- The rating system in the United Kingdom is based on a holistic methodology whereby wealthier Local Government areas assist in funding the Local Government areas which are not as wealthy.
- Also in the United Kingdom, an environmental stewardship program exists and this program provides benefits to the entire community.
- It is important to ensure due consideration is given in Australia to the disparity of population densities, tyranny of distance and disparity of wealth created partly by the revenue raising activity of Local Governments under the existing rules.
- The Council of Australian Governments has agreed to discuss local government funding arrangements once the Productivity Commission study is completed.

What the Association is seeking

- Support from the Australian Government for the reform of the laws which govern how Local Government rates are raised so that equity is provided to all citizens.
- An investigation by the Australian Government about the suitability of the adapting the United Kingdom system for rates on land.

Option 9:Local Government Revenue. Chapter 9 "Are Councils Sustainable"

Adopt holistic approach for all 152 councils for total funding requirements.
Change rating base: total funding requirements divided by total dwellings in the State.
Make rural land for rural use only and unrateable.

Pros
- Users pay for fair share of services State wide.
- Rate pegging obsolete
- $500 million shortfall covered
- Rates based on property's intrinsic values of size and position would be more equitable than rates based on land values.
- It would be perceived as a fairer system as ratepayers would be better able to relate the value of their property to the rates they are levied.
- The tax on capital now being paid by farmers eliminated

Cons
- Effort explaining the change and need for it would diminish over time
- The community level of misunderstanding and general expectations of local government in its present form will make any change difficult.

Preamble

Over the life of LG there have been many changes in technology, commerce, and expectations of service. The relatively simple approach to life in the late 19th century to the complicated and much more integrated and interdependent society in the 21st has not changed the views held by most that local government is just local government, pure and simple in its own little box, to some a branch of State Government!.

The fact that there are forces like vertical fiscal imbalance (VFI), horizontal fiscal imbalance (HFI) and the other niceties explained in chapter five influencing our little box does not gel with the fact that the 152 boxes of local government go to making up a body providing the relatively smooth running of NSW for the benefit of all citizens of the State and Nation..

The boxes need no alteration, being well equipped with administrators knowledgeable of local issues and defined boundaries.

Reason enough to ask for Constitutional recognition and a share of revenue to maintain services. Chapter five puts this as not likely but with the Federal Government forecasting health funds tied to provision of services to rural communities, perhaps in the interests of competition, productivity and the efficient servicing of the one third of population outside major cities, the Federal Government may be persuaded to act.

Problems and Explanations

The underlying theme of "Are Councils Sustainable" is funding, services and payment there of. Acknowledgement of residents being asset rich and income poor (p 18) is equally applicable to a large proportion of farms.

(p26) under 1-13 Recommendations mention is made "greater application of

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user pays". Also it is acknowledged that "the most vulnerable councils --- transfer of their regional roads to state responsibility may be their only chance of survival".

Such grants and transfers ultimately come from taxpayer revenue and are therefore a cosmetic solution that hides the real cost of Local Government.

"Greater application of user pays", or in reality users are not paying, because the term is used too simplistically. (p 205) In relation to payment of services "maintaining local roads takes up a large proportion of country councils' resources".

The fact is that while there are farms being accessed, the producers of inputs to those farms have the benefit of being able to deliver goods manufactured in towns and cities. The produce coming away from the farms gives them revenue to pay rates but it also provides jobs and steady reliable prices for the community at large.

By the same token National Parks and Forestry as pointed out (p 205) do not pay rates (Forestry make some contribution to roads servicing them). In the case of National Parks they are created to please city dwellers but the infra structure to access them, provide the support facilities for their employees and visitors, is supplied by the local council, who are not paid.

Forestry does provide local employment but the product flowing throughout the Nation has been subsidised by the local community with most coming from farmers rates. If $400 per rural residence and $1471 is the average for farms, clearly farms are over taxed. This is confirmed by statistics where in 1999 at Tumut 40% of rates were paid by farmers making up19% of population.

Rural Local Government can not under the existing methods recover what the users in the wider community demand, expect, and can not pay for because there is no means of doing so. This is acknowledged bottom page 205.

Page 206 "On the other hand, the claim sometimes made that local rates create horizontal inequities between areas should be dismissed". This is a completely erroneous statement for the rural situation. A dairy at Tumut pays $15,000 more than an equal enterprise in Wagga Wagga. Grazing land in Tumut Shire is twice as expensive per hectare as Gundagai and four times for Bland Shire. The product is the same from the three shires offered on the same market.

Page 105 discusses grants and FAGs and efficiencies with equity issues which can not be lightly put aside but there is a familiar sound of a cracked record only instead of inefficient farms getting drought relief it is inefficient rural councils being subsidised.

Before too much criticism or judgements is made, a thorough history of events inside and outside the shire is more likely to reveal good thrifty management trying to cope with forces beyond its control over a long period of time.

The use of dwellings in the report does put the financial situation in perspective. The fact that there are statistics available for different locations relevant to dwellings and socio economic situations would suggest that it is not a big step to making dwellings the raw material for change.

The fact that this is proven and working in the UK is encouragement to investigate for NSW, if not Australia.

Put on a dwelling base the $500 million required in extra rates per year equates to $215 per year extra or two cases of wine.

The ability to pay is reflected in location and size of the dwelling, also the quality giving scope for a fair assessment. Capital value to play secondary role as an indicator of vertical and horizontal equity. The UK has eight levels.

A further refinement using curtilage with free standing dwellings is an option.

In the case of farmers there has been a protracted period of social injustice in that farms are the same as Local Government, not able to recover costs, shire rates being a prime example. Made worse in recent times by change in land use due to tax breaks favouring investors or cashed up "life style and views" seekers making it harder than ever for farmers to have the ability to pay after the rates take the inevitable rise.

This situation does not occur in the UK where rural land is for forestry & agriculture only and can not be subdivided easily. Result is that if the price paid is over valued the traditional neighbouring farm is not penalised with a rate rise. Caveat emptor.

Farmers do wish to pay their share and with dwellings on farms counted in the census, they would do so. The number of dwellings on farms in NSW is not available from ABS but as at 30th June 2004 there were 40,827 farms in NSW.

The cost of giving farmers social justice would be:

$179,000,000 rates from all farms, less say $605 State average resident for
40,800 farms (ABS 30-06-2004)

$ 24,684,000

leaves $154,316,000 to be shared by 2,323,879 dwellings = $66.40 or half a dozen bottles of wine

It is quite possible that there are more dwellings on farms than there are farms to provide for farm employees. Argument can be made for such cases to be exempt from more than one charge as the farm is substituting for Local Government.

Conclusion

There are advantages to the whole community in making rural land free of rates:

- Farms have the chance to build reserves to combat drought and trade fluctuations
- The anomalies created by different rates in different shires removed.
- Rates from farming not used to prop up other industries
- Comparative analysis for cost structure enhanced.
- Farmers would be on a level playing field with UK farmers
- Unequal competition between farmers and investors on a better footing.
- Environmental benefits keeping food production close to city markets.

For Local Government the use of dwellings as a basis for rate revenue, not necessarily the direct value of the dwelling, makes it possible for all citizens to pay for the services they require State wide. This in no way alters the necessity to fund local government from Federal Government revenues on a sustained and guaranteed formula.

The problem of Cost Shifting has to be resolved

Having a total state budget covering rate revenue requirements should eliminate the need for rate pegging.

All citizens are treated equally with regard to ability to pay with the added ability of not paying if unable to do so.

The need for creation of Governmental regions left for the future.

It is assumed that industry and commerce would be treated similarly on an area and location basis to cover their present contribution.

With cost shifting and guaranteed Federal funding replacing grants (with their stigma implications) more funds should be available annually to redress the annual renewals gap.

average rates may also reflect historical relativities before rate pegging was introduced in 1976.

The rate's bill paid bears little relationship to the level of council services used by a household. In terms of equity considerations, rates may not equate to a wealth tax. For instance, a freestanding house (with high land content and hence higher rates) may not be worth more than a luxury unit in a multiple dwelling, but will pay very much higher rates. Also, some residents may be asset rich, but income poor, limiting their ability to pay and therefore raising equity concerns.

Nevertheless, rates are efficient and administratively simple because they are impossible to escape unless subject to statutory exemptions (e.g. for state agencies, charities and benevolent institutions) or concessions (e.g. for aged pensioners). Also, since they average just over $600 per household, residential rates are a small proportion of the cost of a home and as such not very distortionary. Exemptions are important, for when the State Government expands its land holdings (e.g. the creation of national parks or state forests) councils may suffer a loss of rateable property.

Council charges for services such as domestic waste management, water supply and sewerage, use of public spaces and parking meters, are not subject to state controls; nor are parking fines. Also, developer charges for water supply and sewerage are not capped. However, other statutory fees (such as for processing DAs) are capped. Rate pegging and fee caps have constrained NSW Local Government revenue growth, notwithstanding, special rate variations. Council rates have certainly grown at a much slower pace than state land tax. There does not appear to be a consistent set of criteria for determining rate pegging and variations thereto.

Commonwealth financial assistance grants (FAGs) to Local Government have grown faster than the consumer price index (CPI), but much slower than the state economy (gross state product or GSP) and have shrunk as a proportion of federal tax revenue. The formula for distributing FAGs between councils is only partially based on their revenue and expenditure disabilities. Furthermore capital (i.e. infrastructure) disabilities are not considered. Unlike the Commonwealth Grants Commission, the NSW Local Government Grants Commission does not publicly disclose its calculations of disability for each council. Instead, it only discloses its measure of disability of a council to that council itself. This prevents third parties (like this Inquiry) comparing LGGC disability measures for all councils.

State grants to Local Government are not published by either the NSW Government or the Australian Bureau of Statistics (ABS) so their total size, composition and past trends are not publicly known. However, data specially provided to the Inquiry by the NSW Treasury shows that total grants (excluding pensioner rate rebates, physical asset transfers, rate payments by state entities, interest subsidies, assumption of HIH insurance liabilities, and capital and welfare disaster relief) increased from $544 million in 1996/97 to $740 million in 2003/04, an average annual rate of growth of 4.6 per cent.

In addition to grants, councils also receive payments from state agencies for performing services on their behalf. For instance, the Roads and Traffic Authority pays councils for maintaining state roads under performance specific contracts.

- **Reordering priorities**
  Saying no to future cost and responsibility shifting where legally possible; embracing a 'back to basics' agenda until the infrastructure crisis is fixed; adopting 'zero-base' budgeting, whereby all existing activities are re-examined as to their necessity; and developing and implementing credible long-term strategic and financial plans to assist in identifying priorities and responding to emerging challenges.

- **Pursuing efficiencies**
  Benchmarking operational practices and results against other organisations, adopting flexible work practices, reengineering work processes and systems to streamline and standardise them, setting productivity savings targets, sharing limited staffing resources (e.g. planners), changing procurement practices (e.g. resorting to ADR rather than litigation, accessing bulk discounts under state supply contracts), joining a shared services centre (e.g. general accounting and financial transaction processing), outsourcing services (e.g. internal audit), and/or merging smaller councils where other alternatives for achieving economies are not viable; and

- **Improving capacity**
  Raising the management and governance capacity of both elected councillors and professional staff, which will include clarifying roles and responsibilities of each party, and setting milestones for monitoring performance.

1.13 RECOMMENDATIONS

Certain reforms are suggested by the findings in this report. They go beyond strictly financial matters because financial sustainability rests on councils winning the trust and confidence of their clients, their communities and their government overseers and sponsors.

The Inquiry canvassed many options before settling on 49 final recommendations, which are listed in Chapter 12. The most important of these are repeated below under the main challenges facing NSW Local Government, namely to:

- Define its role relative to other tiers of government;
- Renew infrastructure to overcome a growing backlog;
- Prioritise services to better reflect public preferences;
- Reform development controls at both state and council levels;
- Improve strategic planning and operational efficiency;
- Boost revenues from rates, fees and grants;
- Strengthen governance structures and procedures; and
- Achieve long-term financial sustainability.

Making NSW Local Government financially sustainable will require a combination of fiscal measures including rate deregulation, increased State and Commonwealth grants, greater application of user pays, increased operating efficiencies and increased borrowings. The most vulnerable councils are rural ones whose small population densities mean that they do not have the financial capacity to maintain let alone renew their road infrastructure. Increased government grants and/or a transfer of their regional roads to state responsibility may be their

Is the degree of dependency on grants problematic in the light of the information in Figure 5.2? Various responses to this question are relevant. Firstly, if we consider the relative magnitudes involved, for NSW the average general purpose component of FAGs per capita in 2003/04 ranged from \$15.84 for urban capital city councils to \$735.37 for rural remote medium councils, with a state average of \$52.81 (DOTARS 2005, Table 2.9).[18] There are thus significant differences between different types of councils, with rural councils securing by far the biggest per capita grants.

Secondly, in principle a problem exists if allocations of FAGs consider only equity issues and neglect efficiency criteria since they then form an implicit subsidy to inefficient councils and thus waste public resources. Limited Australian empirical evidence indicates that in NSW FAGs may have this effect (Worthington and Dollery 2000) since according to the principle of 'effort neutrality' the size of grants is independent of council policies and behaviour.

The NSW Local Government Grants Commission (2006, p2) takes a different view:

> The grants are allocated on the basis of an average level of efficiency for a service in the state. This means that councils that are more efficient than average are able to provide more services from available revenue (or have lower rate imposts) and the less efficient are able to provide fewer services (or have higher rate imposts). Thus, efficient councils are already rewarded for their improved performance.
>
> Horizontal fiscal equalisation (relative needs) is built on a premise of addressing those very issues that affect a council's ability to perform efficiently. This is currently achieved by the Commission's independence and comprehensive assessment of relative disadvantage with respect to revenue raising capacity and expenditure needs in the framework of effort neutrality. Because of the limited level of funds, councils receive a grant that amounts to around forty-five per cent of their assessment need. The Commission is not subsidising inefficiency, rather it is attempting to meet the recurrent needs of councils.

Uralla Shire Councils (2006, p2), a rural council, notes that the general conclusion that grants form an implicit subsidy to inefficient councils and thus waste public resources needs to be specified. Uralla Shire Council expects 52.1 per cent of its budget for 2005/06 to come from grants. However, almost half (45 per cent) of these grants relate to funded activities for delivered services and applied grants, where

> ...funding is competitive, dependent upon efficient and effective delivery of services.

Whatever side one takes in the efficiency versus equity debate, one thing is clear: given the dependence of many rural councils on grants, there appears to be a limit to any reduction of equity funding, otherwise these councils would not survive.

Thirdly, if it is argued that grants should be abolished, then the full consequences of withdrawing LGGC subventions to NSW councils should be carefully considered. For instance, many small rural councils, and especially those with large spatial jurisdictions containing many bridges and roads, which are very expensive to maintain, rely heavily on grant revenue. Indeed, more than half of all NSW local roads (around 82,419km) are unsealed and fall mostly in rural areas.

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18 The categories Urban Capital City and Rural Remote Medium refer to the Australian Classification of Local Government. See LGI (2005, Appendix B).

On the other hand, the claim sometimes made that local rates create horizontal inequality between areas should be dismissed.

It is true that similar households living in similar quality houses pay higher rates (or receive poorer services) when they live in a poor area. This occurs because the rate per dollar of land value is higher in areas with low land values. However, the higher rate in the dollar is compensated by lower house prices. There is substantial evidence in the United States that differential property rates (or service levels) are capitalised in property prices including in land values (Mieszkowski and Zodrow 1989).

A final important matter relates to landlords who own, but do not occupy, about 30 per cent of dwellings. Although landlords pay the rates, the rates are mainly passed on to tenants in the long run. The return on property must equal that on other assets. If costs rise, either rents must rise or landlords vacate the sector in which case market rents rise in due course with falling unit supply. This places renters in a similar position to homeowners with regard to the bearing of local costs. However, as most renters occupy units, they usually pay a low share of the ordinary rates. Also, because renters do not directly pay rates, they may not appreciate the nexus between the level of services they obtain from their council, the amount of rates paid on their behalf, and the consequent impact on their rents. This may make tenants less sensitive to council rating policies than owners.

The above discussion relates to residential rates only. Horizontal equity may be limited in rural shires, where farmers receive very little in the way of services (other than use of local roads), but pay a much higher rate because it is levied on the total value of their farm, rather than just on their house-site. The ability to pay should also be questioned – there are some rural shires where a very high proportion of farm rates remain unpaid. The council is left with vastly reduced income, but a constant demand for service – and has no means of redress other than property foreclosure or adding unpaid interest to outstanding balances.

Finally, equity also requires a judicious balance between what is collected from properties through rates (which being taxes are unrelated to service provision) and charges/fees (which are meant to reflect service usage).

Efficiency

Taxation of land values is generally considered non-distortionary and therefore efficient because the supply of land is fixed. Taxation of land does not affect the total supply of land. This is true up to a point, but it ignores the true economic nature of land.

First, land values include capital improvements to the land, including provision of local roads, water and sewerage services, power supply and so on. Therefore taxation of land value is in substantial part a tax on capital. However, because the demand for these components of a house is highly price inelastic (i.e. people require public utilities regardless of their cost), a land value tax has little (distortionary) effect on the provision of these services.

Second, land uses vary. Insofar as taxes on certain land uses are higher than on others, for example higher on urban housing than on farmland, one might expect land use to be diverted from housing towards other uses such as farmland. This could occur if housing consumption was sensitive to the level of rates. However, at around $600 per household per annum user pays". Also it is acknowledged that "the most vulnerable councils --- transfer of their regional roads to state responsibility may be their only chance of survival".

Such grants and transfers ultimately come from taxpayer revenue and are therefore a cosmetic solution that hides the real cost of Local Government.

"Greater application of user pays", or in reality users are not paying, because the term is used too simplistically. (p 205) In relation to payment of services "maintaining local roads takes up a large proportion of country councils' resources".

The fact is that while there are farms being accessed, the producers of inputs to those farms have the benefit of being able to deliver goods manufactured in towns and cities. The produce coming away from the farms gives them revenue to pay rates but it also provides jobs and steady reliable prices for the community at large.

By the same token National Parks and Forestry as pointed out (p 205) do not pay rates (Forestry make some contribution to roads servicing them). In the case of National Parks they are created to please city dwellers but the infra structure to access them, provide the support facilities for their employees and visitors, is supplied by the local council, who are not paid.

Forestry does provide local employment but the product flowing throughout the Nation has been subsidised by the local community with most coming from farmers rates. If $400 per rural residence and $1471 is the average for farms, clearly farms are over taxed. This is confirmed by statistics where in 1999 at Tumut 40% of rates were paid by farmers making up19% of population.

Rural Local Government can not under the existing methods recover what the users in the wider community demand, expect, and can not pay for because there is no means of doing so. This is acknowledged bottom page 205.

Page 206 "On the other hand, the claim sometimes made that local rates create horizontal inequities between areas should be dismissed". This is a completely erroneous statement for the rural situation. A dairy at Tumut pays $15,000 more than an equal enterprise in Wagga Wagga. Grazing land in Tumut Shire is twice as expensive per hectare as Gundagai and four times for Bland Shire. The product is the same from the three shires offered on the same market.

Page 105 discusses grants and FAGs and efficiencies with equity issues which can not be lightly put aside but there is a familiar sound of a cracked record only instead of inefficient farms getting drought relief it is inefficient rural councils being subsidised.

Before too much criticism or judgements is made, a thorough history of events inside and outside the shire is more likely to reveal good thrifty management trying to cope with forces beyond its control over a long period of time.

The use of dwellings in the report does put the financial situation in perspective. The fact that there are statistics available for different locations relevant to dwellings and socio economic situations would suggest that it is not a big step to making dwellings the raw material for change.

The fact that this is proven and working in the UK is encouragement to investigate for NSW, if not Australia.

Put on a dwelling base the $500 million required in extra rates per year equates to $215 per year extra or two cases of wine.

The ability to pay is reflected in location and size of the dwelling, also the quality giving scope for a fair assessment. Capital value to play secondary role as an indicator of vertical and horizontal equity. The UK has eight levels.

A further refinement using curtilage with free standing dwellings is an option.

Table 9.2: Composition of Local Government revenue by council category, 2003/04 (%)

Area	Rates and annual charges	User charges and fees	Interest revenue	Grants	Contrib'ns and donations	Other revenue
Sydney City	53.7	17.7	4.6	1.8	4.8	17.5
Metropolitan developed	57.6	14.1	3.7	9.8	8.0	6.7
Regional town/city	43.4	19.4	4.0	16.3	14.6	2.3
Fringe	51.9	14.6	3.9	13.2	13.6	2.7
Rural	32.3	18.9	3.4	31.9	11.6	1.9
NSW total	47.6	16.8	3.8	16.0	11.5	4.2

Source: Brooks, J. 2006.

In 2003/04, Local Government in NSW raised 66 per cent of its rate revenue ($1.5 billion) in residential rates, with the balance from business, mining and farmland rates.[27] The state average residential rate was $605. Urban councils levied an average residential rate of $624; rural councils levied an average residential rate of $400.

Within Sydney, average residential rates per council varied from about $500 to $1000 per property per annum. In country areas, average residential rates per council varied from about $200 to $600 per property per annum, with rates generally lower further from the coast. The average rate in a municipality or shire for freestanding houses is much higher than for individual apartments and units.

Average rates may also vary greatly between particular wards within a council area. For instance in the Leichhardt municipality in 1999/00, average rates in the Balmain/Rozelle ward ($1,287) were 66 per cent higher than in the rest of the municipality ($774), reflecting the higher land values of an area constituting a peninsula on Sydney's harbour. Council data showed that, while the ward had 36 per cent of ratepayers, it contributed 48 per cent of council rate revenues (Allan 2001, p76). Such a disparity within a council area is not uncommon. Indeed the disparity between rates in the Pittwater area and the other areas in Warringah Council was a factor in the Pittwater area breaking off and setting up a new municipal council.

In 2003/04, councils received 26 per cent of their rate revenue ($573 million) from business rates. The average rate per business assessment was $3,499. Councils received eight per cent of their rate revenue ($179 million) from farmland rates. The average rate per farmland assessment was $1,471.

Trends in Local Government revenue

Table 9.3 shows the changes in the major components of NSW Local Government revenue and other relevant data over the eight years from 1995/96 to 2003/04. Over this period, the ordinary revenue of Local Government rose by 47.1 per cent compared with a 58.8 per cent increase in gross state product (GSP), and 20.9 per cent increase in the consumer price index (CPI) for Sydney

Rate revenue and annual charges combined rose more or less in line with total ordinary revenue. However, the rate revenue component rose by only 29.2 per cent. User charges and fees rose by 39.4 per cent and total grant income by 30.5 per cent.

27 The data in this sub-section are sourced from Department of Local Government (2005a).