Submission to

Productivity Commission – Annual Review of Regulatory Burdens on Business

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Local Government Study
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LB2 Collins St East
MELBOURNE VIC 8003

The Victorian Farmers Federation

The Victorian Farmers Federation (VFF), Australia's largest state farmer organisation and the only recognised, consistent voice on issues affecting rural Victoria and the VFF welcomes the Productivity Commission's review into the capacity of local governments to raise their own revenue, and to examine the effects of their revenue raising on the community.

The VFF represents 19,000 farmer members across 15,000 farm enterprises. Victoria is home to 25 per cent of the nations' farms. They attract neither government export subsidies nor tariff support. Despite farming on only three percent of Australia's available agricultural land, Victorian's produce 30 per cent of the nation's agricultural product. The VFF represents the interests of our State's dairy, livestock, grains, horticulture, chicken meat, pigs, flowers and egg producers.

Today, around 70 per cent of Victorian agricultural product is exported. Victorian food and fibre exports have an approximate value of $5.75 billion and represent 23.7 per cent of Australia's total agricultural production. Agricultural producers provide one in ten regional jobs and are responsible for as much as 50 per cent of the total employment opportunities in regions outside major towns.

In this submission, our organisation discusses the capacity of local governments to raise their own revenue and the impacts of such on the community.

The VFF notes local governments' inadequate capacity to raise its own revenue. We note the duties impose by statute, the duties assumed voluntarily to meet community expectations and the limits imposed on their revenue raising capacity.

We note the effect on capital investment resulting from *ad valorem* real property taxation and the consequent distortion of investment in agriculture.

We note the effect of dramatic oscillations in seasonal variation on farmers' purchasing power – drought, fire, flood and recovery phases, unknown in the rating system's country of origin, (England), which render this foreign outdated tax basis irrelevant to Australia's conditions.

At the same time, Local Government drifts along, hamstrung by uncertainly specified responsibilities, inadequate funding and additional burdens due to cost shifting from other tiers of Government.

SARamsay

Simon Ramsay
President

Overview

Local Government taxing powers are limited to a rating system based on land valuations. (Ad valorem real property taxation). Valuation based rating was intended to be equitable on the grounds that those who own higher valued assets have a greater capacity to pay and benefit more from the services provided by Local Government.

In attempting to respond to increasingly demanding community expectations, local government now provides an increasing range of community services and infrastructure to support local communities, but lacks appropriate funding, as it ranks lowest on the tier of the federal system.

Local councils in Australia have, in some cases reluctantly, moved beyond their traditional role of being responsible for 'roads, rates and rubbish'. More functions are expected of local government but little or no funding is provided to undertake them.

The rating system is founded on the Poor Relief Act of 1601 in England, which introduced local taxation for Poor Relief. Liability to be rated (taxed) was imposed on every inhabitant, person, vicar, every occupant, land or houses, etc. In the course of time, other rates were levied, e.g. borough, general district, highway (for military purposes).

By 1925, uniformity was entirely absent and incidence and distribution were inequitable. In the same way in 2007, valuations fluctuate significantly and incidence and distribution vary widely between different parts of the State.

Valuations – Historical Principle

The principle of all valuations was to estimate the rent at which the property might reasonably be expected to be let from year to year, if the tenant undertook to pay all usual tenants' rates and taxes, and to bear the cost of repairs and insurance and other expenses, if any, necessary to maintain the property in a state to command that rent. This was the definition of net annual value.

Equitable imposition of rates and charges - Local Government Act 1989 s 7(h)

This reflects the Parliamentary decision of 1949.

"That in municipality rating on unimproved values, farmlands shall be rated at a lesser amount in the £1 than other lands.

Persons engaged in farming pursuits need much more land for a given return than those engaged in other branches of industry. They are undoubtedly carrying a heavy burden under a system which rates on land values"[1].

Rateability

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[1] Hansard: p 3811 [Assembly] *10 November 1949 – Brigadier Tovell*

The Act of 1601 mentions inhabitants and occupiers so that liability to Poor Rate fell on inhabitants as such, in respect of their trading profits, whether they occupied property in the rated area or not. In England, the Rating and Valuation (Apportionment) Act 1928 in conjunction with the Local Government Act 1929, gave complete relief from rates to agricultural land and buildings, other than farm houses and cottages. This de-rating was designed to assist agriculture. Rating authorities lost considerable rateable value as a result of this measure and were compensated by grants.

European Union – our competitors

Australian farmers are reliant on export markets and compete in a world marketplace distorted by subsidies. Australian farmers have remained competitive only through a reducing costs and increasing efficiencies. Any cost or tax applied to Australian farmers that their competitors do not face makes it more difficult to remain competitive.

Other European countries see no point in taxing agriculture more heavily than other industries. First the EU supports agriculture through Articles 39° and 43°, as does the USA through "circuit breaker" arrangements and the Export Enhancement Program, whereas Australia does not. Secondly, most countries recognise that land is a farmer's major income producing asset, whereas land is merely the site where most other enterprises' income producing assets are located. Owners of higher valued assets no longer invest proportionally in land as the tax burden distorts returns.

Local government is thus disadvantaged severely, because communities expect an increasing range of services beyond the roads and rubbish as community wealth increases, but local government's capacity to raise monies does not increase proportionately.

In the 1960s, around 50 per cent of local government expenditure was applied to road maintenance. By the 1990s, this had fallen to just over 25 per cent (although this is higher in rural shires). In the early 1960s, just 4 per cent of expenditure was applied to education, health, welfare and public safety. By the late 1990s, this had risen to 12 per cent - a threefold increase. These changes, driven partly by community demand, and partly by a range of other factors beyond the control of local government, have not been funded.

In rural and remote areas, communities are desperate for a greater emphasis on regional development to generate robust economic growth and counter the drift of young people to the major metropolitan centres.

The resulting expansion in roles and service levels, coupled with rising input prices generally exceeding the average rate of revenue growth, (land values reflect neither income nor capacity to pay nor growth of community wealth) has seen a significant number of councils develop financial operating deficits. In an effort to control the size of these deficits, some councils have deferred or reduced expenditure on infrastructure maintenance.

Such deferrals arise because the other two broad categories of infrastructure, - water/sewerage and roads - have specific user charges to fund maintenance or Australian Government grants such as Roads to Recovery (R2R), to support periodic upgrading. Even with R2R, many rural councils still face ongoing problems funding adequate maintenance of local roads.

The sustainability problem around Australia is generally more critical in smaller sized councils, which are mostly in rural or remote areas. These smaller councils often have constrained own-source revenue streams, compounded by less expertise in financial and asset management capabilities, and have a limited capacity to deal with the challenges

The VFF notes that councils are concerned with cost shifting from State and Federal Governments to Local Government, particularly those involving social and environmental programs. This symptom of confused responsibilities often occurs when other levels of government discontinue a service, and local government then assumes the funding role in response to community demands. In some instances, local government may agree to provide a community service on behalf of another tier of government, but funding is subsequently withheld or discontinued. The State Government has embarked on more extensive cost shifting, despite its responsibility for ensuring that Local Government is funded adequately.

In addition, State and Federal Government has a tendency to enact legislation which imposes additional costs on Local Government, such as changes to food handling laws and amendments to the Water Act.

Councils are investing greater amounts of their scarce resources in an effort to address service and infrastructure gaps which are federal or state responsibilities. Local government needs to partner better with all tiers of Government to ascertain where and when such issues are beyond the capacity or responsibility of councils.

A process is needed to ensure that the financial implications of new Government legislation on Local Government are identified and councils financed adequately.

Consequently, many local councils are faced with problems of financial sustainability. This requires major reforms in the way councils are funded and the way they operate. The problem is exacerbated by the increasing cost of inputs faced by local governments in providing services.

In the absence of such reforms councils should scale back the level of local community services and infrastructure.

Reasons for the crisis in Local Government

The present crisis in Local Government in rural Victoria has arisen as a result of:

- Local Government's reliance on an unfair and inequitable *ad valorem* real property tax (the rating system based on land valuations);
- The unwillingness of many councils to utilise the provisions of the Local Government Act to establish an equitable rating system: sections 159 to 163;
- Difficulties which have emerged with the process of establishing land valuations;
- Problems stemming from deficiencies in the electoral systems adopted by Councils; and
- Higher expectations of local government by ratepayers and increasing responsibilities imposed on Councils by other tiers of Government but without appropriate financial resources to complete the task.

A number of economic and financial problems face small rural councils. Rural Councils strike higher rates than metropolitan councils, relative to valuations and household incomes. Rural Councils also spend more per resident ($943) compared with metropolitan Councils ($505).

The major reason for this is higher road expenditure, which is a less obvious area of cost shifting. Road spending consumes around 43 per cent of rural councils' annual budgets, compared with just 20 per cent in Melbourne. Farmers' families and farm workers comprise around 3 per cent of taxpayers and road users, but the non-farm sector does not contribute 97 per cent towards municipal road costs.

The decay of rail freight infrastructure in regional areas has meant that large trucks are increasingly using local roads in rural areas, and have shifted the maintenance costs from State Government to Local Government. Road expenditure by rural councils averages $406 per head whereas metropolitan councils spend $102 per head. Both metropolitan and non-metropolitan councils face major problems maintaining and renewing infrastructure.

Rural councils have much larger road networks to maintain, with an average 200 kilometres of road per 1,000 residents, compared with around 6 kilometres of road per 1,000 metropolitan residents. Although many rural municipalities have small population bases, they have greater lengths of local roads to maintain. With comparatively low property rate bases to provide revenue, many rural shires currently face major road upkeep problems. These difficulties are likely to grow if population numbers continue to stagnate or decline, and current road and bridge assets continue to age and deteriorate.

Resolving this problem is a greater task in rural Victoria than in Melbourne because of the financial constraints confronting rural councils. Not all cost shifting issues can be solved by allocating responsibilities fully to one jurisdiction, since some activities, such as road funding, fall across jurisdictional boundaries. Currently all three tiers of government have some responsibility for roads, with spending by one jurisdiction affecting others. Such a situation makes cost shifting more likely to occur.

The response from the state government to local government's problems in the 1990's was to amalgamate smaller councils to allow them to develop greater economies of scale, rationalise resources, and seek adequate funding. The Kennett Government undertook comprehensive amalgamations in the early 1990s and reduced the number of councils in Victoria from 210 to 79.

Based on 2004/05 data, the Municipal Association of Victoria (MAV) has concluded that 10 per cent of the 79 councils in Victoria are unsustainable.

Local government suffers from an inadequate organisational base, and many rural municipalities are small and depend on grants from other levels of government. As a result, the Federal government is examining resource distribution at the local level.

Financial sustainability problems

Many councils are struggling with financial sustainability problems. Reasons for this include:

- Minimal revenue growth;
- Limited access, for a small proportion of councils, to rate revenue due to relatively small populations reducing the size of the rates income stream coupled with constraints on the size of annual rates increases;
- Cost shifting gives rise to increasing council involvement in non-core service provision due to escalating community demands, coupled with a related tendency by some councils to step in to provide a non-traditional service;
- Some councils have limited access to the strong financial and asset management skills which are critical to identifying sustainability problems, optimizing renewals expenditure and improving revenue streams;
- Some councils run operating deficits thereby creating a need to defer or underspend on renewal of infrastructure, particularly community infrastructure; and
- Cost growth exceeding revenue growth which is mainly due to a combination of factors including the rising skill level required for most senior roles and hence the higher level of remuneration.

Farm Land Rating

Local government relies currently, for a substantial part of its income, on property based taxes. Property based rating disadvantages farmers relative to other groups in the community, since land is the farmers' primary income producing asset whereas land is merely the site where non-farm businesses' assets operate. Australian property taxation thus subsidises the non-farm sector at the expense of the farm sector.

Farming is, by its nature, a land-based activity, and farm businesses have a very large proportion of their total assets invested in land. This is rare in non-farm businesses. In addition, farms are generally located outside the main population centres, and farmers do not have equal access to the services provided by Councils. Consequently, farmers pay a disproportionate share of the costs of local government.

In Victoria, rates are levied on a hypothetical highest and best use to which the land might reasonably be expected to be put, not on the actual productive capacity of the land. (Refer: Valuation of Land Act 1960 (Vic) section 5A (3)(a) which may be contrasted with Valuation of Land Act 1944 (Qld) section 17. The Queensland Act, in effect, restricts rating to the productive capacity of farm land. These systems are based on the UK system, however in England, farmland was de-rated under the Rating and Valuation (Apportionment) Act 1928 in conjunction with the Local Government Act 1929. This provided complete relief from rates to agricultural land and buildings, other farm houses and cottages.

Victoria, with its higher population density and smaller geographic size, has seen the changing demographics of society have a direct impact on the rate burden being faced.

The tree and sea change phenomena, largely being driven by the baby boomer generation, has seen rural land prices escalate well beyond the agricultural production value of the land in many areas. Under the current valuation system a few sales in an area at these higher values will feed directly into the value applied to farm land causing an increase in rates.

The other impact of this migration is the demand on services. Those moving from urban areas are accustomed to a level of local government service, particularly in the social and amenity areas that are difficult to support in areas with smaller populations. This leads to pressure for Local governments to match and fund these higher levels of service.

Local Government rate funding needs to be based on the value of a ratepayer's house and curtilage. Rates on farm land should be abolished as in the UK because farmland is a means to production, and its value bears little relationship to the farmers' wealth or his capacity to pay. Victorian farm rating disadvantages Victorian farmers against interstate farmers (cf. Queensland), and Australian farm rating disadvantages Australian farmers internationally. Under the present system, farming pays an annual tax on its income producing assets, while other businesses pay only on the valuation of the site from which they operate. For example, a bank does not pay rates on the capital it has lent, on which it earns its income.

The anomaly arises because farm land it is simultaneously the income producing asset and the site from where it operates. This additional burden distorts capital investment, labour and planning, leading to the loss of prime agricultural land. Examples of this trend are Bacchus Marsh and Werribee South in Victoria.

The present system, where Local Government imposes a charge on property owners in the form of rates which are based on property value, discriminates against farm property owners.

Residents who do not own property do not contribute to shire funding, and the cost burden of the maintenance and improvement of shire facilities is the sole responsibility of property owners, despite these facilities being used by other residents, tenants, tourists and visitors. Farmers need road access, and have the use of footpaths, streetlights, drainage and other services which support urban development but the farmers use less of these available facilities than their urban counterparts and thus receive lesser value for rates paid.

While other industries can adjust land use in response to increases in land taxes, generally farmers cannot make such adjustments. Land value can be a poor indicator of an individual taxpayer's capacity to pay. Land ownership is only one form of wealth and does not include the owner's income or debt position. Income and consumption taxes are reduced when the taxpayer is less well off.

Land taxes should reflect the costs of services provided by local government to the affected properties, but this quid pro quo is becoming much less the case over time. Land taxes are more appropriate for the provision of property-based services, such as the construction and maintenance of roads (and the VFF advocates these services should be part funded through fuel taxes). While the services provided by local government have increasingly shifted from property-based services to social services, the funding mechanisms do not reflect this change. It is generally considered that social programs should be funded from taxes which reflect capacity to pay, and land taxes do not generally meet this measure.

Fixed (inelastic) revenue requirements from land taxes often mean that land tax rates need to be higher in rural areas. A particular land tax rate in a city will raise significantly more revenue than the same land tax rate in rural areas, where property prices are lower. Thus a farm that lies in a mainly urban council may have much lower rates than a property next door in a largely rural council, unless the valuer envisages subdivision of that property.

This is illustrated by the case of the Gannawarra Shire, which applies a flat rate to all properties. There is no Municipal Charge. Although farmers represent just 13 per cent of ratepayers in the Shire, they pay 58 per cent of total rates. On average, farm families in Gannawarra pay over ten times the rates paid by non-farm families. Of course, it is highly unlikely they have either ten times as much capital, or ten times as much income. Rating inequities in the Gannawarra Shire are extreme, however similar problems exist in other shires across Victoria. The VFF supports the system of farm rating applied in the England, where farm houses and immediately surrounding land or curtilage, is rated at the general residential rate and farmland has been de-rated since 1929.

In 2006/07, the 13.5 per cent increase in rates paid by the 500 farmer family ratepayers in the City of Horsham represented a total of $319,000 or $640 per family. The overall rate rise of 7.5 per cent meant the 8,000 residential sites increased by just $374,000 or $46 per family. This is a $150,000 cost shifting from residential ratepayers onto farmers. Both share the same municipal services.

The effect of the 13.5 per cent rate hike resulted in many farmers suffering increases in excess of 20 per cent, the largest being 39 per cent. The biggest increase at Mockinya was a rise of $1,387 to $22,779 per annum. By comparison, the dearest residential house in Horsham incurred an increase of around $100.

One step towards alleviating the unfair rate burden on property owners, is to change the current limitation on the municipal charge. The municipal charge is a flat charge on all properties which is intended to distribute overhead costs evenly throughout the community. Councils are permitted to raise only a maximum of 20 per cent of total rate revenue by this means. The municipal charge is intended to ensure all ratepayers make a uniform contribution to the cost of council administration.

The municipal charge should be termed a community charge, to reflect the fact that it represents an equal contribution by all ratepayers to community services provided by councils. The community charge should also be mandatory, so that all councils are required to raise 30 per cent of total rate revenue through this means, or such amount as the Productivity Commission deems appropriate.
Farms should be rated on the basis of house and curtilage rating, where dwellings on farms are separately valued and rated on the same basis as other residential properties within the shire. A nil rate should apply to farmland, reflecting an equitable imposition of taxes on income producing assets in the non-farm sector. Farm houses and curtilage should be rated to reflect services provided by local government to those farm houses.

The VFF seeks a commitment to change the Local Government Act, so that Councils are required to implement a flat community charge, payable by all ratepayers within the municipality, and that 30 per cent of total council revenue be raised through this process.

Unreasonable rate increases are placing incredible pressure on local farm business budgets, and signal an inability of local councils to spread revenue collection equitably. The only practical solution to this problem, and many others across the State, is to review and rewrite the revenue collection components of the Local Government Act.

There are significant tracts of land set aside for easements from which utility companies gain private benefit but pay no rates. Since utility companies are no longer statutory bodies, they should be required to pay rates on the land set aside to benefit their businesses.

There are a series of rating exemptions for land including exemptions for public land. This disadvantages councils within whose boundaries there is a high proportion of public land.

Local councils are struggling to fund the maintenance of infrastructure, much of which is decaying across rural Victoria. This affects the competitiveness of Victorian farms, roads, bridges and thus urban employment.

The VFF sees significant merit in reforming inter-government transfers to assist in supporting councils in funding of renewals work on a range of community infrastructure assets.

Differential Rating

Although the Local Government Act empowers councils to establish a fair rating system through differential rates and a municipal charge, the Act provides no guidance on how to use these tools to strike an equitable rate. Regrettably, differential rates on farm land are often seen by councils as a concession, or discount, to the farm sector rather than an essential tool to ensuring a fair and equitable imposition of taxes on the farm sector. Few councillors appear to be aware that this was the reason for the introduction of the Farm Rate. Studies by Professor Michael Jones[2] and Professor David Johnson[3] have established that the current level of rates imposed on farms is unjustifiable.

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[2] Professor Michael Jones: '*The Victorian local government property tax system and its effect on farmers- the case for change'* 1990

[3] David Johnson (Senior Research fellow) Institute of Applied Social and Economic Research: '*Alternative systems of local government rating of farm land*' 1991

Ratepayers have little opportunity to challenge or seek independent review of a given rate struck by councils, even when, as in the case of the Gannawarra Shire, the rating system adopted by council embodied and perpetuated manifest detriment to the farmers affected. Appeal provisions were removed from the Act following successful legal action taken by a group of farmers against the City of Hamilton. (*Falkenberg v. City of Hamilton* [1987] VR 65)

If the council adopts a differential rating system, the Act requires it to specify the objectives of the differentials adopted and ensure they are consistent with the equitable carrying out of the council's functions [LGA 1989 section 161(2)]. There is no such obligation on councils which choose to strike a uniform rate, to explain why this results in an equitable imposition of the rating burden.

This implies a tacit assumption underpinning the drafting of the Act that a uniform rate is inherently equitable and councils have only to justify the equity of the rating system if they implement a differential rating system. Experience suggests the reverse is true, as does the introduction of the farm rate in 1949.

Serious inequities are more likely to arise when councils take the unfair course of adopting a uniform rate compared with situations where councils analyse service provision and the returns on capital invested.

The VFF recommends amendment to the Local Government Act to:

- Furnish logically probative evidence for uniform or differential rates;

- Require councils to assess the effect of a uniform and/or differential rate on the major classes of ratepayers; and

- Allow a ratepayer who believes the rating system to be manifestly inequitable or unfair, access to a third party appeal process. This could be through the introduction of provisions for judicial review of the rating system, review by the Ombudsman, or a review panel established by the Minister for Local Government.

Rating of Easements

Section 156 (2A) of the Local Government Act makes holders of a mining licence under the Mineral Resources Development Act liable to pay the rates and charges applying to land covered by the licence.

Easements from which utility companies gain private benefit but do not pay rates restrict farming activities, i.e. farmers managing land including easements, are often limited on the work that can be undertaken over the easement. Since they represent assets to utility companies and are consistent with provisions for mining licences, these easements should be rateable. The companies owning the assets within the easements on private and public land should pay appropriate rates and charges.

Rating Exemptions

Section 154 of the Local Government Act exempts certain land from rates, including Crown land, land owned by public statutory bodies, and land used exclusively for charitable purposes.

The exemption of Crown land from rating places a significant disadvantage on those rural councils which have a high proportion of Crown land. The exemption reduces the rateable base of affected municipalities and existing ratepayers are burdened further.

Current legislation treats Crown land inconsistently from other exempt land: public statutory bodies or the Crown can undertake some commercial activities on Crown land, while farmers are not permitted to do so. A person holding a grazing licence for Crown land is liable to pay rates as though it were rateable land. Land utilised by private companies which provide services previously delivered by government should no longer be exempt from rating.

The VFF seeks a commitment to remove the exemption of Crown land from local government rating, or that Crown land managers provide ex gratia payments to local government in lieu of rates.

The VFF advocates that the current exemption of Crown land from local government rating be reviewed, and Crown land be treated as rateable. Existing exemptions to rating should continue to apply to land used exclusively for charitable purposes; for religious bodies; the Country Fire Authority and for land held in trust and used exclusively as a club or memorial to persons who served in Australia's armed forces, as currently defined in the Local Government Act.

Special rates and charges

Section 163 (1) of the Local Government Act bestows on councils the power to declare a special rate, or charge, to cover the costs of providing services which the council considers are of special benefit to those subject to the rate.

Those affected by the special rate are able to make submissions to the council, but there is no practical low cost mechanism of appeal.

Councils can impose a special rate to provide a service that the affected ratepayers do not want, or which should reasonably be provided from general rate revenue. If a council chooses to take this approach the affected ratepayers have little option but to accept the charge.

An example of an inappropriate use of special rate or charge is the City of Whittlesea's rural roads strategy. The City of Whittlesea funded the cost of sealing rural roads through special charges on properties fronting unsealed roads. Property owners were not given a reasonable option, and many would have preferred the road to remain unsealed given that they were required to meet the full cost of the work, as they were not the major beneficiaries.

Road construction and maintenance is a core function of local government. It is the most important service rural ratepayers expect from councils, and it is unacceptable for a council to seek to full recover the costs of maintaining rural roads from a special rate, in addition to the normal rates landowners pay.

Special rate and charge provisions in the Local Government Act were intended to facilitate the provision of specific services to a defined group of ratepayers, such as proposals to redevelop and promote 'main street' retail precincts. The clear misuse of these provisions by the City of Whittlesea highlights the need for safeguards to be built into the Local Government Act to govern special rates and charges.

Appropriate safeguards need to be built into the provisions of the Local Government Act allowing councils to impose special rates and charges, including a requirement that special rates and charges only be used when there is 80 per cent agreement from affected ratepayers.

Property valuation

Valuations and the setting of rates

Steps should be taken to improve the current valuation system. When revaluations occur, councils must be provided with data in sufficient time to properly analyse the impact of the revaluation on the equity of the rating system. This was highlighted by problems that flowed from the major revaluation that occurred in January 2000. In most municipalities, the 2000 revaluation was the first for at least six years, and there were major shifts in the relative valuations of properties.

In many cases, Councils did not acquire relevant information in sufficient time to enable them to review their rating systems properly, to ensure the cost burden was spread equitably across the different classes of ratepayers. Many councils applied the same general rating model that had been used previously merely adjusted for the new valuations. As a result, serious inequities arose in the imposition of rates. The appropriate response to the revaluation would have been a comprehensive review of the rating model, but many councils lacked sufficient time to do this thoroughly and comprehensively, and to take relevant matters into consideration.

Property revaluations should allow sufficient time for Councils to consider the impact of various rating scenarios, and consult with ratepayers prior to finalising the rating system.

Inclusion of water right in property valuations

Property valuations for rating purposes currently include the value of any water right <u>attached</u> to the land. In 1989, the State Government implemented a new Water Act, which allowed for <u>separation</u> of water right from land. As a result of this legislation, water rights became freely tradeable.

Since 1989, a sophisticated market for water rights has developed in the major irrigation areas. Farmers trade water rights both permanently and on a temporary basis. The introduction of negotiability of water right has changed, fundamentally, the concept of an irrigation water right. Irrigation water is now an input which is bought and sold in the same manner as fuel, fodder or fertiliser. There is no justification for including the value of irrigation water in property valuations for rating purposes.

The value of irrigation water rights should not be included in property valuations for local government rating purposes. The VFF proposes that transitionary assistance be provided to councils, whose rate base has been reduced, as a result of the Government's decision to exclude the value of transferable water rights from property rating values.

Electoral issues

Amalgamation of local government was intended to make service delivery more efficient, but at the cost of some loss of accountability of councils to the community. Victoria has a lower councillor-to-population ratio than other States.

In Western Australia, a councillor on average represents 1280 people, in New South Wales it is 3470, but in Victoria each councillor represents 7900 people. Many farmers feel disenfranchised in local government. This occurs particularly in large councils dominated by a major regional centre. Councils reflect the views of majority urban populations; issues relevant to the farm community are often not given high priority by councils.

This detriment can only be remedied through attention and rigor in the electoral process adopted by local government. A range of electoral systems operate across Victorian local government. Some councils are undivided with councillors representing the whole shire. Other councils maintain a system of wards with one or more councillors representing each ward.

The VFF expresses no opinion as to which is the preferred electoral system, however the following general principles should apply:

• In undivided councils or where two or more councillors represent each ward, a proportional voting system should be adopted. The current system of exhaustive preferential system encourages ticketing and can result in councils not representative of the major communities of interest.

• Ward boundaries should be set taking into account population, community of interest and rate revenue. Population and rate revenue should be reasonably balanced in all wards making up the municipality. As far as possible, wards should represent a common community.

• An independent panel or organisation, such as the Electoral Commission, should establish internal ward boundaries consistent with criteria established by the relevant Acts.
• Eligibility to stand for council should be limited to ratepayers in the shire.

Rating Reform

Victoria's local government revenue system is too narrow. It is based on asset value, not on income generation and unfairly prioritises asset value ahead of income generation. In medieval England, where this system originated, rainfall was reliable and most wealth was generated by agriculture. Net rental of property was not then unreasonable as a tax base. In 21st century Australia, with its unpredictable weather patterns, the old English system is inappropriate. Farmers across rural Victoria currently pay more than their fair share of rates, to subsidise services for the urban and rural living communities. This problem has been aggravated by unpredictable drought, fire, flood and recovery costs. It is likely that the prevailing level of rates inhibits long term investment in agriculture. Until a fairer system is introduced, steps must be taken to alleviate the burden on the agricultural sector.

Droughts, fires and floods erode the productivity of farmland, and in turn, the capacity of rural communities to pay for a given level of services. Farmers' capacity to pay has been substantially diminished in recent years, with large falls in farm production and income, coupled with rising farm costs, including interest rates, insurance and of course, council rates.

One effect of Victoria's local government's revenue raising during drought, after fire and flood and during the recovery phase, is to cripple farmers' purchasing power just when they need it in a market economy. This leads to a transfer of debt from the non-farming community to farmers, due to the vagaries of weather. This involves overcapitalisation and hence a distorting burden on capital investment in agriculture.

The principle of taxing agricultural land for "the highest and best use" leads to planning anomalies – i.e. the most valuable agricultural land goes under factories and houses, as these return more per acre to local government in rates than agriculture. Loss of prime agricultural land to development is of increasing concern.

"Australia is the only country in the world which regards its prime agricultural land as a commodity, not a resource[4]."

Local Government taxing powers are limited to a rating system based on land valuations. Valuation based rating is meant to be equitable, on the grounds that those who own the higher valued assets, have a greater capacity to pay and benefit more from the services provided by Local Government. This system does not take relevant matters into consideration.

The concept of property-based taxes was arguably appropriate when the main function of Local Government was provision of property-based services, particularly the construction and maintenance of roads. The emphasis of local government activity is shifting more and more from property-based services to human services, however this change in activity has not been matched by an appropriate change in how local government is funded.

Land valuations as a basis for taxation is an inappropriate concept in 21st century Australia. Land value is both a poor indicator of an individual ratepayer's capacity to pay and the level of service required. Land ownership has no regard to the owners' income or debt position. Its origins date back to a period when land ownership was a good proxy for both wealth and income, and when the majority of services provided by local government were property related, for example roads, bridges and drainage.

The VFF urges a reform of Victoria's outmoded local council funding system. The sharp rate increases being faced by farmers across Victoria can only be remedied by a full review of the local government funding system.

The funding system for local Government is long overdue for an overhaul.

Local government and other tiers of government should be funded by taxes on income and consumption. Any Local Government funding shortfall could be financed by the Federal Government from the pool of GST funding, and since everybody contributes to GST on various purchases, this is a more equitable solution to Shire maintenance. Property based taxes, if they remain at all, should be restricted to funding the limited range of property-based services provided by local government.

The current system of funding local government, primarily through local property based taxes, is inherently inequitable and unsustainable. The national total backlog in local

4 *Professor Thiel, (Munich University), 1964*

government infrastructure renewal work, an estimated $14.5 billion must be addressed. There is a growing gap in many councils, between their revenue base and the funding required to deliver a broader range of services, as well as maintain and renew the infrastructure which supports these services. Failure to consider such reforms may result in councils having no option but to cut back on the level of local community services and infrastructure.

Under current funding arrangements, local government collects just three per cent of the total taxes collected by all levels of government in Australia. The Commonwealth Government acknowledged responsibility for funding of local government in its GST agreement signed with all state governments. However, to date, it is yet to recognise the extent of the financial challenge facing the sector.

The VFF advocates a substantial shift in the approach to funding local Government, and suggests that reform be based on an approach to improving financial sustainability, through the maximising of internal efficiency reforms and changes to inter-government funding.

Measures to reduce local government dependence on property based taxes

The VFF advocates reducing the dependence on property based taxes through:

- Providing Local Government with ongoing access to a fixed share of income tax and GST revenue in an effort to remedy the problem of vertical fiscal imbalance. This should be set at a fixed rate of taxation revenue, providing councils with funding that grows as the economy grows;
- A greater reliance on user charges in a market economy;
- The introduction of taxpayer funds to pay for public land maintenance;
- Making funding for R2R permanent. This program has delivered substantial benefits and there would be significant merit in extending its duration and further augmenting the funding levels to promote transport of agricultural products to processing centres and ports;
- Amending the Victorian Grants Commission formula to accord greater weight and financial support to sparsely populated country municipalities;
- Local government having a greater involvement in the process of allocating service delivery, thereby reducing overlap or duplication of services between the tiers of government. Logically allocated service provision would improve the cost effectiveness of government services and achieve significant savings; and
- Ensuring that all levels of Government contributes to the cost of providing Local Government services to Government offices, National Parks, State Parks and State Forests. Although these properties are exempt from council rates yet councils are expected to provide and maintain roads, bridges and other services.

Reforms to inter-government transfers should target councils with serious ongoing funding problems.

The standard of infrastructure, particularly transport infrastructure, is declining at an alarming rate across rural Victoria. Local councils are having serious trouble funding the maintenance of infrastructure. Significant additional funding is required to maintain and upgrade local roads and bridges. Faced with this growing funding pressure, some councils have been forced to consider new methods of revenue collection, such as the idea of imposing levies on specific road users to pay for rural road maintenance and upgrades (e.g. Yarriambiack, Pyrenees and Ararat Shires) for roads which service industry. Although the VFF opposes these tolls, the fact that such schemes are being canvassed is a sign of the emerging crisis in rural Victoria's local infrastructure funding.

The VFF notes that a study by PriceWaterhouseCoopers,[5] (PWC) on the sustainability of Local Government, commissioned by the Australian Local Government Association (ALGA), recommended establishment of a new 'Local Community Infrastructure Renewals Fund targeted to assist those councils facing sustainability problems. The ageing community infrastructure asset base, largely established in the 1950s, now requires maintenance and upgrading. Funds distribution should be based on relative need, perhaps using the Roads to Recovery (R2R) distribution method, and the quantum could be set to provide a similar level of renewals support as that provided by R2R or as agreed between Federal and State Governments from time to time.

The PWC report recommends that this fund support the funding of community centres, aged care facilities, libraries, health clinics and sports and recreation facilities. The VFF, while agreeing with the principles recommended by PWC, believes that resources from such a fund must be allocated to developing the economic base and the capacity to improve the efficiencies of rural and regional businesses, not ancillary services.

The VFF supports the PWC recommendation, that the State government provide funding support to encourage local council efficiency and asset management reforms.[6]

Inadequate in-house skills to improve efficiency, and to establish robust asset management and financial plans, indicate it would benefit local government to liaise with other spheres of government.

As an example of lack of due diligence and skill, local government is still paying the costs of maintaining overhead electric lines clear of vegetation in 'declared' urban areas, despite the fact that these costs should be a normal recurrent maintenance expense for the overseas owned electricity distribution companies. The profits are now privatised, but some costs, for historical reasons are still socialised.

PWC argues that there would be significant benefit in the State Government providing partial funding, to assist the development of tailored reform programs. Funding could take the form of that provided by the Queensland Government in its Size, Shape and Sustainability Program of $25 million over 5 years, or the Step Program developed by MAV.

The VFF seeks a commitment from the State Government to establish a Regional Council Infrastructure Maintenance Fund, to provide financially stressed rural councils with funding to maintain their asset base*,* or to allocate funds to Vic Roads.

Presently, the range of services provided by local governments varies widely according to factors such as differences in population levels, legislative provisions, community willingness to pay for services, geography and community preferences.

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[5] Australian Local Government Association, '<u>National Financial Sustainability Study of Local Government</u>', (Pw*C Report*) November 2006, P137

[6] *Australian Local Government Association, '<u>National Financial Sustainability Study of Local Government</u>', (Pw*C Report*) November 2006, P17*

At a strategic level, a long-term service plan defining and limiting what services councils should provide, how those services will be undertaken, and how they might be funded, needs to be identified.

Local government must liaise with other tiers of government to remove overlap, to establish guidelines for differential taxation, for establishing fair and equitable distribution of municipal overhead costs and identifying clearly those services Local Government must provide.

Development of a nationally consistent Local Government Body of financial and asset management data is imperative. There is a need for a new national program, to improve the consistency and quality of local government data, to enable more robust and accurate analysis and planning, and to produce a uniform national approach for measuring viability and financial sustainability.

The Municipal Accounting Regulations (MARs) should be amended to furnish meaningful, relevant financial information, grouping cost classifications and detailing comparative cost trends over at least a three year span to councillors and State Government.

Difference in roles of Local Governments

Table 1 illustrates the differences between the roles of local government in various states. Councils in NSW, Tasmania and Queensland all have responsibility for water and sewerage and consequently their 'sale of goods and services' revenue increases accordingly. Victoria does not provide water and sewerage services Victoria and South Australia are ranked lowest in local government revenue from interest and sales of good and services. Victoria ranks last in capital grants revenue per capita.

Table 1 Local government revenue by source by State, $ per capita, 2002-03

	NSW	Vic.	Qld	WA	SA	Tas.	NT	Average
Taxation revenue	354.98	377.57	388.34	392.93	414.98	370.67	247.95	374.88
Sale of goods and services	336.37	163.35	632.05	183.40	132.61	440.57	328.92	320.27
Interest	31.78	9.72	24.83	19.86	9.24	25.42	20.24	21.60
Current grants and subsidies	115.75	106.70	126.90	97.71	100.28	152.50	232.77	114.64
Capital grants	16.49	7.24	45.03	48.59	7.92	19.06	15.18	22.18
Other revenue	141.18	157.77	188.58	118.61	40.24	65.66	106.27	141.97
Total	**996.55**	**822.34**	**1405.73**	**861.09**	**705.26**	**1071.77**	**951.34**	**995.60**

Source: Australian Bureau of Statistics, *Government Finance Statistics,* cat. no. 5512.0 and Australian Bureau of Statistics unpublished data.

Community Benefits of better funding

Local government was said to be close to the people and to have, therefore, an ability to be respond to community needs. Local Government's focus on locality, its closeness to citizens and its interactions with many different levels of government, community and private sector interests, should place it in a unique position to inform the direction of future policy. Electoral imbalance due to disparity of numbers and interests now vitiates that ideal. Urban minded councillors and municipal staff rarely comprehend that the return on capital in agricultural enterprises is less than in the non-farm sector. They prefer to tax the minority heavily to win approval from the more lightly taxed majority, who elect them.

Clear guidelines and additional funding would assist local government to gauge and respond to community expectations, and meet its obligations to changing community demands. Among the benefits which would flow through to all aspects of the community:

- Local communities would be strengthened by ensuring an adequate standard of key facilities for the ongoing provision of a range of significant social and recreational services;

- Encouraging greater participation in community activities through greater choice and consultation, would promote increased community cohesion and safety, particularly in rural and regional areas;

- Business and community links with regional areas would be enhanced to promote regional equity and development;

- Promote further economic development and the generation of employment benefits through links with the business community;

- Improve the quality of life of local residents through the support and alignment of health and welfare agencies within the area; and

- Support for local recreation, arts and culture and an appreciation of heritage in order to promote vibrant and active communities.

Conclusion

It is clear that the current capital-based rating system is flawed and unsustainable. Our current system of local government rating is based on the English system, however in England, farmland was de-rated in the 1920's.

Local Government rate funding needs to be based on the value of a ratepayer's house and curtilage. Rates on farm land should be abolished as in the UK because farmland is a means to production, and its value bears little relationship to the farmers' wealth or his capacity to pay.

The VFF advocates a substantial shift in the approach to funding local Government, and suggests that reform be based on an approach to improving financial sustainability, through the maximising of internal efficiency reforms and changes to inter-government funding.

We urge the Productivity Commission to consider the various recommendations made in this submission aimed at reducing the dependency of local government on property based taxes.