

ALGA'S RESPONSE TO THE PRODUCTIVITY COMMISSION STUDY ON LOCAL GOVERNMENT REVENUE RAISING CAPACITY

Background to the Productivity Commission research report

- The final Productivity Commission (PC) research report into local government revenue raising capacity was released on 17 April 2008. A summary of the PC's findings is reproduced below.
- The final PC report was issued following the release by the PC of a draft report (December 2007), an issues paper (May 2007) and various roundtable discussions.
- The genesis of the Report stems from the previous Federal Government's response to Recommendation 17 of the 2003 report of the House of Representatives Standing Committee on Economics, Finance and Public Administration, *Rates and Taxes: A Fair Share for Responsible Local Government* (more commonly known as the Hawker Report).
- The Hawker Report's Recommendation 17 was that a summit on intergovernmental relations should be hosted in order to more fully discuss cost shifting and the role of States and Territories.
- The previous Federal Government rejected Recommendation 17 but instead agreed with the importance of local government having the capacity to raise revenue from their own sources, and undertook to ask the PC to examine this issue.
- The PC was tasked by the previous Government to conduct the research in April 2007, with a focus on three main issues:
 - The capacity of different types of councils to raise revenue and the factors contributing to capacity and variability in capacity over time
 - The impacts on individuals, organisations and businesses of the various taxes, user charges and other revenue sources available to local government; and
 - The impact of any State and Territory regulatory limits on the revenue raising capacity of councils.
- The PC report was issued within the 12 months timeframe specified by the previous Federal Government.
- Under the relevant legislation, the Federal Government is not required to table (and therefore is not required to formally respond to) the PC Report, as it was a research study only. (The Federal Government is only required to table PC Inquiry reports).

What ALGA has said about the Productivity Commission study

- In the 18 April 2008 edition of *ALGA News*, ALGA's President Cr Paul Bell said: "I welcome the Report's conclusion that councils are already approaching their hypothetical maximum own-source revenue raising capacity."
 - Cr Bell noted the Report's key findings that: state government legislation and regulatory factors can limit the ways in which councils raise revenue and that in fact this is affecting capacity in NSW; that councils could benefit from principles to guide their revenue raising and expenditure decisions, noting the Report's positive observation that many councils are already applying such principles; and that there is a need to improve the integrity and consistency of statistical data in this area.
- Cr Bell further noted that in its Report, the PC acknowledged that some councils, especially in rural areas, would struggle to raise more own-source revenue from local communities already faced with financial hardship. Cr Bell said this highlighted the fact that whilst local governments' own-source revenue has an important part to play in local government resourcing, it is only one part of a very complex issue, and that a fair share of Commonwealth revenue (being a 1 per cent share of total Commonwealth taxation revenue) is the only way to ensure adequate revenue growth for general purposes.
- In the 24 April 2008 edition of *ALGA News*, Cr Bell said "One of the most telling findings in the PC Report – finding 5.4 – is that whilst local governments may have a theoretical capacity to increase their own-source revenue raising, the PC explicitly points out that this does not imply that local governments should increase the revenue they raise".
 - ALGA believes this is an important distinction, as the question whether a local council can raise additional own-source revenue depends on issues including the preferences and expectations of the local community, the extent and nature of economic activity in the local council's area, the demographic and geographic attributes of the local community, and of course, the community's willingness to pay for services provided by local governments.
 - The PC Report acknowledges that the local government sector is characterised by a high degree of diversity in terms of its functions, characteristics and revenue sources, and that this diversity exists both within and across jurisdictions. That is, no two councils are exactly the same. In this respect, ALGA considers that the PC report should make a positive contribution to fostering better understanding by all Australians of the uniqueness of local government.
- In an ALGA media release of 13 May 2008 titled *Tax Review an Opportunity for Equitable Funding for Local Government*, ALGA welcomed the announcement in the Federal Budget that day that there will be a comprehensive review of Australia's taxation system.
 - Cr Paul Bell said "The decision of the Federal Government to look at the full tax system - Commonwealth, State and Local - underlines what ALGA has been saying for some time - you cannot treat each sphere in isolation".

- Cr Bell noted further that

"The recent study by the Productivity Commission into Local Government's capacity to raise Own Source Revenue ignored the fact that local government taxes and charges are part of a whole of government approach to raising revenue and providing services. While Local Government has been doing its bit to raise revenue, the real problem has been the tax sharing arrangements between local government which is called on by communities to provide an enormous range of services and the Federal Government which raises vastly more revenue than it spends."

- ALGA welcomes the Federal Government's taxation review, which is to report to the Government by the end of 2009. Of specific relevance to the distribution of taxation revenue is the finding of the PC that '...there is a case to review the provision of Australian Government general purpose grants to local governments'.

THE 29 FINDINGS OF THE PRODUCTIVITY COMMISSION REPORT INTO LOCAL GOVERNMENT REVENUE RAISING CAPACITY

- 1. At the national level, the ratio of local government rates revenue to GDP decreased over the period 1990-91 to 2005-06.*
- 2. At the state level, the ratio of own-source revenue to gross state product varies across jurisdictions due to a large number of factors, including differences in the functions of local governments, such as provision of water and sewerage services in some States but not others.*
- 3. There are numerous inconsistencies and inaccuracies in the government finance statistics and other statistical series relating to local governments. There is a need for the ABS and various grants commissions to improve the consistency and accuracy of the local government data collections.*
- 4. There is considerable variation, in per person terms, in both own-source revenue raised and grants received by local governments in Australia.*
- 5. For the majority of local governments, own-source revenue is the principal revenue source. However, for 20 per cent of councils, which represent only one per cent of the population, grants account for 48 per cent or more of total revenue.*
- 6. Rural and remote councils receive substantial grants on a per person basis. Fifty per cent of remote councils receive grants in excess of \$3816 per person, compared with \$441 per person for 50 per cent of all councils. Ten per cent of remote councils receive in excess of \$10 841 per person, compared with \$3059 per person for 10 per cent of all councils.*
- 7. Expenditure per person varies considerably across councils. Rural and remote councils have higher expenditure per person, on average, compared with urban councils. This is largely explained by the inability of rural and remote councils to capture scale economies, having to pay higher input costs, maintaining more kilometres of roads per person and undertaking a relatively more extensive service mix.*
- 8. Fiscal capacity, as measured by a community's total after-tax income per person, differs across classes of local governments. There is considerable variation both between classes of local governments and within classes of local governments. Capital city and some remote local governments have very high fiscal capacities because of the concentration of business income and their relatively small resident populations.*

9. *Revenue-raising effort, a measure of how much own-source revenue a local government raises relative to its income base, varies significantly within and between classes of local governments. Capital city, urban regional, rural and remote local governments have the highest average revenue-raising efforts, when adjusted for population size.*

10. *An empirical assessment indicates that local government own-source revenue raised per person:*

- *increases with personal and business incomes per person of the community*
- *increases with the length of roads, the number of properties rated and served, and whether water and sewerage services are provided*
- *increases in communities experiencing population growth*
- *decreases with population size.*

There are also differences between jurisdictions and classes of local governments.

11. *A sophisticated benchmarking analysis of the relative potential of local governments to increase their own-source revenue suggests that, on average, councils are raising about 88 per cent of their hypothetical benchmarks. Whether a council can realise its assessed potential to raise additional revenue will depend on its individual circumstances. (The scope for raising additional revenue should not be taken to imply that local governments should increase the revenue they raise.)*

12. *A number of councils, particularly in capital city and urban developed areas, have the means to recover additional revenue from their communities sufficient to cover their expenditures without relying on grants. However, a significant number of councils, particularly in rural (87 per cent) and remote (95 per cent) areas would remain dependent on grants from other spheres of government to meet their current expenditure. Some councils would remain highly dependent on grants.*

13. *Given the differences in the scope to raise additional revenue across different classes of councils, there is a case to review the provision of Australian Government general purpose grants to local governments.*

14. *In principle, rates revenue is not constrained by limits on the range of land valuation methods available to councils or the specific type of land valuation method applied because councils can adjust the rate in the dollar to achieve their revenue requirements.*

15. *Differential rating provisions generally increase the capacity of councils to raise revenue from property rates. They do so by enabling councils to structure better rates payable to the different capacities to pay of, and services received by, different categories of ratepayers.*

16. Rates exemptions reduce local governments' rates bases and do so differentially across local governments with different proportions of exempt land. Whether exemptions constrain the overall capacity of local governments to raise revenue from rates depends on the extent to which it is (politically) feasible for them to set rates higher than otherwise would be required on non-exempt land.

17. Rate pegging has dampened the revenue raised from rates in New South Wales relative to other States and there seems to have been little offset from non-rates revenue sources in recent years.

18. In most jurisdictions, only a small number of fees and charges are statutorily set by State Governments. Most are set by councils and the extent to which they recover costs will largely reflect the preferences of their communities.

19. Where councils are required by another sphere of government to provide a service that has a statutorily set or capped fee or charge below full cost recovery, associated revenue-raising capacity from fees and charges is constrained.

20. State government setting and/or capping of fees and charges applies to some services which councils are not legislatively required to provide. But where these services are provided (for example, because of community pressure), the impacts on councils are no different from the provision of mandated services at fees that do not cover costs.

21. There is a case for periodic reviews of the restrictions and regulations imposed on local government by other spheres of government to assess both their rationales and their benefits and costs.

22. Nationally, developer contributions per new dwelling commencement have increased substantially over the four years to 2005-06. However, the effect of developer contributions (either in cash or in-kind) on councils is generally likely to be revenue neutral over time.

23. The available data and measurement limitations make it impossible to estimate the distributional impacts of revenue raising within councils.

24. Few Australian studies have attempted to measure the distributional impact of rates across households, either nationally or within states or regions. The evidence from studies that have been undertaken, which only assess burdens across councils and not within councils, suggest that residential rates decrease as a share of income as income increases. This is consistent with similar international evidence.

25. In general, as the average income per person (measured at the local government level) increases across councils, the average incidence of rates decreases. For a large proportion of councils, the average rates incidence is between 1.5 and 1.8 per cent of after-tax income.

26. The evidence suggests that average rates incidence is higher for rural councils than for urban councils.

27. Using household expenditure survey data across councils, rates decrease relative to disposable income as income increases. For 50 per cent of households, the rates incidence is about 1.7 per cent or less of after-tax income.

28. The application of a set of principles to guide revenue-raising and expenditure decisions of councils can assist them in improving the well-being of their communities.

29. There is scope to utilise further the existing institutional arrangements between Australian and State Governments, local government associations and local governments to promote best practice in all aspects of revenue and expenditure decisions by local governments.