Tasmania
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Tasmanian Government Response to Productivity Commission Issues Paper May 2007:

Assessing Local Government Revenue Raising Capacity

July 2007

OVERVIEW

1. The Productivity Commission (the Commission) has been asked by the Australian Government to conduct a study into the capacity of Local Governments to raise their own revenue. The terms of reference for the study request an examination of the capacity of different types of Councils to raise revenue, the impact of the various revenue sources available to Local Government and the effects of their revenue raising on the community.

2. The Commission has written and distributed an issues paper entitled "*Assessing Local Government Revenue Raising Capacity*" that has been circulated for comment by interested parties in May 2007. This submission is the Tasmanian Government response to that issues paper.

3. The Commission Issues Paper poses a number of specific questions. The Tasmanian Government's response is framed to provide general information to the Commission, although some of this information indirectly addresses some of the Commission's questions.

4. A number of specific questions asked by the Commission, particularly in relation to Local Government's own policy decisions, are best left to Local Government to answer. However, it is noted that a number of independent studies of Local Government financial viability have been commissioned by the Local Government sector itself. These studies analyse specific financial issues as experienced by Local Government and may provide some additional insight into the Local Government sector.

INTRODUCTION

5. There are currently 29 local Councils in Tasmania. The population size of Local Government varies significantly, ranging from less than 1 000 (Flinders Island) to around 65 000 (Launceston), with the average population size being approximately 17 000.

6. The Local Government sector within Tasmania has relatively unrestricted revenue raising capacity to finance its core business. External factors have an effect on the capacity of Councils to raise revenue, but generally all Councils have the flexibility and autonomy to ensure they have sufficient revenue to achieve their operational goals.

7. Local Councils have significant autonomy to gather revenue through rates, fees and charges to fulfil their public service obligations. This autonomy extends to allowing the application of differential rates to their rating bases, if the Council so chooses, in order to ensure the collection of revenue is more equitable on its resident population. Part 8 of the *Local Government Act 1993* details the revenue raising powers of Tasmanian Local Government.

8. Under the Local Government Act, local Councils may impose the following types of rates:

   - *a general rate* – imposed on rateable land irrespective of whether any services are provided on that land. A general rate may comprise two components, one that is based on the value of the rateable land and the other a fixed charge;
   - *a service rate* – for water supply, sewerage removal, waste management, stormwater removal, fire protection or any other prescribed service;
   - *a volumetric charge* – a general rate may include a volumetric charge relating to the volume of water supplied;
   - *a construction rate or charge* – a general rate may include a construction rate or charge for land that is not supplied with water supply or sewerage removal; and
   - *a separate rate or charge* – in addition to any other rates or charges for the purpose of planning, carrying out, making available, maintaining or improving anything that, in the local Council's opinion, is of benefit to the affected land or owner/occupiers of the land.

9. The Local Government sector has benefited from significant financial and economic reforms over the past two decades. The reforms have had the overarching aim of increasing the ability of local Councils to improve their sustainability and enhance their delivery of essential public services.

10. In the early 1990's, significant Local Government boundary changes were introduced thus reducing the number of Councils from 48 to 29. One outcome from these reforms was to create a more financially secure Local Government sector with more adequate rating bases.

11. Certain areas of Tasmania, for example King and Flinders Islands, are considered remote communities and allowances were made for these communities as the reform process advanced, as it was felt that amalgamations with adjoining municipalities may not have provided for a more effective outcome.

STATE-LOCAL GOVERNMENT FINANCIAL REFORM

12. The revenue raising capacity of the Local Government sector in Tasmania has improved due to the State Local Government Financial Reform (SLGFR) process that was completed in July 2004.

13. The reform was undertaken through a ground-breaking statewide Partnership Agreement, as part of the Tasmanian Government's Partnership Agreement program with Local Government. It was developed through the Premier's Local Government Council and is understood to be the only one of its kind in Australia. (A copy of the Agreement and additional information can be downloaded from www.dpac.tas.gov.au/divisions/lgo/partnerships/financialreform.html).

14. The SLGFR process took several years to implement with the aim of simplifying and making more transparent the financial arrangements between the two levels of government. The reforms assisted in the better alignment between revenue

and expenditure responsibilities of the two levels of government to better ensure that both governments face charges that are fully reflective of costs.

15. The important aims of the reforms were that both State and Local Government should be subject to the tax system of the other (reciprocal taxation), subsidies and concessions between the two levels of government should be removed and there should be a better alignment of service delivery and revenue raising responsibilities.

16. In practice the reforms were to make Councils eligible to pay state taxes including land tax, while Councils would be able to receive rate revenue for all State owned properties, with limited exceptions for certain types of reserves, roads, bridges and associated infrastructure and property controlled by Hydro Tasmania.

17. The reforms increased the rating base of Councils as they are now able to collect rates on State-owned properties. The SLGFR project also gave Local Government the opportunity to collect future rate revenue from State Government property that at that time had not been classified and valued by the Valuer-General. This gave local Councils a further increase in their rating bases that was not factored into the reform process.

18. The principle of 'revenue neutrality' guided the reform negotiations. The SLGFR was not intended to provide a source of additional income to either level of government. However, the outcome was a benefit of $3 – 4 million annually to Local Government overall.

19. When the reforms were implemented, 27 out of a total of 29 Tasmanian Councils gained a financial advantage through the reforms. Two Councils judged to be at a slight disadvantage through the introduction of the reforms have been provided with transitional compensation payments.

20. Since the SLGFR agreement was signed in July 2003, Local Government, along with other taxpayers, have benefited from a range of tax reforms that have been implemented by the Tasmanian Government. Local Government have benefited most notably in the areas of land tax and specifically through a duty exemption on transfers of land to Local Government for use as Park and Reserve Land.

PARTNERSHIP AGREEMENTS

21. The Tasmanian Government has an extensive program of Partnership Agreements with Local Government through statewide, regional and bilateral Partnership Agreements. The Agreements document the agreed cooperative action that will occur on a wide range of issues including economic development, roads and transport, tourism, arts, culture, education, community safety, land management, health and other community wellbeing.

22. While there is no separate Partnership Agreement budget, the Agreements may reflect financial commitments from both parties, may result in feasibility studies that lead to additional funding or the parties successfully attract funding from other sources through joint approaches.

23. The first tripartite Partnership Agreement in the program, the Tripartite Partnership Agreement for Population Ageing in Tasmania, was signed in August 2006 and involves the Commonwealth Government as well as State and Local Government.

CONCESSIONS

24. The *Local Government (Rates and Charges Remissions) Act 1991* requires Local Government to provide a pensioner rates remission which enables eligible pensioners to claim a rebate of 30 per cent, or the specified maximum amount, off their Council rates, whichever is the lesser. Local Councils are fully reimbursed for these amounts as the scheme is funded by the Tasmanian Government.[1]

OWN SOURCE REVENUE RAISING

25. Local Government in Tasmania principally relies on property rates revenue as its primary revenue source. According to the Access Economics review into the financial sustainability of Tasmanian Local Government[2], rates revenue comprises 74.7 per cent of total own source revenue. This suggests that Tasmanian Local Government fees and charges are a significantly less utilised revenue raising source compared to rates, relative to Local Government in Australia as a whole. The remaining own source revenue is made up of fees and charges (20.5 per cent) and other revenue including investment income (4.7 per cent). The Access Economics figures are generally consistent with key performance indicator data collected by the Tasmanian Government from Tasmanian local Councils.

26. The Access Economics review also notes that for all Tasmanian Councils, own source revenue comprises 86.5 per cent of total operating revenue, with the remaining 13.5 per cent of revenue coming from grants from other levels of government.

27. These figures indicate that the average Tasmanian Council has very significant autonomy over its total revenue through direct policy and pricing control of rates and user charges.

28. Tasmanian local Councils have experienced a significant increase in revenue raising capacity as a result of the property boom that has occurred in the recent past. Local Government has benefited because as property values have increased so has the capacity for increased rate revenue. Whether Local Government chooses to exploit this increased capacity is a matter for each Council to consider.

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[1] Due to an extension of the eligibility criteria for the Australian Government issued Pensioner Concession Card, Tasmania receives payments as compensation. In return Tasmania agreed to continue funding a range of core concessions to pensioners. The amount of compensation from the Australian Government will be approximately $6.5 million in 2007-08. However, this is a small proportion (approximately 2 per cent in 2007-08) of the total cost of providing concessions to pensioners.

[2] A Review of the Financial Sustainability of Local Government in Tasmania - A Report for the Local Government Association of Tasmania - Access Economics Pty Ltd - March 2007.

29. There is, however, a marked variance in the ability of individual Tasmanian Councils to raise revenue. A variety of economic and demographic factors influence the revenue raising capacity of Councils. Some of these factors include population change, geographic location, socio-demographic composition and local economic activity.

30. It is recognised that metropolitan Councils, having a relatively high revenue raising capacity, can raise a greater proportion of their revenue from rates when compared to smaller Councils. As a consequence, smaller Councils are generally more dependent on grants from other levels of government in order to finance their core business.

31. It is often the smaller remote Councils that lack sufficient scale to deliver services effectively and efficiently and to raise sufficient own source revenue (through rates or user charges) to fund these services.

32. The State Grants Commission's assessments compensate these Councils in part for this disadvantage. An argument exists whereby the disadvantages encountered could be more effectively addressed if the principle of horizontal fiscal equalisation (HFE) were to be applied in a 'purer' form, rather than being limited by the application of the minimum grant principle. It should be acknowledged that the removal of the minimum grant may create a more equitable result, but the change would have a negative impact on larger, more advantaged councils.

33. It is understood that this issue is not covered in the terms of reference of this study, but it is worthy to note that a portion of Financial Assistance Grants (FAGs) is distributed, as per Australian Government legislation, to all Councils on a per capita basis. These funds could be more equitably distributed if the entire base grant were to be distributed on a needs basis. The smaller Councils, that have a lesser revenue raising capacity and who depend more on grants from other levels of government, would benefit from a more complete equalisation regime.

34. The Tasmanian Government also provides grants and subsidies to the Local Government sector. These grants are generally established through agreements with individual Councils and are primarily for specific purposes. Given the high revenue raising autonomy of Tasmanian local Councils, State funding is usually for limited purposes and can vary significantly from year-to-year. Difficulties exist in providing State funding estimates due to the fact that grants and subsidies are often provided through agency budgets under more general programs, and thus are difficult to identify in aggregate.

35. Tasmanian Local Government is assisted in its efforts to set appropriate revenue measures in order to account for their expenditure in relation to water and sewerage infrastructure. The Government Prices Oversight Committee (GPOC) conducts a biennial study that measures the extent to which individual Councils recover costs associated with providing water and sewerage services. This report provides a benchmark against which Councils can be seen to be complying with the National Water Initiative.

REGULATORY CONSTRAINTS

36. There are few restrictions on Local Government revenue raising in Tasmania when compared to some other states. For example, there is no rate capping imposed on Local Government in Tasmania.

37. There is some restriction on Local Government in Tasmania relating to the extent of Local Government borrowing. The *Local Government Act 1993* details the limits on Council borrowing. A Council may not borrow an amount that requires in excess of 30 per cent of Council revenue, excluding specific purpose grants, from the preceding financial year in order to service the debt. If an amount is required to be borrowed where the annual debt burden is greater than 30 per cent of revenue, then permission must be sought from the Treasurer.

38. This 30 per cent limit on borrowing is very high and would represent a relatively high risk in regards to the ability of the Council to service its debt. In this light, this restriction is in place as a safety-net to ensure local Councils do not over-extend their borrowing capacity. As a rule, Councils have sufficient ability to borrow funds to ensure adequate levels of infrastructure renewal.

39. It should be noted that the limits imposed on local government borrowing in practice have little or no effect on their borrowing habits. Furthermore financial restrictions on borrowing were put in place to not only support Local Government financial sustainability, but also as part of a mechanism to manage Tasmania's Loan Council Allocation.

40. The terms of reference of the Productivity Commission study is quite clear that the borrowing capacity of Councils should not be included in the study. This is considered unfortunate as sustainability studies completed on Local Government seem to indicate that there is a link between ineffective use of debt and adequate infrastructure renewal.

FINANCIAL MANAGEMENT

41. A number of national and state level studies, some conducted on behalf of Local Government, have highlighted financial management skills and practices as an issue that affects Local Government financial sustainability. The financial management skills and practices of individual Councils are varied across Australia, and Tasmania is unlikely to be any different in this regard.

42. The Local Government and Planning Ministers Council (LGPMC), made up of the Australian, State and Territory Governments, has been working to develop strategies in which the overall level of Local Government financial management skills and practices can be lifted.

43. The LGPMC has developed nationally consistent frameworks for assessing financial sustainability, asset planning and management and financial planning and reporting. Each State and Territory has agreed to apply the frameworks in the context of their relationships with their Local Government sectors.

44. The frameworks provide tools for all Councils that are consistent across the areas of financial sustainability, asset planning and management, and financial planning and reporting.

CONCLUSION

45. While there are differences in revenue raising capacity between Council areas within Tasmania, on the whole the Local Government sector in Tasmania has the ability to raise a very high proportion of its revenue from its own sources, and thus has the capacity to manage its financial position. This is in contrast to the significant Vertical Fiscal Imbalance faced by the State, whereby Australian Government financial transfers are necessary for the Tasmanian Government to fulfil its expenditure responsibilities to the Tasmanian community.

46. As is the case for all levels of government, it is the responsibility of Local Government to ensure that its revenue raising effort is sufficiently balanced to meet its expenditure responsibilities and policy choices.