

# GIVING LOCAL GOVERNMENTS THE REBOOT: IMPROVING THE FINANCIAL SUSTAINABILITY OF LOCAL GOVERNMENTS

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**UTS:IPPG**  
INSTITUTE FOR PUBLIC POLICY AND GOVERNANCE



# EXPOSITION OF THE MCKELL REPORT

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- > Over the past 20 years local government expenditure has increased fourfold.
- > That is an average of 7.3% p.a. every year over 20 years
- > Indeed this is likely to understate the problem given that many jurisdictions removed water and sewer functions over this time.

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## MCKELL PART 1 (ii)

Why has expenditure increased?

1. Cost-shifting
2. Need to address market failure – i.e. where it is not financially viable for the private sector to provide essential goods/services
3. Rising community expectations

What is to be done?

1. The tier of government instigating the change should be financially responsible – which requires oversight
2. Appropriate grant transfers (again with independent statutory oversight)
3. Responding to community demand -- **This is largely the focus of re-booting**

# BACKGROUND

- > Financial sustainability has been the **OVERWHELMING PUBLIC POLICY PREOCCUPATION** in the area of local government
- > From 1990 alone there has been a plethora of public inquiries and accompanying academic literature on the topic
- > The **OVERWHELMING POLICY RESPONSE** has been to resort to compulsory or forced programs of amalgamation (although there have been other responses – e.g. shared services; leadership changes). Reduction of around 252 councils nationally since 1990;
- > These programs have **not** resulted in the savings for government as projected
- > They have also been characterised by acrimonious state-local government relations

## NEW THINKING IS REQUIRED

- > Therefore, we cannot rely simply on structural reform to mitigate financial sustainability problems.
- > There needs to be fresh thinking that addresses both revenue *and* expenditure deficiencies.

## PART 1 (iii)

- Key argument: “the financial sustainability of local government is threatened by the erosion of the link between local government expenditure and local government revenue. When inadequate price signals are sent to resident-consumers, then an inefficient quantity and quality of local government goods and services is likely to result”.
- Current revenue sources for local governments deviate from the desired link thus eliciting demand for local government goods and services which is not tempered by willingness to pay considerations. Put simply: if one can get something for free (or heavily subsidised) then one is more likely to *demand* the good or service.
- Yet it is possible to strengthen the link between local government revenue and expenditure and recommendations to achieve precisely this outcome that forms the substantive contribution of **Re-booting**.

## PART 2 (i): SOME ECONOMIC THEORY

- The mandate of government is to produce public goods and services. Pure public goods are both non-excludable and non-rival (i.e. consumption by one individual does not affect the quantity of the good available for consumption by others);

Juxtaposed with pure private goods:

- Merit goods, (pools; libraries), and
- Goods with positive externalities (sewerage and waste disposal).
- **Re-booting** argues that: “It is important to be conscious of the different types of local government goods and services, as the source of funding should *ideally* respond to the characteristics of consumption. When this association is not observed, then **inequity** and **inefficient levels of consumption** result”.

## PART 2 (ii) WHO GETS WHAT AND WHY IS NOT MAKE EXPLICIT ENOUGH

*Local government taxation is also often employed inappropriately.*

The problem is rent- seeking lobbies...i.e. understandable behaviour that citizens argue for the priority of their interests.

Failure to communicate the level of subsidy fails to send an adequate price signal to consumers of merit and positive externality goods. In the absence of a price signal, consumers will tend to demand an inefficiently high quantity and quality of the subsidised local government good.

Failure to make transparent the level of subsidy impedes the enhanced effectiveness of local governments.

## SO... A NEW APPROACH IS NEEDED

1. Focus is on expenditure – particularly re-visiting the level of subsidy to ensure that it is appropriate (and sustainable) and ensuring that the implications of this for the provision of other goods and services is understood.
2. Emphasizing enhanced democratic opportunities when it comes to money and signaling subsidies as part of pricing.
3. This is challenging – because this requires a new way of thinking for local government and communities.
  - Note, however, that the argument does not entail that we ought not to subsidise merit goods and goods with positive externalities, simply that both the donors and recipients should be made aware of the level of subsidy (as occurs, for instance, with PBS medicines, NDIS, aged care, environment, etc.)

# SOME OF THE RECOMMENDATIONS FROM THE MCKELL REPORT:

## RECOMMENDATION 1

Local government taxation should only be used to fund local government public goods and the subsidised component of merit goods and positive externality goods.

## RECOMMENDATION 2

The level of subsidy should be justified and clearly communicated to donors and recipients. Subsidy components can be indicated through footnotes on rating assessments and by clear display of subsidy on receipts and at places where subsidised goods and services have been provided.

# RECOMMENDATIONS

## RECOMMENDATION 3

Higher tiers of government should be discouraged from crowding-out the local government tax base. Ideally, retreat by state governments is desirable, but may not be practical. Moreover, serious consideration should be given to returning Capital Gains Tax (CGT) relating to subdivision of land to local governments (which bear the costs of providing infrastructure related to the subdivision).

If it is not possible for the Australian Taxation office to identify and transfer these amounts to local government then the same effect could be achieved by local governments levying a tax- deductible fee on subdivisions equivalent to CGT liabilities.

# RECOMMENDATIONS

## RECOMMENDATION 4

Exemptions and concessions (to rates) should be reduced and abandoned wherever possible. Welfare is the legitimate responsibility of federal governments. If exemptions and concessions are desired then they should be provided outside of the local government tax cycle, to preserve the link between revenue and expenditure. These can include discounts for pensioners as well as exemptions on crown or other government lands.

## RECOMMENDATION 5

Every council should be required to make public the calculation method of each of the differential rate categories (in an accessible form), in order to increase transparency and thus reduce opportunity for rent-seeking. Comparative differential rate category data (expressed in cents in the dollar terms) should be clearly stated on all local government rate notices.

# RECOMMENDATIONS

## RECOMMENDATION 6

Rate capping should be abandoned as a matter of priority. Local government tax limitations (rate capping) erode the link between revenue and expenditure and diminish financial efficiency and sustainability.

## RECOMMENDATION 7

Councils should be provided with the flexibility to make incremental adjustments to local government taxation on a quarterly cycle. This enhances local government resilience, strengthens the nexus between new expenditure and revenue, and avoids 'rate shock' (which can lead to calls for deleterious measures such as rate capping).

# RECOMMENDATIONS

## RECOMMENDATION 8

Regulated fees and charges should be abolished on the grounds that they erode the link between revenue and expenditure.

## RECOMMENDATION 9

A floor on developer levies should be legislated to prevent councils from eschewing developer levies entirely, or imposing an inadequate levy out of fear of litigation. However, it is important that legislation clearly provides councils with the opportunity to pursue higher fees and charges when justified.

In addition, caps on developer charges should be removed on the basis that they erode the link between revenue and expenditure and financial sustainability.

# RECOMMENDATIONS

## RECOMMENDATION 10

Financial assistance grants should be allocated by a central national authority free of political interference.

## RECOMMENDATION 11

Financial assistance grants should be linked to a predictable and growing source of revenue to ensure financially sustainable local government. The most likely path to achieving this aim is for the grants to be linked to a share of personal and corporate income tax revenues for which the allowed amount is no more than the existing grant allocation.

# RECOMMENDATIONS (FAGS)

## RECOMMENDATION 12

Section 6(2)(b) of the *Local Government (Financial Assistance) Act 1995* [i.e.: the bit that says *all* local governments get some] should be repealed. This section of the Act subverts principles of horizontal fiscal equalisation, compounding inequity.

## RECOMMENDATION 13

Financial assistance grants should be allocated on the basis of robust empirical methodology which principally responds to horizontal fiscal imbalance. There already exists an empirically robust methodology that has been demonstrated in the scholarly literature since at least 1989.

# FINAL RECOMMENDATION!

## RECOMMENDATION 14

Robust empirical analysis of debt capacity should be conducted to support the analysis of the suitability of local government borrowings.

It is imperative that, before local governments take on debt, the mechanisms for mitigating the moral hazards posed to past and future generations are clearly understood. Should the preceding significant challenges be resolved, there is scope to improve the efficiency of debt through the establishment of a bond bank or similar institution.

Similarly, borrowing for infrastructure that can support growth and future income can be useful for local governments, providing these other issues are first addressed.

## A SAMPLE OF IPPG'S RECENT WORK IN THIS AREA:

- Drew, J. and Grant, B. (2016). 'Means, motive and opportunity: Local government data distortion in a high stakes environment'. *Australian Journal of Public Administration*. Link: <http://onlinelibrary.wiley.com/doi/10.1111/1467-8500.12225/full>
- Drew, J. and Grant, B. (2016). 'Multiple agents, blame games and public policy-making: The case of local government reforms in New South Wales'. *Australian Journal of Political Science*. Link: <http://www.tandfonline.com/doi/abs/10.1080/10361146.2016.1238872>
- Drew, J., Grant, B. and Campbell, N. (2016). 'Progressive and reactionary rhetoric in the municipal reform debate in New South Wales (NSW) Australia'. *Australian Journal of Political Science*. Link: <http://dx.doi.org/10.1080/10361146.2016.1154926>
- Drew, J., Grant, B., and Fisher, J. (2016). 'Re-evaluating municipal amalgamations: Utility maximisation meets the Principle of Double Effect (PDE)'. *Policy and Politics*. Link: <http://dx.doi.org/10.1332/030557316X14539914690045>
- Ryan, R., Hastings, C., Grant, B., Lawrie, A., O'Shea, E. and Wortley, L. (2015). 'The Australian experience of municipal amalgamation: Asking the citizenry and exploring the implications'. *Australian Journal of Public Administration* Link: <http://onlinelibrary.wiley.com/doi/10.1111/1467-8500.12182/abstract>

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QUESTIONS/DISCUSSION

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