Local Government Finance and Performance

Peter Abelson
Applied Economics P/L

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Key Messages

- The provision of inter-governmental financial assistance to councils should depend on:
  - The provision of council services to non-residents.
  - Local financial capacity, specifically low local disposable income, and not on the value of the tax base (or on political advantages).
  - The ability of local councils to provide welfare services efficiently.

Context

- Productivity Commission Research Report, April 2008, "Assessing Local Government Revenue Raising Capacity"
  - Present speaker was an adviser to the Commission.
- Numerous other studies: e.g. "Are Councils Sustainable? Independent Inquiry into the Financial Sustainability of NSW Local Government" (Chair: Percy Allan, NSW, 2006).
- Australia's Future Tax System Review (Henry Tax Review). On going
  - Present speaker prepared a paper for ALGA: "Local Government in Australia: Role, Finance and Taxation".

Main conclusions of PC report

- The revenue raising capacity of a local government is a function of the aggregate after-tax income of its local community.
- However the amount of revenue that a local government can raise depends on what the local community is willing (and able) to pay for local services.
  - This varies because of financial capacity.
  - NSW an exception because of rate pegging.
- Using a sophisticated statistical exercise, the PC estimated that on average councils in Australia could raise 12 per cent more revenue than at present.

Main conclusions of NSW Inquiry

- NSW local governments need extra $900 million a year to overcome present infrastructure crisis. Compared with total expenditure of about $7 billion. About a 13% increase.
- This includes $400m to service $5.3bn debt and $500m to close the gap between use of assets (depreciation) and current expenditure on asset renewal. Based on an engineering report (not necessarily economic views).
- Local government should raise $700 million extra per annum and the Commonwealth and state governments should contribute $200 million.
- This does not take into account: population growth areas; rising demands with living standards; or special needs of rural areas with large road networks and narrow rate bases.

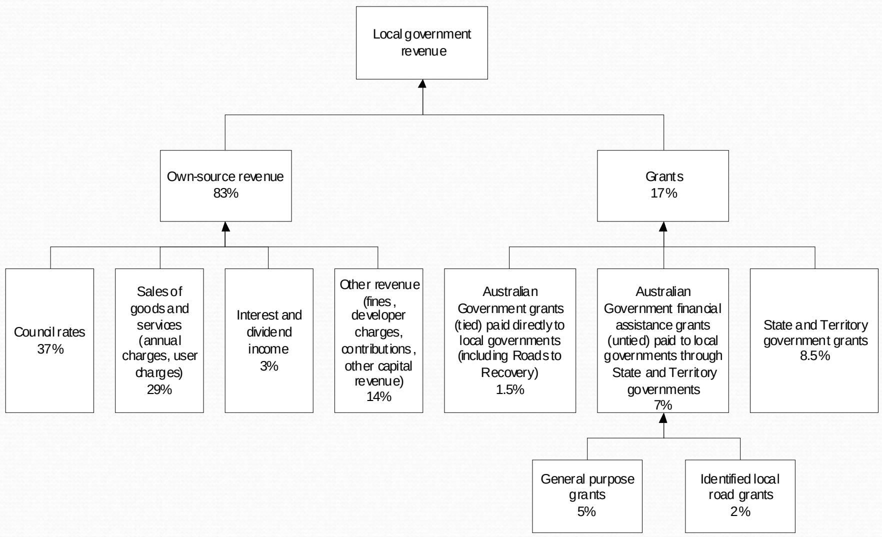
The nature of local services

- Most local government services are for the local population.
- Some services are regional – roads and bridges. This implies state or Commonwealth contributions.
- Some are welfare services that are the primary responsibility of Commonwealth or state governments.

Role of Commonwealth and state governments

- To pay for services with broader geographical effects: e.g. inter-jurisdiction roads; major new infrastructure for growth areas.
- Also, main responsibility for welfare. Local councils cannot take prime responsibility for welfare and re-distributional transfers.
- But these services may be delivered by local governments (if they are efficient).

Sources of local government revenue in 2005-06



Revenue raised by local councils

- Nationally, councils raise a low level of own source revenue.
- Ratio of own source revenue to GDP is only about 2%.
- Ratio of rate revenue to GDP is less than 1%. Between 1990-91 and 2005-06, this ratio fell from about 1.0% to 0.9%.

Trends in local government revenue

Table 2.4 **National trends in real local government revenue**

Shares, 1998-99 to 2005-06[a]

Year	*Council rates*	*Sales of goods and services*	*Grants and subsidies*[b]	*Interest and dividend income*	*Other revenue*[c]	*Real total revenue*[d]	*Per person real total revenue*
	%	%	%	%	%	$m	$/person
1998-99	40	30	17	2	12	18 331	985
1999-2000	38	29	18	3	12	19 661	1 044
2000-01	38	28	19	3	12	20 018	1 049
2001-02	38	28	19	2	13	20 814	1 077
2002-03	38	31	17	2	13	21 980	1 123
2003-04	37	30	16	3	13	22 395	1 131
2004-05	37	30	17	3	13	23 177	1 155
2005-06	37	29	17	3	14	23 915	1 174

Local government revenue as percentage of GSP and HDI

Local Government revenue, state output and personal income

	NSW	Vic	Qld	SA	WA	Tas	NT
Own rev / GSP							
1998-99	2.13	1.48	2.93	1.62	1.74	2.82	0.92
2005-06	1.97	1.78	3.25	1.68	1.53	2.88	1.38
Rates / GSP							
1998-99	0.95	0.85	1.13	1.11	0.91	1.19	0.63
2005-06	0.84	1.07	1.01	1,20	0.77	1.10	0.49
Own rev./ HDI							
1998-99	3.10	2.33	4.44	2.38	3.00	4.57	1.60
2005-06	3.02	2.76	5.40	2.55	3.09	4.46	2.79
Rates/HDI							
1998-99	1.39	1.33	1.71	1.63	1.57	1.93	1.09
2005-06	1.28	1.65	1,68	1,83	1.56	1.70	0.99

Source PC 2008

Rate increases

Rate increases by jurisdiction 1995/96 to 2003/04

	Per cent increase
NSW	29.2
ACT	35.2
Tasmania	36.3
South Australia	55.1
Queensland	55.6
Western Australia	64.8
Victoria	66.1
GDP	61.8

Source: Independent Inquiry (2006, Allan: Chair)

Revenue observations

- Rates are generally a low proportion of household disposable income.
- There is capacity to raise more local revenue via rates. This is a local choice.

Measuring revenue capacity and need

- Revenue capacity depends on the resources of the local community.
- This capacity is a function of aggregate community disposable income.
- This is the real criterion of capacity to pay for public goods. Rates are paid from income.
- Our ability to pay rates changes with our incomes; **not** with changes in property values.

Some Issues

- The tax system must allow the local jurisdiction access to this income base. Land tax (rates) do allow this.
- Exemptions and rate pegging restrict this and should be examined. But they do not affect the basic proposition that revenue capacity depends on local income.
- However, there are substantial differences between the revenue capacities of local areas (see following slide).

Income constraints on fiscal capacity

Table 5.1 Distribution of the average fiscal capacity of local governments
2000-01 to 2004-05, dollars per person[a, b]

Local governments ranked in order of total income *Decile and mean*	*Personal income*[c]	*Business income*	*Total income*[d]
Lowest	2 096	2 538	4 634
10 per cent	9 218	5 197	14 415
20 per cent	8 980	7 259	16 239
30 per cent	8 385	9 454	17 839
40 per cent	8 878	10 284	19 162
50 per cent (median)	16 058	4 723	20 781
60 per cent	13 298	9 227	22 524
70 per cent	14 463	10 567	25 030
80 per cent	10 184	19 298	29 483
90 per cent	7 094	31 988	39 083
Highest[e]	22 001	438 162	460 163
Mean[f]	12 837	15 213	28 050

Fiscal capacity: the tax base approach

- Revenue raising capacity is viewed as a function of the value of the tax base.
- Traditional Australian approach: still held by Commonwealth Grants Commission and most state grants commissions.
- CGC calculates values of most tax bases in each state.
- NSW Local Government GC calculates value of rateable land values. Councils with low values per property are assessed as having low revenue raising capacity.
- Victoria LGGC assesses revenue capacity from standardized charges and fees as well as from land values.

Fundamental flaws of tax base approach

- The values of tax bases are often poorly correlated with income.
- Many old people live on high land value but have low incomes.
- For many people, especially those with mortgages, high land values are a cost of housing not an indicator of wealth.
- Similar issues arise with other tax bases such as payroll tax, gambling turnover, and so on.

The absurd case of the ACT

- Because ACT has low property values and a low payroll tax base, the CGC recommends substantial grants to the ACT even though the citizens of the ACT have the highest average incomes in Australia and the ACT is a relatively low cost area to service.

The tax base method: conclusions

- The continued reliance of CGC and State Grants Commissions on the tax base method for calculating revenue capacity is intellectually lazy, a misuse of resources, and inequitable.

Conclusions

- The fundamental revenue adequacy problem is a lack of local disposable income.
- Consequently some local areas lack adequate services as judged by services that are generally available elsewhere.
- The situation is exacerbated by:
  - Rate pegging in NSW
  - Some fiscal inefficiencies e.g. rate exemptions.

Efficient delivery of services

- Examples of high cost delivery
  - Family day care
  - Long day care
  - Local community bus
  - Storm water reuse

Family Day Care Costs

- Average cost per FTE child is about $2500 p.a.
- Factors affecting cost per FTE included
  - Size of centre
  - Location
  - Ownership / management of centre
- Holding other factors constant, cost per FTE is higher in local government-run agencies than in community-run and private agencies.

Long Day Care Costs

- Average cost per FTE child is about $13,000 p.a.
- Factors affecting cost per FTE included
  - Differences in age of children
  - Size of centre
  - Location
  - Ownership / management of centre

- Holding other factors constant, cost per FTE is higher in local government-run agencies than in privately-run or community-run agencies.

High costs in an inner Sydney Council

- Cost of the community bus = $9 per passenger trip of less than 2 km.

- Cost of water from storm water re-use project = $4- $5 per kilolitre.

Conclusions

- The Commonwealth or states should provide financial assistance to councils when the councils:
  1. Provide services to non-residents.
  2. Have low revenue capacity as measured by disposable local household and other income, not by the size of the tax base.
  3. Deliver services efficiently.

- (1) and (3) are empirical issues and can be measured.

- Low revenue capacity (2) can be measured, but extent of support to low income areas is a political decision.