Funding Local Government: The Infrastructure Dimension

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Presentation to the BITRE
2009 Infrastructure Colloquium:
Infrastructure for the Nation's Future

- **Local Govt has very successfully projected itself into national policy discourse and decision-making**

    - ALGA membership of COAG and relevant Ministerial Councils

    - House of Reps Report (2003) *Rates and Taxes: A Fair Share for Local Government*

    - State and national financial sustainability studies

    - PC (2008) Research Study: Assessing Local Government Revenue Raising

- Recently also
  - Australian Council of Local Government established
  - Constitutional recognition on the agenda (again)
  - $800m Community Infrastructure Program funding through the Nation Building Economic Stimulus Plan
- The $800m, plus continuing Roads to Recovery funding ($350m pa next 5 years), means the question of how to fund LG and its Infrastructure answered, for the time being – but not entirely satisfactorily

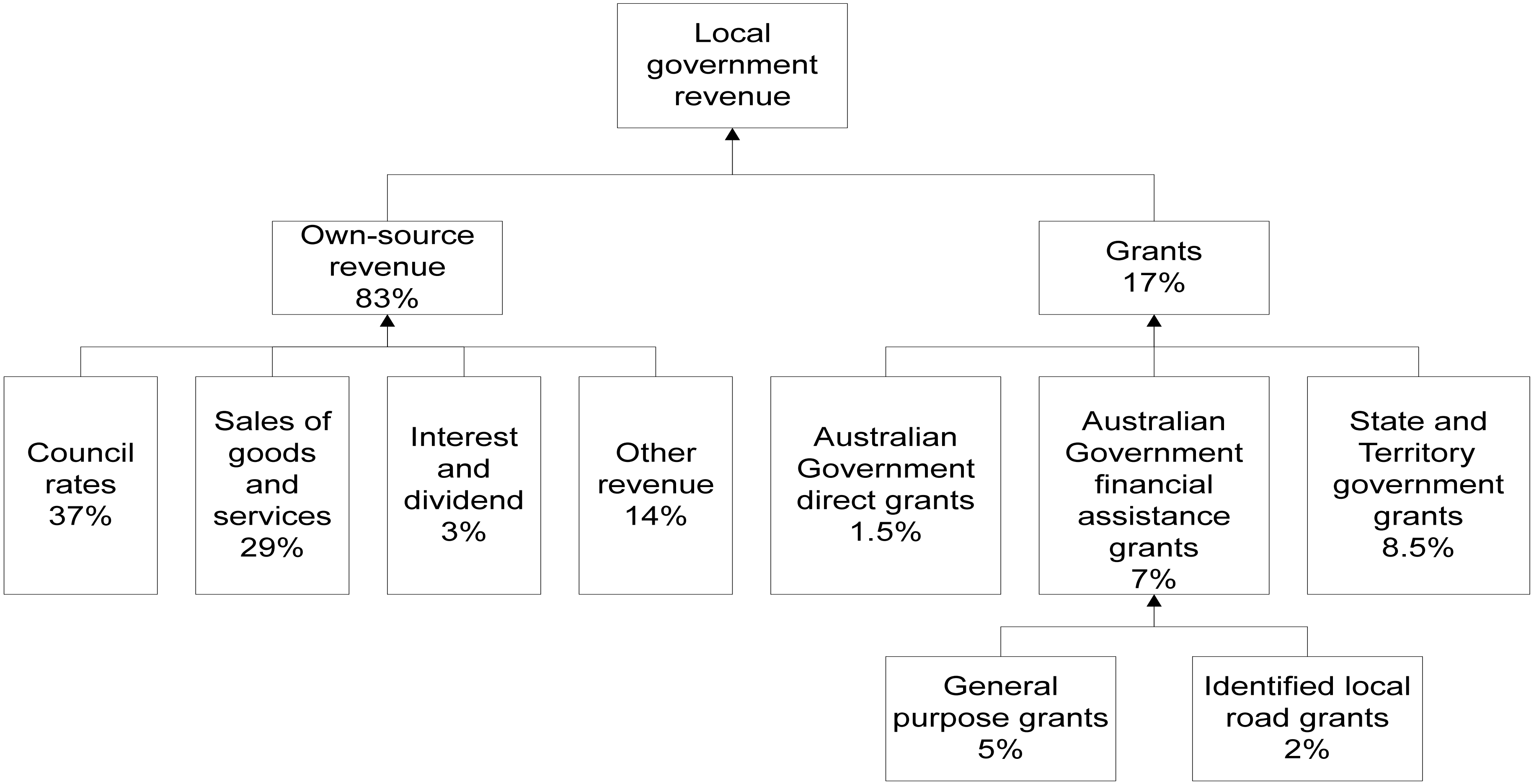
- Constant claims of LG include that there is
  - a growing gap between LGs' revenue base and funding required to meet broader range of services they are expected to provide;
  - an inability by LGs to fund infrastructure renewal, leading to increasing backlogs;
  - a significant number of councils close to being financially unsustainable;
  - the need for a "fairer" share of funding from major national tax bases to put LGs on a sounder financial footing.

- The structure of LG revenue-raising

  See next slide, but note:

  - presents aggregates across the whole LG sector: hides very substantial variations.
  - 2005-06 data: most recent reliable data, carefully constructed by PC from multiple sources.
  - have been significant trend changes: user charges increasing share over longish period.
  - capital grants (most of S&T grants and some of Commonwealth) can be variable (lumpy).

Local government revenue shares (Australia) 2005-06



(Source: PC (2008) Assessing Local Government Revenue Raising)

- **A high degree of variability of revenue raising capacity among LGs**

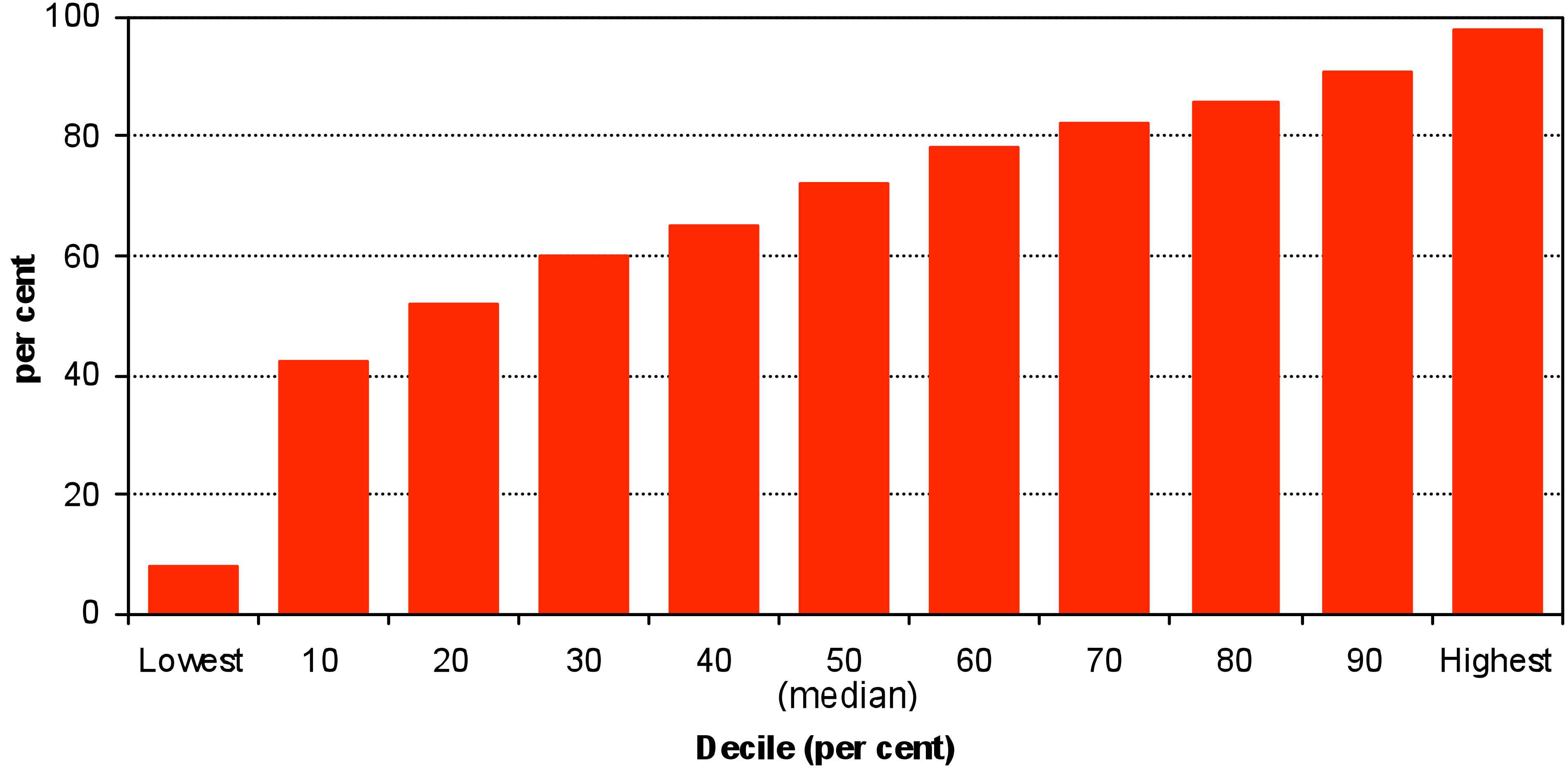
  See next slide:

  - top 25% of LG areas raise from 85% up to virtually all of total revenue from own-sources.
  - bottom 25% less than 55% from own-sources.

- These numbers partly a statistical artefact:

  - Because all LGs receive grants, they are all *statistically* ‘grants dependent’, but not necessarily incapable of doing without grants.
  - Because general purpose component of Commonwealth FAGs is distributed according to “need”, grants are *statistically* a larger share of total revenue of needy LGs.

Own-source revenue as a share of total revenue, 2005-06

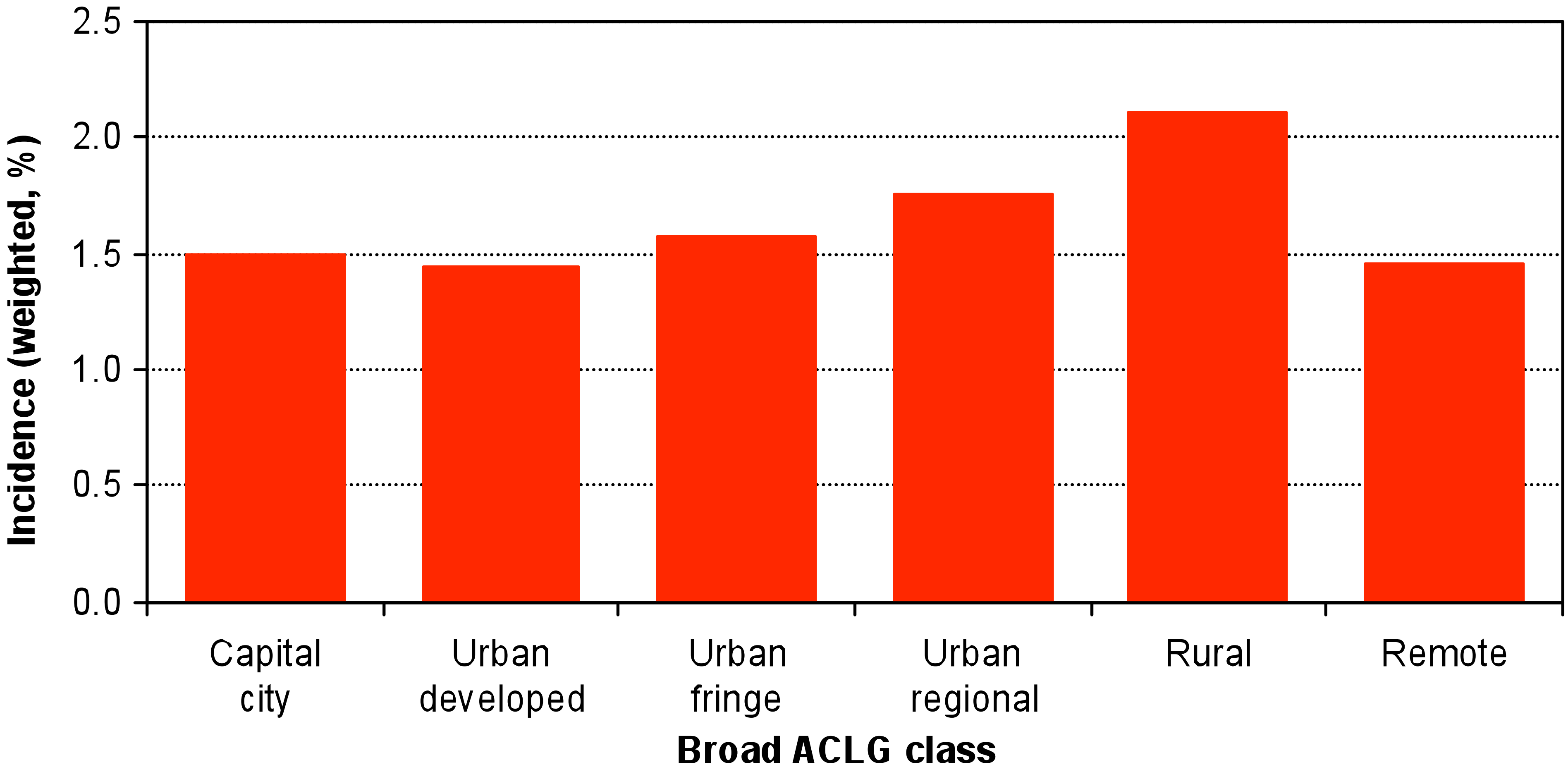


- **Could LGs raise more revenue from their own sources?**

  - LGs' revenues from rates – their totally discretionary revenue source – is a small proportion of the disposable incomes of their residents and businesses

  - See next chart, but n.b. variability within broad classes of LG

Total rates ‘incidence’ by ACLG class

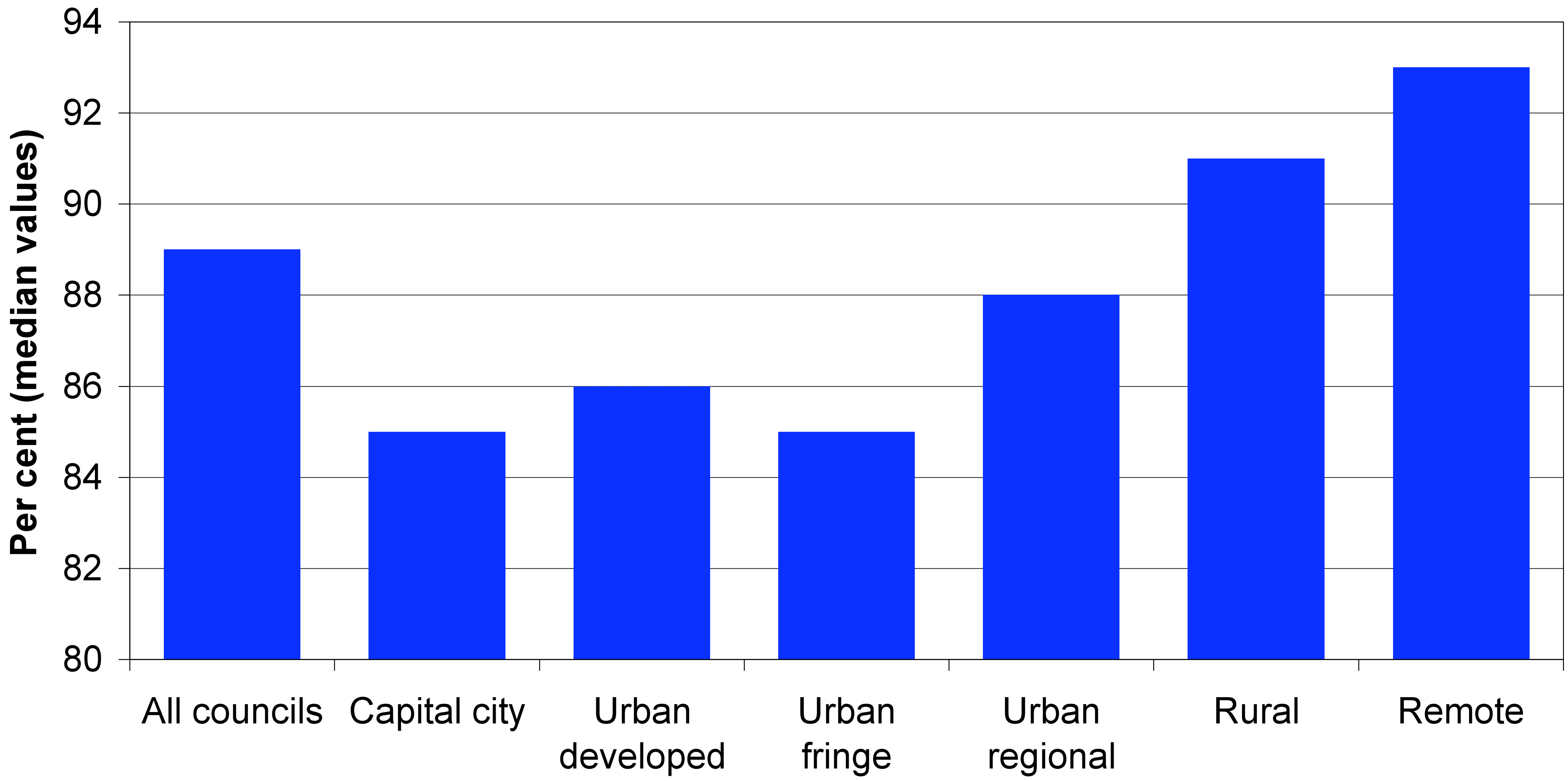


The PC undertook a sophisticated form of benchmarking

- Each LG's revenue-raising ***effort*** (per person) was compared to *all* other LGs, adjusting for differences in major factors driving their different revenue-raising ***needs*** (e.g., length of roads per person, number of rateable properties per person, rate of population growth, population density etc).

- On average, LGs were assessed as raising about 88% of their hypothetical benchmarks, though differ by class of LG
  - Rural and Remote above average (greater than 90%) urban fringe and CBDs lowest (85%).

Distribution of the estimates from hypothetical benchmarking



- Implication:

all LGs *potentially* could raise more own-source revenue--based *not* on simple observation that current revenue raising by LGs is small relative to their community's aggregate disposable income, but rather because statistical benchmarking indicates that others do so.

- **What has all this to do with funding local infrastructure?**

Both rates and user-charges are “benefit charges” for:

- use of suburban infrastructure (local access and connecting roads, pavements, parks, storm-water drainage etc.) in the case of rates; and
- use of community infrastructure (such as sports and recreation facilities, meeting halls, swimming pools etc.) in the case of user charges.

- Not a complete mapping of rates as benefit taxes and user-charges as benefit fees.

  - User charges most often set below full costs and balance covered by topping-up from LG funds available for discretionary purposes – that is rates and general purpose grants revenues.

- However, between them, rates and user charges plus any specific intergovernmental grants to enable below-cost service provision (e.g., for roads and for libraries) ***should*** generate sufficient revenue to cover operating costs *and* make provision to fund future infrastructure refurbishment/renewal.

  If they don't, LGs generally have the capacity to adjust rates or charges, &/or reduce outlays, and should!

- **In reality, it appears that:**
  - ➢ faced with expectations of their communities that LGs fund new services, or
  - ➢ desire of councillors and officials that they do so,

LGs have underprovided for and underspent on asset maintenance and refurbishment and also been unwilling to borrow against future revenue streams to undertake major renewals of long-lived assets.

- The consequence is a *legacy* of infrastructure renewal backlogs (over $14bn PwC report suggested).

  - AND ALSO a continuing under-provision for meeting future costs of *current* asset consumption (PwC estimated about $1bn p.a.).

- In fairness to current generations of ratepayers and councillors, part of the backlog, in effect, bequeathed by previous generations of residents and LG decision-makers.

  - And it's perfectly rational for LGs to seek help from another sphere of government to address the backlogs.

- However, in practice, it involves each current ratepayer asking every other current ratepayer/taxpayer, wherever they live, to share in the cost of addressing the legacy in their community!

  - Ultimately a zero-sum game: the costs are still met by current generation – just the distribution of the cost-burden within the current generation that's changed.

- LG has had some success in getting the *distribution* of costs of meeting backlogs changed
  - through Roads to Recovery funding ($350m p.a. for next 5 years); and
  - more recently, and more fortuitously, the CIF under the Nation Building Economic Stimulus Plan ($800m over about 2 years).
- **BUT**, even assuming the grants funding is prudently spent, who is going to ensure that LGs' future decision-making doesn't again inappropriately shift the costs of future renewal of the new assets onto future generations?
  - Better asset management and financial planning at LG level is being widely promoted, but what's the incentive to LG decision-makers to resist the political pull of spending the money that should be, in effect, stashed away for future refurbishment and renewal?

- LG has also been arguing that it should get a fairer share of Commonwealth revenues--comparing LG grants to those the States get.

  - Fact: % of Commonwealth revenue (net of GST) paid in FAGs to LGs has declined from 1.1% in 1996/97 to 0.71% 2009/10 and projected to decline further over time.

  - But comparison with the States is flawed: GST revenues paid to the States predominantly compensation for Commonwealth's acquired monopoly of the income tax base.

- Something to the argument that LGs are providing "redistributive" services out of regressive rates base--but they chose to do so, and do so to different extents in different States and LG areas.

- Possibly more prospective argument(?):

  Commonwealth should progressively increase general purpose funding levels till the objective of achieving full HFE (equalising *capacity* of LGs to provide similar standards of services to their residents) is achieved.

  - ➢ Consideration also be given to progressively reducing the proportion of the pool required to be allocated as a minimum grant.

- Of course, would also bring into play the issue of the incoherence of distributing the pool between S&Ts on equal per capita basis.

  - ➢ And also the question of why the States shouldn't contribute to the general revenue pool.

- May be hard arguments to win given commitments by other spheres to future debt reduction strategies.

  - But possibly more prospective than simply bidding for (at least) 1% of Commonwealth revenues without a completely coherent foundation.