



# Proposed Issues for Exploration

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## ERA Microeconomic Reform Inquiry

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## 1. Introduction

The Western Australian Local Government Association (WALGA or 'the Association') is the united voice of Local Government in Western Australia. The Association is an independent, membership-based group representing and supporting the work and interests of all 138 mainland Local Governments in Western Australia, plus the Indian Ocean territories of Christmas Island and Cocos (Keeling) Islands.

The Association provides an essential voice for 1,249 elected members and approximately 23,400 Local Government employees as well as over 2 million constituents of Local Governments in Western Australia. The Association also provides professional advice and offers services that provide financial benefits to the Local Governments and the communities they serve.

The Association believes the Local Government sector is an ideal area of focus for the ERA's 'Inquiry into Microeconomic Reform in Western Australia'. Local Governments are a key component of Australia's Federal system of government and is a major provider of direct services to the community on behalf of all spheres of Government.

From an economic perspective, Local Governments are important institutions that perform a number of vital roles to ensure communities, businesses and individuals can prosper:

- The provision of public goods such as local roads, parks and street lighting that would otherwise be under-provided in private markets
- Subsidising the provision of goods and services with positive externalities such as public health services and libraries
- Minimising the impact of negative externalities on local residents through services such as waste collection and management
- The provision of natural monopoly goods and services such as local roads, bridges, footpaths and drainage

The direct economic impact of Local Governments is also significant. As of June 2012, the WA Local Government sector employed 23,400 persons, which represented 1.8% of total employment in the State<sup>1</sup>. The ratio of total Local Government revenue to Gross State Product in 2011-12 was 1.9%<sup>2</sup>.

The following sections set out recommended reforms that the State Government could implement to improve the efficiency and effectiveness of Local Governments and consequently deliver benefits for communities throughout WA. The Association is grateful to the State Government for requesting the inquiry and providing the opportunity to raise such reforms.

Note that the recommendations below have been compiled by the Association's policy staff based on WALGA's current policy positions. As the ERA's inquiry progresses the Association will be able to consult more widely with Local Governments to potentially identify further areas of reform that would benefit the sector and WA's communities.

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<sup>1</sup> Source: Australian Bureau of Statistics, *Employment and Earnings, Public Sector*, Catalogue 6248.0.55.002; Australian Bureau of Statistics, *Labour Force*, Catalogue 6202.0; author calculations.

<sup>2</sup> Source: Australian Bureau of Statistics, *Government Finance Statistics*, Catalogue 5512.0; Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Catalogue 5220.0; author calculations.

## 2. Local Government Fees and Charges

Fees and charges are a significant source of funding for WA Local Governments, contributing 18.4% of total sector revenue in 2011-12<sup>3</sup>. Local Governments are able to charge users for specific, often incidental, services. Examples include dog registration fees, fees for building approvals and swimming pool entrance fees.

In some cases, Local Governments will recoup the entire cost of providing a service. In other cases, user charges may be set below cost recovery to encourage a particular activity with identified community benefit, such as sporting ground user fees or swimming pool entry fees.

Currently, fees and charges are determined according to three methods:

- By legislation
- With an upper limit set by legislation
- By the Local Government.

Fees determined by State Government legislation are of particular concern to Local Governments and represent significant revenue leakage because of:

- Lack of indexation
- Lack of regular review (fees may remain at the same nominal levels for decades)
- Lack of transparent methodology in setting the fees (fees do not appear to be set with regard to appropriate costs recovery levels).

Examples of fees and charges of this nature include dog registrations fees, town planning fees and building permits. Since Local Governments do not have direct control over the determination of fees set by legislation, this revenue leakage is recovered from rate revenue. This means all ratepayers end up subsidising the activities of some ratepayers.

This subsidy effect becomes progressively larger over time when fees are set at low nominal dollar levels for indefinite periods. For example, dog registration fees were set at the same nominal level from 1995 to 2013. Therefore, rate payers without dogs were increasingly subsidising registration costs for dog owners during this period. In contrast, State Government charges such as motor vehicle licence fees, drivers licence fees and public transport fares are generally increased on an annual basis.

When fees and charges are restricted by legislation, rather than being set at cost recovery levels, this sends inappropriate signals to users of Local Government services, particularly when the consumption of those services is discretionary<sup>4</sup>. When legislative limits allow consumers to pay below 'true cost' levels for a discretionary service, this will lead to overprovision and a misallocation of resources.

Under the principle of 'general competence'<sup>5</sup> there is no reason why Local Governments should not be empowered to make decisions regarding the setting of fees and charges for specific services. There may be an argument that certain fees and charges should be consistent across the State or the metropolitan area; however, it is not clear why dog registration fees, as an example, should be the same in every Local Government area. Local

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<sup>3</sup> Source: Australian Bureau of Statistics, Government Finance Statistics, Catalogue 5512.0.

<sup>4</sup> Productivity Commission 2001, *Cost Recovery by Government Agencies*.

<sup>5</sup> The *Local Government Act 1995* provides Local Governments in Western Australia with a power of general competence. This power means Local Governments have considerable discretion and flexibility to implement policy in response to the needs of their communities.

Governments in Victoria, Queensland, South Australia and Tasmania are able to set animal registration fees at their own discretion.

Car registration fees are not the same in every State and few would argue they ought to be; setting fees, charges and tax rates is a core function of government and Local Governments, as a legitimate sphere of government, should be able to make policy decisions regarding their services and revenue streams. Therefore, Councils should be empowered to make policy decisions regarding user-paid services provided by the Local Government.

#### WALGA recommendation

That the ERA investigate reforms to the fee and charge restrictions that are currently compromising the effectiveness of Councils' service provision and capacity to efficiently raise revenue.

### **3. Rating Exemptions – Charitable Purposes**

In 2005, the Local Government Advisory Board (LGAB)<sup>6</sup> inquired into the operation of section 6.26(2)(g) of the *Local Government Act 1995*<sup>7</sup>. This section provides that 'land used exclusively for charitable purposes' is exempt from Local Government rates.

In principle, this section of the Act is supported by the Local Government sector. Clearly, Local Government, like any sphere of government, must continue to play a role in supporting and encouraging charitable organisations in their work for the benefit of the community. Accordingly, advocacy by the Local Government sector for legislative amendments relating to this section of the Act should not be misinterpreted as disregard for the positive work of charities in the community.

The Local Government sector contends that exemptions under this section of the Act have extended beyond the original intention and now provide rating exemptions for non-charitable purposes, which increases the rate burden to other ratepayers. The most prominent example of this is the exemption provided to Independent Living Units, which is well documented in the LGAB's Report<sup>8</sup>. It is estimated by the LGAB that approximately \$3 million of revenue was foregone by Local Governments in 2005 as a result of this section of the Act. If this issue is not addressed, the rate burden on other ratepayers will continue to increase as the demand for Independent Living Units increases as the population ages.

The LGAB recommended in 2005 that Independent Living Units should not be exempt from rates. Furthermore, the Legislation Reform Working Group recommended in 2010 that Independent Living Units should not be exempt from rates<sup>9</sup>. The Local Government sector and the Association agree.

WALGA's policy position on this issue is that the Local Government Act 1995 should be amended to remove the rate exemption for Independent Living Units. There may be an argument for exemptions to be granted by State or Federal legislation. Examples include

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<sup>6</sup> The Local Government Advisory Board is a statutory body established under the Local Government Act 1995 to provide advice to the Minister for Local Government on Local Government constitutional matters.

<sup>7</sup> Local Government Advisory Board 2005, *Inquiry into the Operation of Section 6.26(2)(g) of the Local Government Act 1995: An inquiry by the Local Government Advisory Board into the operation of the provisions of the Local Government Act relating to rating of land used for charitable purposes*.

<sup>8</sup> *Ibid.*, p14-22.

<sup>9</sup> Legislation Reform Working Group 2010, *Report to the Local Government Reform Steering Committee*.

exemptions granted by the Commonwealth Aged Care Act 1997 and group housing for the physically and intellectually disabled which is supported under a government scheme such as a Commonwealth-State Housing Agreement or Commonwealth-State Disability Agreement.

As a matter of principle, the sphere of government that determines that exemptions should be granted should fund the exemption. This will ensure that funding the revenue shortfall will be equitably and appropriately distributed amongst taxpayers. For example, the State Government has a compensatory fund of this nature relating to pensioner discounts for the payment of rates.

The Local Government Act 1995 needs to be amended to provide clarification on rating of land used for charitable purposes.

#### WALGA recommendation

- a) That the ERA's inquiry into microeconomic reform considers amendments to the *Local Government Act 1995* that would remove the rate exemption for Independent Living Units.
- b) That the ERA's inquiry into microeconomic reform considers how the *Local Government Act 1995* could be amended to provide clarification on rating of land used for charitable purposes.
- c) That the ERA's inquiry endorse the principle that the sphere of government that determines exemptions should fund the exemption.

## **4. Council Controlled Organisations**

The Association believes Local Governments should be enabled to establish Council Controlled Organisations (CCOs). This model is available to Local Governments in New Zealand where they are used for a variety of commercial purposes. The model allows one or more Local Governments to establish a wholly Local Government owned commercial organisation.

In New Zealand, CCOs are employed:

to carry out a broad range of functions where (in the opinion of the shareholding local authorities) the efficiency of delivering such functions would be enhanced by the creation of professionally governed entities established for the specific purpose and where the appropriate consultation and oversight measures are in place.<sup>10</sup>

One key example of a function that could be undertaken by a Council Controlled Organisation is urban regeneration on a small, localised scale where low financial returns might be justified in pursuit of broader social objectives.

There are a number of benefits of the CCO model. Firstly, the CCO governance structure is flexible and will primarily consist of independent directors with experience relevant to the organisation's purpose and undertakings. Secondly, while the broad purpose and objectives will be set at the Council level, the CCO model removes commercial decisions from the political realm which can lead to improved decision making. Risk can also be reduced by the

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<sup>10</sup> Western Australian Local Government Association 2010, *Local Government Enterprises as a Means of Improving Local Government Efficiency*

CCO model by quarantining ratepayers from legal liability and financial risk arising from commercial decisions. Another benefit is the increased oversight that a CCO provides relative to the traditional Local Government approach. The board of the CCO will provide greater oversight to the organisation's undertakings than if the function was undertaken by a business unit inside the Local Government with a hierarchical oversight chain through the Chief Executive Officer to the Council.

Adoption of the CCO model would allow Local Governments the flexibility to pursue commercial objectives, currently passed up by the private sector, with appropriate accountability and transparency to ensure beneficial outcomes for the community. The Association has developed the full legislative amendments required for the CCO model to be implemented in Western Australia. These amendments were included in the Association's 2012 submission to the Metropolitan Local Government Review<sup>11</sup>.

#### WALGA recommendation

That the ERA investigate amendments to the Local Government Act 1995 and Regulations that would enable Local Governments to establish Council Controlled Organisations.

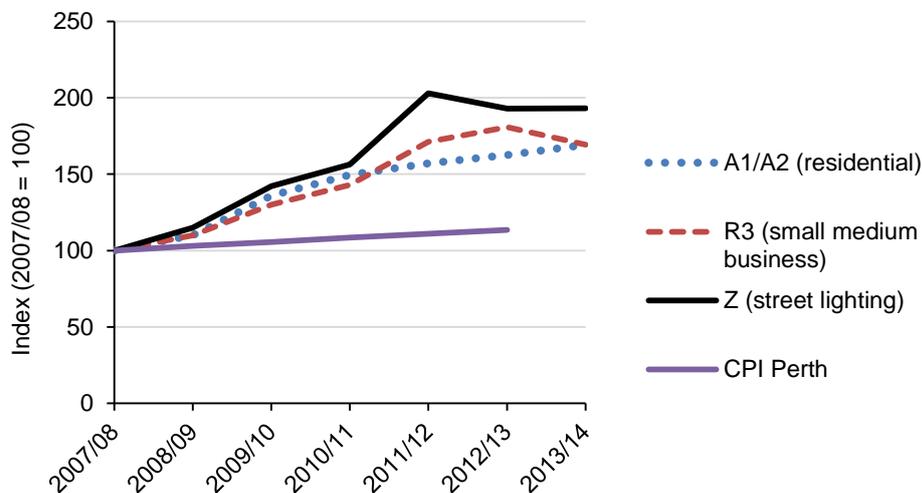
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<sup>11</sup> Western Australian Local Government Association 2012, *Submission – Metropolitan Local Government Review*.

## 5. Street Lighting Market Reform

Local Governments are sometimes criticised for contributing to households' cost of living pressures by increasing property rates more than the prevailing inflation rate. Unfortunately, less attention is paid to changes in the costs faced by Local Governments where these increase at a greater rate than inflation and are not able to be controlled through efficiency gains. For example, street lighting is one of the key public goods that Local Governments pay for and in recent years the escalating cost of street lighting has had a significant impact on the sector.

The following graph uses indexes to compare the price increase in the 'contestable' retail tariffs used by Local Governments with the increase in residential tariffs and the Perth CPI since 2007/08. The R3 and Z (street lighting) tariffs are used, since these are the contestable tariffs that are most relevant to Local Governments (though in the case of Z tariffs – while they are listed as contestable – there is no competitive market for this electricity).



Source: WA Treasury Budget Papers (2009/10 - 2013/14)

Streetlight tariffs have increased 93.1 per cent since 2007/08<sup>12</sup>. In comparison, residential tariffs increased by 69.1 per cent and the R3 tariff increased by 69.3 per cent over the same period. The comparison between the R3 tariff, where competitive market forces apply, and the Z tariff, where there is only one retail supplier, suggests that monopoly power is being applied to the street lighting market.

The Association therefore believes there is a case for investigating reforms in WA's street lighting market to enable and encourage more competition. More suppliers in this market may also have the advantage of encouraging the more widespread deployment of energy efficient technology such as LED street lighting. Comparisons with other Australian jurisdictions suggest that competition between electricity distributors has led to innovation and efficiency improvements.

<sup>12</sup> The 2013-14 Budget indicated street light tariffs would increase by 11.8% in 2013-14. However, advice from Synergy was that these tariffs were expected to increase by less than 1% in 2013-14 – the figures presented here use the Synergy estimate, rather than the State Budget estimate.

It could also be argued that the WA electricity market as a whole could benefit from further reforms. Indeed, a recent report by the Productivity Commission proposed a number of recommendations for achieving greater efficiency in electricity markets across Australia<sup>13</sup>.

WALGA recommendation

That the ERA investigate the benefits of further reforms to WA's electricity markets, particularly the street lighting market.

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<sup>13</sup> Productivity Commission 2013, *Electricity Network Regulatory Frameworks*.

## 6. State Agreement Acts

Before the 1980s, State Government conditions of consent for major resources projects in WA included the requirement for purpose-built towns in close proximity to project sites. These conditions were detailed in State Agreement Acts, which are essentially contracts between the State Government and proponents of major resources projects that are ratified by the State Parliament.

The requirement to provide community services and infrastructure meant State Agreement Acts typically included a Local Government rating exemption clause. Many of these towns have since been 'normalised' due to Local Governments, the State Government and utility providers assuming responsibility for services and infrastructure. Because Local Governments require revenue for these services, they – along with the Association – advocated for a fairer rating regime for resources projects.

In 2011, the State Government responded to this advocacy by allowing for Gross Rental Valuation rating to certain improvements on land within mining tenements. However, these arrangements only apply to new State Agreement Acts and only for a 'trial period' in the three years from July 1, 2012.

Existing State Agreement Acts, on the other hand, continue to provide rate exemptions. Local Governments can only rate projects covered by existing Agreements in the unlikely event of 'both parties agree[ing] to adopt the policy'<sup>14</sup>. Alternatively, the State Government has also stated that 'projects that operate under existing State Agreements and currently exempt from rates may apply the policy as part of their respective Agreement Variation processes with the Department of State Development during the trial period'<sup>15</sup>. Again, this statement suggests it is unlikely that the rating exemptions will be removed for existing State Agreements since variations are infrequent and there is no real requirement to remove the exemptions.

Rating exemptions on State Agreement Acts mean that Local Governments are denied an efficient source of revenue. There are also equity issues associated with the existing exemptions since they only apply to a select group of mining companies whose projects are subject to older State Agreement Acts. Removing the rates exemption clauses from the pre-July 2012 State Agreement Acts would provide a fairer outcome for all other ratepayers, including the proponents of new resources projects.

### WALGA recommendation

That the ERA investigate the benefits of removing rates exemption clauses from pre-July 2012 State Agreement Acts.

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<sup>14</sup> Barnett, C (Minister for State Development) & Castrilli J (Minister for Local Government) 2011, *Communities benefit from resources projects policy*, media release.

<sup>15</sup> Ibid.

## 7. Landfill Levy Hypothecation

The WA Landfill Levy was introduced in 1998 and applies to waste sent to landfill sites in Metropolitan Perth. The Landfill Levy has two functions:

1. To increase the comparative price of landfill and make recycling more cost-competitive
2. To provide resources for the State Government to strategically invest in recycling initiatives<sup>16</sup>

Prior to 2010, revenue from the Landfill Levy was completely hypothecated to spending on strategic waste management activities designed to help reduce the amount of waste sent to landfill. This is no longer the case – only 25 percent of Levy revenue is now used for this purpose.

The Levy increases the cost of waste to landfill and in theory leads to higher recycling rates. However, without the reinvestment of Levy funds back into waste management activities all that occurs is that the cost is passed on to those landfilling material (directly via gate fees or indirectly through rates) and there is a very limited impact on waste diversion.

For the Levy to work as a disincentive to landfill there needs to be higher level strategic planning in place. If there is no alternative end market for material, or the end market is marginal, the Levy will not affect diversion. Recycling in WA is often a marginal activity, active investment in infrastructure and market development is needed.

For example, in New South Wales Local Governments are paid for the recycling that is collected through the Kerbside system – in WA recycling comes at a cost (for collection and processing). There is a sizeable risk for those investing the recycling market and for publically listed companies borrowing to upgrade or put in new infrastructure may be problematic. This is why direct investment in recycling initiatives is needed. The Landfill Levy is the best source of funding for that investment.

### WALGA recommendation

That the ERA investigate the benefits of greater levels of hypothecation of Landfill Levy revenue towards waste management initiatives.

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<sup>16</sup> Blyth M. 2007, *Landfill Levy Review*.

## **8. Native Vegetation Clearing Regulations**

The *Environmental Protection Act 1986* and the associated *Environmental Protection (Clearing of Native Vegetation) Regulations 2004* (the regulations) provide a regulatory framework that prevents inappropriate clearing and minimises the impacts of clearing.

For Local Governments the key issue with the regulations is a lack of clarity about the roles and responsibilities for the sector and the effect of the regulations on the timeliness of the works Local Government has to undertake.

Government needs to finalise the review of the clearing regulations as a matter of urgency, as the continued delay is a major impediment to the maintenance and upkeep of the local road network, essential for both road safety and the effectiveness of the road transport task.

### WALGA recommendation

That the ERA investigate the benefits of amending the *Environmental Protection (Clearing of Native Vegetation) Regulations 2004* to provide clarity on Local Government roles and responsibilities.