Interim Submission to the Economic Regulation Authority

Inquiry into Microeconomic Reform in Western Australia

May 2014
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 24,900 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 is grateful to the Economic Regulation Authority (ERA) for the opportunity to provide a submission in response to the Draft Report of the Inquiry into Microeconomic Reform in Western Australia. Local Governments have a strong interest many of the issues raised by the Draft Report and support reforms that would increase the prosperity and well-being of the community.

This submission focuses on the Draft Report’s recommendations that are of key interest and importance to the Local Government sector. The submission provides the Association’s perspective on the ERA’s recommendations in respect to:

- Royalties for Regions;
- Unsolicited infrastructure proposals;
- Congestion charging;
- Reducing the cost of complying with regulation;
- Review of state taxes; and,
- Keystart.

Due to meeting schedules and the tight deadline to provide input to the ERA, this submission has not yet been endorsed by the Association’s State Council. The ERA will be informed of any changes to the Association’s submission following consideration by the Council.

2. Royalties for Regions

**ERA recommendation:**

4. Repeal the Royalties for Regions legislation, or restrict regional funding to an amount determined annually as part of the Budget process and guided by appropriate cost benefit analysis on a project-by-project basis.

The Association does not support repealing the Royalties for Regions (RFR) legislation. The ERA’s Draft Report does not acknowledge that in the years before the RFR policy, regional areas of WA struggled for appropriate levels of State Government support and expenditure. RFR has enabled regional WA to have a fair share of the state’s taxation revenue and has
directed funding towards critical projects in regional communities that may have otherwise been spent on ‘higher profile’, though not necessarily higher priority, infrastructure in Perth.

The State Government’s objectives for regional development are dependent upon Communities outside Metropolitan Perth being able to secure stable and continuing funding for infrastructure and social and economic development. The Association therefore supports the use of RFR for this purpose.

The Draft Report is critical of RFR being a hypothecated fund and emphasises the impact of hypothecation on budget flexibility. The ERA points out that RFR appropriations have increased from ‘around 3 per cent of general government revenue in 2009-10 to well over 5 per cent in 2013-14’. However, it should be noted that from 2013-14 onwards, a number of services/agencies that have regional components to them are being funded by RFR rather than through consolidated revenue, as in previous years.

The State Budget released on 8 August 2013 saw the Department of Regional Development, Regional Development Commissions, agriculture, regional health, education, tourism, community services, business development, transport and infrastructure projects sharing in the $1.3 billion of Royalties for Regions investments for 2013-14. This weakens the arguments against the hypothecated nature of RFR because it demonstrates that the State Government has greater budget flexibility than the ERA suggests.

The Association’s main focus with respect to RFR has been the Country Local Government Fund (CLGF). The CLGF is a program funded by RFR and its purpose is to address the infrastructure backlog across the country local government sector.

The Draft Report cites the recommendations of the standing Committee on Estimates and Financial Operations: ‘Royalties for Regions’ Policy. This included the Committee’s finding that it ‘was unable to establish any evidence of an actual infrastructure backlog in regional local government’. However, the extensive research undertaken by the Association to compile the Systemic Sustainability Study revealed an infrastructure backlog of $1.75 billion.

Despite the significant infrastructure backlog for country Local Governments, the CLGF was effectively ended in the 2013-14 State Budget (funding was only provided to complete previous years’ projects). The Association is currently advocating to the State Government for the retention of the Country Local Government Fund at a level commensurate with its original intent of addressing the country Local Government infrastructure backlog.

The Association position on the Fund’s reinstatement is consistent with the Western Australian Regional Development Trust’s (WARDT) recommendations contained in their 2012 Review of the Country Local Government Fund. In their Review, the WARDT acknowledged that WALGA’s previous estimate of Local Government’s infrastructure backlog.

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backlog at $1.75 billion is ‘potentially very conservative’ and that $800 million of maintenance expenditure may be required for the State’s road network alone\textsuperscript{2}.

The very essence of why the Royalties for Regions fund was created is based on equitable access for those who live, work, and play in regional Western Australia. Pitching regional WA against the goliath that is the population of the metropolitan area via contestable, competitive applications would be a step backwards without the appropriate capacity building of regional applicants.

To suggest that ‘a significant proportion of projects are too small to justify detailed cost benefit analysis’ based on the fact that Royalties for Regions has allocated more than $4.2 billion to over 3,500 regional development projects at an average value of $1.2 million per project funded, shows a lack of understanding of the positive impact this type of investment is having on regional communities.

There is no doubt that measures need to be taken by the State Government to ensure the return of the AAA credit rating status, however is there also the need for a realistic mechanism for Local Governments to access the funds that are produced by the resources situated in the areas they represent. The CLGF has and should continue to be available as an option for Local Governments as part of the Royalties for Regions fund. Further, a portion of the fund should contribute to the human capacity building of those in the regional Western Australia to enable an opportunity for equitable access to funds through robust business cases.

Section 8 of the *Royalties for Regions Act 2009* states: ‘[t]he Treasurer is to ensure that the amount of money standing to the credit of the Fund at any time does not exceed $1 billion’. The Draft Report criticised this $1 billion cap on the RFR fund, stating that attempts to stay under the cap could ‘hasten the expenditure of large amounts of funding’ and this is ‘not consistent with good practice infrastructure project planning or delivery’. The Association agrees with the ERA’s statements regarding the cap on the RFR fund. The Association believes the cap should be removed and that there could be some advantages if the RFR fund builds up substantial ‘reserves’. A larger RFR fund could lead to a more efficient allocation since it would improve the funding prospects for strategic large scale infrastructure projects.

In summary, the Association’s position on RFR is:

- RFR secures vital funding for regional WA and the RFR legislation should not be repealed.
- The Country Local Government Fund should be reinstated and sufficient funding provided to address the Local Government infrastructure backlog.
- The $1 billion cap on the RFR fund should be removed.

\textsuperscript{2} Western Australian Regional Development Trust (2012), *Review of the Royalties for Regions Country Local Government Fund.*
3. Unsolicited infrastructure proposals

ERA recommendation:
9. Develop a process and guidelines for unsolicited infrastructure proposals from the private sector.

The Association agrees with this recommendation because the development of unsolicited proposal guidelines would enable greater input from the private sector into infrastructure provision while also ensuring the probity of such a process. More input from the private sector could encourage greater innovation and efficiency in delivering infrastructure as well as providing different options for financing projects.

The Association also agrees that care should be taken in designing the guidelines for accepting such proposals. The Association believes transparency would be a particularly important consideration in the proposal process and that a strong oversight role for the WA Office of the Auditor General could help to achieve this.

Local Governments in WA could potentially benefit from unsolicited private sector proposals for projects such as land development, street lighting, and developing and running facilities (e.g., regional airports). The potential gains from private sector proposals would be increased if Local Governments had the power to form Council Controlled Organisations (CCOs).

This model is available to Local Governments in New Zealand where CCOs 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. CCOs in New Zealand 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.³

A key advantage of CCOs is that they would be able to enter into commercial partnerships with the private sector to deliver infrastructure and related services more effectively than Local Governments themselves. The Association believes that the establishment of CCOs would lead to productivity gains in the Local Government sector and has therefore advocated to the State Government to make the necessary amendments to the Local Government Act 1995.

³ Western Australian Local Government Association (2010), Local Government Enterprises as a Means of Improving Local Government Efficiency
4. Congestion charging

**ERA recommendation:**
5. Trial a congestion charge for entering the CBD during morning and afternoon peak periods. In order to implement this, further investigation will be required in order to determine the borders of the charging area, the fee structure, the charging and management system and the capacity of the public transport system to handle the likely increase in patronage.

The Association acknowledges the need to address congestion issues in the CBD and believes a congestion charge trial could be worthwhile. There are a number of issues that should be considered by such an investigation:

- Any trial or policy must consider exemption for personnel that perform functions for service authorities and require their vehicles in the execution of these duties. The trial should also consider the limited transport options that many working people face.
- A study must be performed to address a solution for residents that do not have adequate access to public transport.
- A comprehensive traffic assessment must be performed to gauge the impact on bordering parking facilities and the capacity of station parking areas.
- The trial should consider the destination of drivers using congested roads at peak times (i.e., whether the traffic is travelling through the CBD or into the CBD).
- The trial should consider that congestion charging will divert some traffic to the local road network and assess the potential impact of this, including the increased wear and tear on local roads. This also has implications for road funding in Metropolitan Perth. If the congestion charge increases traffic on local roads then some of the revenue raised by the charge should be earmarked for the maintenance of those roads.
- The trial should also consider the impact of the number of long and short term parking bays in the CBD.

5. Reducing the cost of complying with regulation

**ERA recommendations:**
11. Appoint a lead reform agency (either the Department of Premier and Cabinet, or alternatively the Department of Finance) to work closely with senior departmental staff across all areas of Government to develop regulatory reform targets and monitor, enforce and publish performance against the targets.

12. Set Key Performance Indicators for regulatory reform targets for senior departmental staff.

13. Establish an Information and Communications Technology (ICT) office within Government (the Department of Premier and Cabinet, or alternatively the Department of Finance) to:

   a. identify technology-based strategies to reduce regulatory burden in Western Australia;
b. develop and implement a policy and implementation plan for ICT reform in the State; and

c. provide ongoing support to the Western Australian public sector, in the areas of service delivery, strategic ICT policy and planning, public sector innovation, and information management, focusing on reducing the level of regulatory burden.

14. Update the Red Tape Reduction Group’s 2009 assessment of regulatory burden in Western Australia, to measure current levels of regulatory burden in the State.

15. Require departments with a regulatory role to:

   a. establish a customer service charter with clear and measurable service standards;

   b. have this customer service charter reviewed by a lead reform agency responsible for the reform programme;

   c. publish this customer service charter online, and display it in areas where staff provide services to the public;

   d. include a report on actual performance against the service standards in the departmental Annual Report; and

   e. set Key Performance Indicators for service standards for senior departmental staff.

16. Where regulatory problems are particularly broad or complex, establish working groups that include public, private, and community-sector representatives to assist in developing solutions.

17. Replace the Regulatory Impact Assessment Guidelines for Western Australia with a statutory mandate establishing the Regulatory Impact Assessment process, and defining the roles and responsibilities of the Regulatory Gatekeeping Unit.

18. Establish a five-yearly recurring review of the implementation and effectiveness of the Regulatory Impact Assessment process, to be undertaken by the Office of the Auditor General.

19. Transfer responsibility for the central publication, but not preparation, of Regulatory Impact Assessment documentation to the Regulatory Gatekeeping Unit, including the timely publishing of:

   a. Preliminary Impact Assessments;

   b. Consultation and Decision Regulatory Impact Statements;

   c. Compliance Notices and advice of non-compliance;
d. statements of the supporting rationale for any non-compliant proposals adopted by Government, to be provided to the Regulatory Gatekeeping Unit by the Government;

e. notices of exemptions (including the supporting reasons for approval of the exemption);

f. notices of any changes made between a Consultation Regulatory Impact Statement and the subsequent Decision Regulatory Impact Statement, to be included with the Decision Regulatory Impact Statement; and

g. a current list of all proposals undergoing Regulatory Impact Assessment, including the status of each, with the exception of cases where Cabinet-in-Confidence restrictions apply.

20. Amend the Guidelines (or their legislated replacement) to:

   a. limit applications for exemptions, including Treasurer’s exemptions, to the period immediately after the requirement for a Regulatory Impact Statement has been triggered;

   b. limit the granting of exemptions to exceptional circumstances (such as emergency situations) where a clear public interest can be demonstrated;

   c. remove the capacity for exemptions to be granted in the case of election commitments, except where exceptional circumstances apply; and

   d. require timely publication of the reasons for all exemptions granted.

21. Establish a training and resourcing initiative to ensure that all Government departments involved in the preparation of Regulatory Impact Statements and Preliminary Impact Assessments have the capacity to conduct key analytical work (such as cost benefit analysis) in-house.

22. Mandate a 30-day minimum consultation period for Regulatory Impact Assessments, where consultation is undertaken as a part of the Regulatory Impact Assessment process.

23. Empower the Regulatory Gatekeeping Unit to develop and conduct post-implementation reviews for all non-legislative proposals that have been subject to a Regulatory Impact Assessment.

24. Direct the Regulatory Gatekeeping Unit to perform an audit of legislation overdue for review, and set a schedule for the review of these Acts.

25. Establish a review policy to be applied to all new legislation, specifying:

   a. criteria triggering the mandatory inclusion of a Review of Act clause;

   b. criteria for identifying the most appropriate Government or external organisation to perform the review;
c. criteria to guide legislators in identifying how frequently a review should be performed; and

d. standard wording for the Review of Act clause.

The Association generally agrees with the Draft Report’s recommendations for reducing the cost of complying with regulation. Like other sectors of the WA economy, Local Governments face significant costs from out-dated and poorly designed legislation. As pointed out in the Association’s response to the Microeconomic Reform Inquiry’s Issues Paper, key areas for regulatory reform should include:

- Removing regulatory restrictions on Local Government fees and charges, since these cause inequitable outcomes for ratepayers and deny Local Governments an efficient source of revenue.
- Reforms to the Local Government Act 1995 that would enable Local Governments to rate land used for Independent Living Units where these services have been provided for profitable services.
- Amendments to the Environmental Protection (Clearing of Native Vegetation) regulations 2004 to provide clarity on Local Government roles and responsibilities.

6. Review of state taxes

**ERA recommendation:**
26. Consider options for reforming payroll tax, residential transfer duty and land tax:

a. broadening the base and lowering the rate of all three taxes to increase their efficiency; or

b. increasing reliance on efficient taxes (land tax and payroll tax) and reducing or abolishing the inefficient taxes (residential transfer duty).

**Payroll tax**

The Association is opposed to Local Governments being included in the payroll tax base. There is a long standing agreement that governments in Australia do not tax each other – an agreement that the Association supports.

If the current payroll tax exemption for Local Governments was removed, this would then suggest reciprocal taxation arrangements should apply: Local Governments should pay State taxes and State Government entities should pay Local Government rates.

The Draft Report’s recommendation to broaden the payroll tax base ignores the political and practical difficulty of implementing such arrangements. The impact of reciprocal taxation on Local Governments would vary according to the State Government presence in their district, i.e., the additional rates revenue raised compared to the State taxes incurred. When
Tasmania introduced reciprocal taxation in 2003, it was estimated that only three out of 29 Local Governments would be worse off in net terms as a result of the changes. However, in WA there is a high proportion of small rural Councils that would be probably be worse off due to reciprocal taxation since they have little or no State Government presence in their Local Government Area.

The ERA’s recommendation that the payroll tax base should be broadened is based on conceptual and philosophical arguments with little or no consideration of such ‘real-world’ complications such as reciprocal taxation. The Association believes a much broader review of State taxation should take place before such a recommendation could be considered.

**Transfer duty**

The Association supports the Draft Report’s recommendation that the State Government should considering decreasing its reliance on transfer duty. Transfer duty can be considered an inefficient tax on several grounds:

- Transfer duty is a volatile source of revenue for the State Government since it relies on both the volume and value of transactions. As an example of this volatility, the WA State Government raised $2.2 billion in transfer duty in 2007-08, but only $1.0 billion in 2008-09.
- Transfer duty adds a substantial outlay to the costs of purchasing a home. This acts as a disincentive for people to move house, which causes the following problems:
  - Low turnover of ‘family’ sized housing, since older couples are discouraged from downsizing and young purchasers tend to buy bigger homes than they immediately need to avoid paying transfer duty in the future.
  - Workers are discouraged from moving closer to their jobs, which contributes to longer daily commutes.
  - Workers are discouraged from moving from areas with high unemployment to regions with labour shortages.

In the case of retirees, transfer duty significantly adds to the costs of downsizing to a smaller home. For example, the median price for small homes (one to two bedrooms) in Metropolitan Perth was $525,000 in 2013. Purchasing a home at this price would result in a transfer duty bill of $18,952.50.

There is a wide consensus that transfer duties on property transactions are inefficient and the Association believes this form of State taxation should be phased out. However, the Association also recognises that such comprehensive tax reform is difficult. If transfer duty is to remain, the State Government could at least mitigate the disincentive for older people to

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6 Source: Real Estate Institute of Western Australia.
downsize in retirement through targeted concessions. Some jurisdictions in Australia have already taken this step:

- In Victoria, card-holding seniors are eligible for a transfer duty exemption for property purchases under $330,000. Properties up to $750,000 receive a partial concession.\(^7\)
- The Northern Territory offers a ‘Senior and Pensioner Carer Concession’ on transfer duty of $8,500 for homes under $750,000.\(^8\)
- The Pensioner Duty Concession scheme in the ACT charges transfer duty at a concessional rate of $20 on homes up to $580,900. Properties up to $742,000 receive a discounted rate of transfer duty.\(^9\)

**Land tax**

The Association recognises that land tax, when applied to a comprehensive base, is a far more efficient tax than transfer duty. Land taxes have a number of advantages:

- They can be used as a fair and efficient method of taxing and funding infrastructure (since any uplift in land values caused by new infrastructure will be partly captured by the government via increased land tax revenue).
- Because land taxes are based on the unimproved value of land, they encourage development and for land to be put to its most productive use. They therefore also tend to discourage land banking, speculation and urban sprawl.
- They provide a stable source of revenue for the State Government – particularly compared to other revenue sources such as royalties and transfer duty.
- Progressive land tax rates can be used to ensure owners of higher valued land pay a higher proportion of tax (just as progressive income tax rates increase the rate of tax paid by higher income earners).
- In contrast to transfer duty, broad land taxes spread the tax burden among the community, rather than the small group of people that move house in a given period.
- If land tax replaced transfer duty this would have positive effects on labour productivity and congestion, since this would remove the disincentive for people to relocate for work purposes.
- If land tax replaced transfer duty this would have a positive impact on housing affordability, since the upfront costs of home ownership would be reduced. Additionally, the supply and turnover of housing stock would probably increase, further improving affordability.

While there are many potential advantages to broadening the land tax base, the Association would only support such a reform subject to the following conditions:

- That Local Government does not act as the land tax ‘collector’ for the State Government. Furthermore, if land tax is to be applied to a comprehensive base, the

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\(^7\) Source: Victorian Department of Human Services.  
\(^8\) Source: Northern Territory Department of Treasury and Finance.  
\(^9\) Source: Australian Capital Territory Revenue Office.
State Government should take the opportunity to use the same arrangements to collect the Emergency Services Levy from property owners.

- That land tax be levied at relatively low rates (similar to those suggested by the ERA's Draft Report) so that the tax does not compromise Local Governments’ ability to raise rates revenue.
- That appropriate transitional arrangements are in place. This should include phasing in the land tax over time and exemptions or concessions for households and other entities that have recently paid transfer duty.
- That appropriate arrangements are made for ‘asset-rich, income-poor’ households. This could include allowing pensioners to defer their land tax payments until the property is sold, as currently occurs with Local Government rates.
- That Local Governments continue to be exempt from land tax.

As with broadening the payroll tax base, implementing broader land taxes has a number of implications. The Association believes that the State Government should initiate a major review with a view to improving the equity and efficiency of the State’s taxes. This review should be broader in scope than the ERA’s assessment of State taxation in the Microeconomic Reform Inquiry. The ERA’s Draft Report outlined a number of compelling conceptual arguments for reforms of state taxes and the predicted net economic benefits to the community that would result from such changes. However, a broader review is necessary so that the costs and benefits to all parties affected by taxation change can be understood. Such a review should include extensive consultation with the community and discussion of transitional and compensatory arrangements for those groups adversely affected by tax reform. In the case of Local Governments, this would include investigating the implications of reciprocal taxation in WA.

7. Keystart

**ERA recommendation:**

31. Abolish Keystart as soon as possible

High demand and limited supply has caused the cost of housing in Western Australia to rise dramatically during the last ten years. Many communities across the State are suffering from the lack of affordable housing which is essential in supporting economic growth as well as maintaining vibrant and diverse communities. As such, the Association is concerned that the removal of any programs which help improve housing affordability, including Keystart, would be detrimental to both WA households and also the State’s economic competitiveness.

While it appears that the ERA is recommending that ‘Keystart’ be dissolved, the Inquiry’s recommendations relating to Keystart are inconsistent and in need of clarification. The Draft Report’s ‘summary of recommendations’ sets out the recommendation to ‘abolish Keystart as soon as possible’. However, Chapter 7.5 states that the ‘ERA considers that there are two options for reform: 1. Keystart is abolished; or 2. Keystart’s pricing structure is altered to allow Government to be adequately compensated for the risk to which it is exposed’. As such, the headline recommendation is somewhat misleading and does not reflect the findings and recommendation set out in the main body of the report.
Nevertheless, should the ERA wish to pursue the recommendation to abolish Keystart, the Association is concerned that the Inquiry does not provide sufficient evidence to justify this recommendation. The current analysis of the risk to the State posed by Keystart is limited to the level of debt held within the program. There is little assessment of the Program’s lending criteria and the level of default amongst borrowers, which the Association understands is considerably less than that within the private lending sector. Given the limited range of evidence examined by the Inquiry in relation to the performance of Keystart, the Association recommends that the ERA undertake further research and a full cost benefit analysis of the Keystart program. It is important that such analysis includes examining the social and economic impacts of the Keystart program together with the cost to the State Government of providing alternative housing programs should Keystart be abolished.

The Association is concerned that the Draft Report unduly emphasises that by increasing access to home ownership opportunities for lower earning households, Keystart increases demand for affordable housing which in turn leads to price increases. While there may be some impact on housing prices in the affordable segment of the market, the ERA does not quantify this effect or provide any empirical evidence of it. Additionally, focusing on house prices only considers one aspect of housing affordability policy.

There are many different components of housing and affordable housing, including social and private rentals in addition to home ownership options which the Draft Report fails to recognise. One of the key benefits of the Keystart program is that helps people to transition from social housing to private housing and thereby reduces the State’s social welfare expenditure. This also frees up scarce social housing stock for Western Australians on the waiting list for these services.

It is also important to recognise that improving the accessibility of homeownership is likely to reduce demands for rental properties, making rental accommodation more affordable. Furthermore, reducing the demand for rental properties and the value of the rental market is also likely to reduce housing demand pressures, in turn helping to alleviate investor demand, which otherwise may lead to increased housing costs for both home occupiers and renters.

The Draft Report states that ‘Keystart’s activities are attempting to address a problem that is not a true market failure… [as] potential homebuyers are unable to access private finance because they have insufficient deposits’. Indeed, throughout the report the ERA suggests market failure is the only justification for Government intervention in a market. However, social policy and equity considerations are also frequent and justified reasons for Government intervention. For example, Government intervention in the health sector is ‘undertaken with a view to providing equity of access to a satisfactory system that promotes good health at a low cost’.

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The Draft Report suggests that increased levels of home ownership leads to ‘improved individual social outcomes, providing stability, security and increased community connection’. Keystart improves access to home ownership for lower income earners and ensures these benefits are shared throughout the community. Therefore, Government involvement in the housing market is justified on the basis of sound social policy.

Furthermore, there may be no ‘true’ market failure in the housing market, but the market is leading to undesirable outcomes for Western Australians. The current cost of housing, whether rental or for purchase, is such that it prevents people from saving for a deposit. Indeed, recent research by the Bankwest-Curtin Economics Centre, found that over half of households in private rentals were paying more 40% of their gross incomes in rents. This severely reduces their ability to save for a housing deposit. Additionally, this report found that those on low to moderate incomes are only able to purchase a property in a small proportion of suburbs in metropolitan Perth which ‘provides strong evidence that the housing market in WA is failing to clear for all sections of the state’s population’\textsuperscript{11}. Again, such outcomes indicate the need for a body such as Keystart to help overcome the barriers to home ownership.

\textsuperscript{11} Bankwest Curtin Economics Centre (2014) \textit{Housing Affordability: The real costs of housing in WA}. 