Parliamentary Inquiry into Rate Capping

Please find attached my submission.

My contact details are,
Name: Murray Beattie

Yours sincerely,
Murray Beattie
Submission to the State Government inquiry regarding local government Rate capping.

Capping the increase in Local Government rates and associated charges will instil needed discipline. The use of CPI as the index to define the upper limit for such change has the advantage of being well known but the disadvantage of requiring a number of adjustments.

Local government, based on a local knowledge, provides a range of vital services for the benefit of the community. A central task of Local Government is to balance the need to provide appropriate services funded by government grants and Rate revenue determined after rigorous financial projections.

In the first place, to actively encourage fair and reasonable decision making, Ratepayers should have easy access to all information; except where there are contractual negotiations taking place and it would otherwise not be in the Ratepayers best interests. Transparent information with easy access for open scrutiny to any interested Ratepayer can only help to promote a sound decision making processes. When Ratepayers experience veiled, incomplete or misleading information, at the very least it dilutes confidence in the financial processes and, more to the point, it can obfuscate lower quality determinations including the Rating outcomes.

The Rate setting process within Local government is a remarkable price setting mechanism. Prices are self-determined on the basis of expenses and suitable contingencies for its product, without direct market pressures on the downside. It seems that, by and large, the only governor on the Rates levied is whether or not the annual Rate increase is in line with the past and its comparison to the forecast increases foreshadowed in previous years. This is circular and insufficient.

Hence, the proposition that Rates should be capped via a price index framework would seem to be beneficial. Can such a framework be expected to achieve its end? It will depend on the Index and allowance for some change, without the framework being adulterated beyond effectiveness.

Wages and salaries
Employee expenses are a significant proportion of the total local government expenditure and, in general, wages tend to change at a rate which outpaces the CPI. This presents a difficulty for a Rate capping proposition based on CPI. However, although the staff within local government don’t directly benefit by profit participation, without a framework to govern the level of Rates, the employee expenditure doesn’t have a direct downward pressure and it can lead to a wide-range of inefficiencies.

While Rate capping at CPI will provide a downward pressure on expenditure, it will, at times, likely require special consideration for a catch-up adjustment if there is a demonstrable accumulation of wage cost differences over CPI. Perhaps, in this way, a CPI cap provides a means by which the current level of salary expense can be moderated? The alternative is to allow for a margin above CPI to progressively accommodate the cost difference.
Investment Analysis
The strength of local government is their focus on the particular needs of their community and, in doing so, they make significant (relative to their size and Rate base) investment decisions across a variety of capital works and local infrastructure. However, the combined financial prowess of the executive and Councillors is questionable. Where inadequate investment decisions are made, the consequent deficiency in the value of the financial outcomes can be significant with consequent implications for Rate setting. The impacts of poor investment decisions are capable of far out-weighting the impact of differences within salary expenditure.

For example 1: Capital works might be deemed to have particular set of “social benefits” and, whilst it might be acknowledged that there is a consequent cost, it is easier not to determine such (because to do so would be in some way anti-social).
- Generally, there is either insufficient ability and/or desire to differentiate the outcome.
- Every project should be required to be analysed inclusive of
  - Opportunity costs of the project; given that capital is scarce.
  - Project development costs, inclusive of internal expenses, project management and prudent financial contingencies.
  - A valuation, based on a current cost of capital, of both
    - the expected operating cashflows, and, alternatively,
    - the operating cashflows based on commercial terms.
- Only then can a cost be attributed to the “social benefit”, allowing comparison between competing projects and the impact on Ratepayer charges going forward.

For example 2: A second problem is where a project doesn’t stand up to complete analysis.
- Initially under-estimate the project costs.
- Begin the project construction.
- Subsequently “discover” some additional costs.
- Then re-examine the investment analysis ignoring the “sunk costs”.

Poor quality project analysis might be overcome if there is adequate and sophisticated scrutiny prior to the first sod being turned. Assessment by an experienced and independent third party, (perhaps the Dept. of Local Government?), will ensure sufficient thoroughness of the project costs and the consequent economic impact on the Ratepayers.

If investment analysis is not open to transparent scrutiny, the result of the introduction of Rate capping will simply give rise to application for “special” consideration.

Is CPI an appropriate index?
It would be simplistic to suggest that the CPI represents the price changes for those goods and services required by local government. The question then, is as to whether or not the CPI is representative of the price changes of those goods and services offered by any one local government?
Summary of some of the influences on expenditure.

- **The price of goods and services** relative to those within the “basket of goods” measured by CPI. If the type of goods and services within the “local government basket of goods” tend to experience higher/lower price changes than for CPI, then the Rate cap mechanism should be higher / lower. This should be demonstrable.
- **The types of services delivered**: if there are additional services introduced, from one year to the next, that are either necessary or demanded by the community, then the Rate cap mechanism should be expected to be higher than CPI.
- Similarly, if the **qualities of services are** increased / decreased, then the Rate cap mechanism might be expected to be higher / lower than CPI.
- **Capital works**.
  - If the level of past maintenance was higher/ lower than required to sustain the capital assets, then the ongoing expenditure may likely be lower / higher, with the consequent impact being a lower / higher Rate cap. However, the Rate cap mechanism should guard against maintenance being restricted by insufficient funds and so deferring a funding problem.
  - If there has been an increase in capital expenditure for additional assets, driven by population growth, resulting in additional maintenance expenditure, the impact on Rates should benefit from economies of scale.
- **Employee costs** tend to outpace CPI; notwithstanding the potential for economies of scale, employee costs will tend to cause Rates to increase at a higher rate than CPI, but only if the base expenditure is already both necessary and sufficient.
- **Economies of scale**: economic growth within the local government region should be expected to deliver, on average, economies of scale and consequently a relative reduction to a Rate cap mechanism. If this is not being achieved then the push for economic growth might be questioned.

Conclusions
The notion of Rate Capping would seem to be a sound proposition. However a number of inherent problems will need to be addressed …

1. The use of CPI as the index to define the cap has the advantage of being well known but the disadvantage of requiring a number of adjustments. How will the adjustments be determined from one year to the next?
2. If a cap is applied to the Rates, it assumes that the Rates are fair and reasonable in the first place. How will the current Rate revenue be determined to be fair and reasonable?
3. Finally, should there be “special” adjustments to the Rates, and, if so, what are the circumstances and how will they be adjudicated?