Standing Committee on State Development

New South Wales Inquiry into the Ability of Local Governments to Fund Infrastructure and Services

United Services Union Submission

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1. Introduction

On 21 March 2024, the NSW House of Representatives Standing Committee on Regional Development Infrastructure and Transport announced an *Inquiry into the Ability of Local Governments to Fund Infrastructure and Services.* The new Inquiry will consider a range of matters, including financial sustainability and funding, evolving infrastructure and service delivery obligations, as well as workforce attraction and retention and labour hire practices.

The formal Terms of Reference for the Inquiry are as follows:

'That the Standing Committee on State Development inquire into and report on the ability of local governments to fund infrastructure and services, and in particular:

(a) The level of income councils require to adequately meet the needs of their communities

(b) Examine if past rate pegs have matched increases in costs borne by local governments

(c) Current levels of service delivery and financial sustainability in local government, including the impact of cost shifting on service delivery and financial sustainability, and whether this has changed over time

(d) Assess the social and economic impacts of the rate peg in New South Wales for ratepayers, councils, and council staff over the last 20 years and compare with other jurisdictions

(e) Compare the rate peg as it currently exists to alternative approaches with regards to the outcomes for ratepayers, councils, and council staff

(f) Review the operation of the special rate variation process and its effectiveness in providing the level of income Councils require to adequately meet the needs of their communities

(g) Any other related matters'.

In this submission, we address items (a) to (g).

2. Addressing the Terms of Reference

(a) The level of income councils require to adequately meet the needs of their communities

The NSW local government system comprises different categories of local council with differential revenue-raising capacities and significant disparities in local service provision, which face substantial spatial variations in input costs. Accordingly, metropolitan councils, regional councils, rural councils and remote councils face different fiscal challenges in providing adequate services to their respective local communities (Dollery, Crase and Johnson 2006; Dollery, Wallis and Allan 2006; Dollery, Kortt and Grant 2013). It is thus not possible to calculate a common adequate level of income for NSW local councils.

The question of an 'adequate' municipal income has numerous different dimensions. Firstly, aggregate income for all NSW local authorities is not the problem. Rather the distribution of income amongst local councils is problematic. This derives from a host of factors, including (a) grant allocations that are inadequate or incorrectly calculated; (b) local councils that have different socio-economic characteristics and hence different capacity to raise income through property taxes and fees and charges, with small rural councils typically the least able to raise adequate 'own-source' revenue; and (c) large differences in the revenue effort exerted by various NSW councils as a result of differences that existed back in 1975, compounded by five decades of rate-capping and demographic changes over time (Drew and Dollery 2015b).

Secondly, over the past several decades there has been a substantial change in the composition of local government service provision, characterised chiefly by a shift from 'services to property' to 'services to people' (Dollery, Wallis and Allan 2006). In essence, local councils are providing a growing quantum of discretionary goods and services, whilst simultaneously often ignoring basic needs, such as road re-sealing.

Thirdly, most NSW local councils do not levy fees and charges in line with production costs - or Long-Run Marginal Costs (LRMC) - and thus fees and charges often do not reflect the costs of service provision. Indeed, at present, municipal accounting weaknesses mean that most councils are not able to accurately identify the actual cost of providing most of the goods and services that they provide (Drew and Dollery 2015b).

Remedial policy measures are necessary to address these and other problems in municipal finance in the NSW local government system (Dollery, Kortt and Grant 2013). For example, what is required is for councils to extract a consistent revenue effort across the state, charge

prices at LRMC, and for a competent local government grants regime to make up the horizontal fiscal equalisation (HFE) differences between local councils. Moreover, the abolition of rate-pegging, or at least a much more flexible rate-cap methodology, is required (Dollery 2022).

(b) Examine if past rate pegs have matched increases in costs borne by local governments

At present, municipal costs in NSW local government are calculated by means of the Local Government Cost Index (LGCI). The LGCI measures price changes over a given year for goods, materials and labour employed by an 'average council'. Specifically, the LGCI computes the average change in prices of a fixed 'basket' of goods and services employed by local councils relative to the prices of the same basket in a base period. The LGCI has 26 cost components, encompassing *inter alia* worker benefits and on-costs, together with building materials for bridges, footpaths and roads. These cost components embody the purchases made by an average local council to conduct its 'typical activities'. In its LGCI calculation process, the Independent and Pricing Regulatory Tribunal (IPART) uses Australian Bureau of Statistics (ABS) price indexes for wage costs, producer prices and consumer prices. In computing these price indexes, the ABS includes quality adjustments in its price measures to accommodate increases in capital and labour productivity.

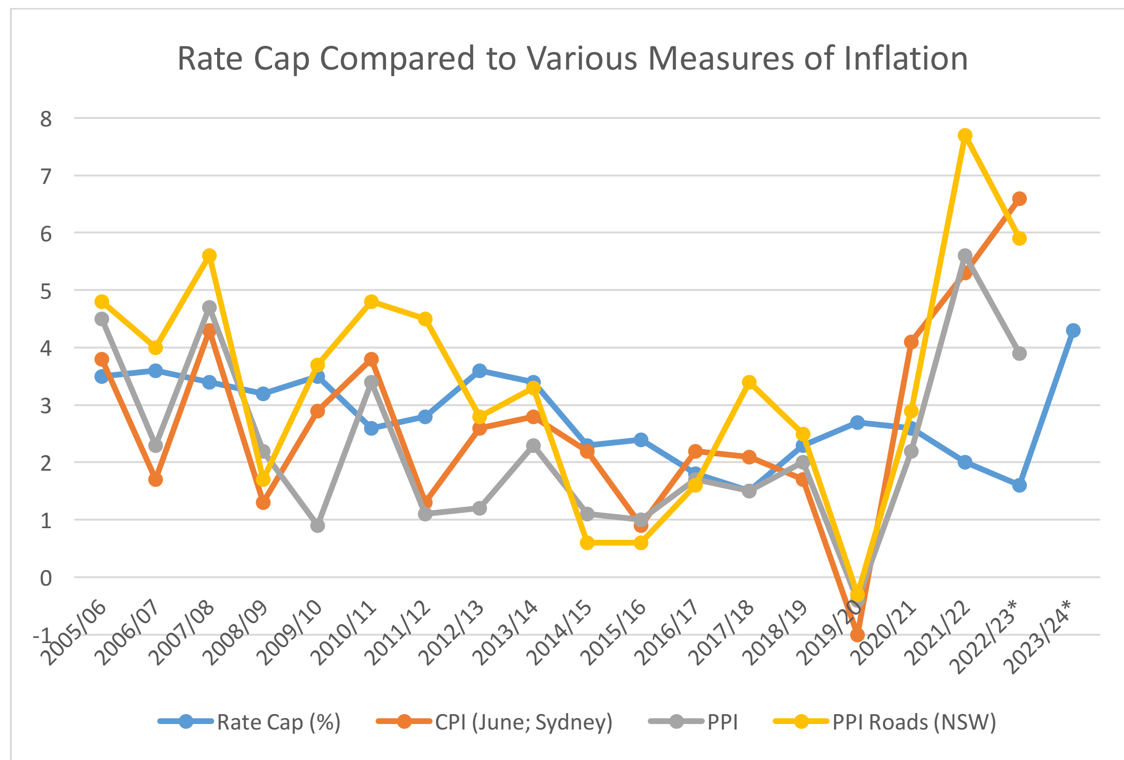
Use of the LGCI as a proxy for NSW local government cost escalation is problematical for several reasons. Firstly, different categories of local council, such as metropolitan councils, regional councils and rural councils, do not use the same input mix or basket of goods and services to provide their respective services given that the composition of their services differs. For example, in the Greater Sydney region, Sydney Water provides water and wastewater services, whereas in non-metropolitan NSW these services are largely supplied by local councils.

Secondly, metropolitan councils, regional councils and rural councils often face different cost structures for many of the resources they employ in service delivery, given the considerable spatial variation in costs that exists across NSW. In general, rural and remote councils typically bear higher costs than their metropolitan and regional counterparts.

Given the fact that input costs differ between different categories of local council, as well as between different geographical areas across NSW, it is thus not possible to generalise across the entire NSW local government system on the precise nature of the relationship between increases in municipal costs and adjustments to the rate-peg.

However, in recent work he did for the Federation Council, Professor Joseph Drew (2024) produced a useful graph (Figure 1) that aptly illustrates the deficiencies in the NSW rate-cap in terms of the level of the rate-peg, the Consumer Price Index (CPI), the Producer Price Index (PPI) and the PPI for Roads (PPI (Roads)). The PPI (Roads) is included in the graph since roads represent the most substantial component of NSW council costs. It should be noted that for the final two years covered by the graph, the rate-cap was a range and that some councils actually received less than illustrated.

Figure 1



As Drew (2024) has observed, the CPI has heavily influenced the IPART rate-cap determination. Moreover, it continues to be dominated by the CPI. Given the fact that CPI projections are often less accurate in a high inflation environment, post-2019/20 rate-peg determinations are more likely to be problematical.

Furthermore, as noted, the largest single item of municipal expenditure is local roads (Drew 2022). It is evident from the diagram that the PPI (Roads) is consistently above the rate-cap.

(c) Current levels of service delivery and financial sustainability in local government, including the impact of cost shifting on service delivery and financial sustainability, and whether this has changed over time.

Terms of Reference item (c) raises multifaceted dimensions of local government performance. In the interests of clarity, discussion falls into three main parts: the changing nature and composition of municipal service provision; financial sustainability; and cost shifting.

The Changing Nature and Composition of Local Government Service Provision

Australian local councils have traditionally provided a comparatively narrow range of local services, mostly 'services to property', financed through a complex mix of property taxes, grants, and fees and charges. However, over time, the amendment of the different Local Government Acts across all Australian state and territory local government systems has created the legislative scope for a much greater role for local municipalities (Dollery, Crase and Johnson 2006). As a result, the power of general competence embodied in these statutes has expedited a dramatic transformation of the composition of municipal service provision away from traditional 'services to property' towards 'services to people'.

Changes in the composition of municipal service provision have been occurring for several decades. For instance, in 2003, the Commonwealth Hawker Report (2003, p.9) observed that there had not only been increasing diversity across Australian local government service provision, but also an 'expansion of the roles beyond those traditionally delivered by the local sector'. This shift in emphasis in service provision had two main characteristics: (a) Local authorities were assuming responsibility for more social issues, including 'health, alcohol and drug problems, community safety and improved planning and accessible transport'; and (b) local councils were increasingly active in the application and monitoring of regulation, especially in 'development and planning, public health and environmental management' (Hawker Report 2003, p. 9).

Similarly, in its *Local Government National Report, 2003-04*, the (then) Commonwealth Department of Transport and Regional Services (DOTARS 2007, p.2) also recognized the ongoing changing role of Australian local government, noting that local authorities were 'increasingly providing services above and beyond those traditionally associated with local government' (DOTARS 2007, p. 2). It observed that 'local government now delivers a

greater range of services, broadening its focus from “hard” infrastructure provision to spending on social services, such as health, welfare, safety, and community amenities’.

The Commonwealth Grants Commission (CGC 2001) calculated trends in the composition of municipal outlays across Australian local government by function over the period 1961/62 to 1997/98. It found that councils had expanded human service functions sharply relative to their longstanding ‘services to property’ focus over a 35-year time period. For example, ‘general public services’ fell from slightly in excess of 20% of expenditure in 1961/62 to around 13% in 1997-98. The decline in ‘transport and communication’ was even more pronounced.

The CGC (2001) ascribed four main characteristics to the observed changes in the composition of local government expenditure:

(a) It comprised a continuous shift from ‘property-based services to human services’.

(b) The relative weight of ‘recreation and culture’ and ‘housing and community amenities’ had increased to about 20% of expenditure in each case.

(c) Expenditure on roads declined from more than 50% in the 1960s to just over 25% by 1997/98.

(d) Expenditure on ‘education, health, welfare and public safety’ expanded (CGC 2001, pp. 53-54).

The CGC (2001, p.54) concluded that ‘the composition of services being provided by local government has changed markedly over the past 30-35 years’. In essence, ‘local government is increasingly providing human services at the expense of traditional property-based services (particularly roads)’.

These trends appear to have continued. For example, the Allan Report (2006) observed that changes in NSW local government expenditure since 1995/96 exhibited three main characteristics:

(a) The ‘fastest growing activities have been housing and community amenities, public order and safety, and economic affairs, particularly within Sydney City’.

(b) ‘Transport and communications (largely road maintenance and depreciation, though not necessarily renewal) had a marked increase in 1996-97, but has stabilized since then’.

(c) ‘Health’ and ‘mining, manufacturing and construction’ both fell relative to the Consumer Price Index. (Allan Report, 2006, Ch. 7, p. 153).

It is thus evident that a longstanding and significant change has occurred in the composition of the services provided by Australian local government, including the NSW local government system. However, a caveat to this conclusion is required. These aggregate trends in the service mix disguise a high degree of diversity in municipal service provision between different local government systems across Australia, between metropolitan, regional, rural and remote local authorities, and between individual councils within each of these categories. For instance, water and wastewater services are a local government responsibility in some Australian jurisdictions, but not in others. In NSW local government, water services are delivered mostly by water utilities in large urban conurbations, but often by local councils themselves in regional, rural and remote areas. Similarly, local councils spatially distant from major urban centres often provide services previously supplied by Commonwealth agencies, state governments or the private sector, such as aged-care facilities, postal services, banking services and even undertaker services (see, for example, Dollery, Wallis and Akimov 2010; Dollery, Wallis and Allan 2006).

In NSW local government, the 2016 compulsory council amalgamation program generated substantial additional local service provision in forcibly amalgamated local councils through service ‘harmonisation’ across new enlarged local government entities as the range and level of service provision had to be equalised for all residents (Drew, McQuestin and Dollery 2023). Harmonization costs in this context refer to the expense of equalizing both the salaries and services across the former constituent council entities. Previously, local government services of the constituent entities had typically differed according to the particular tastes expressed by the local community in question, as well as in consequence of differential service capacities.

Once a municipal merger has been completed, it is reasonable for local residents to demand equal service standards, especially if property rates, fees and charges have been harmonized. Given the political risks associated with reducing service levels following a forced merger, local service levels tend to increase. In the case of the 2016 NSW amalgamation program, Drew, McQuestin and Dollery (2023) found that the costs of service provision in the new entities increased, in part due to service harmonisation.

Financial Sustainability in Local Government

Financial sustainability has come to occupy an important role in contemporary public policy discourse and this is reflected in the local government literature. While the concept of financial sustainability has much to offer the analysis of local government, especially the fact that it obliges scholars and practitioners alike to consider the inter-temporal dimension of local government policy-making, significant difficulties exist in giving precise meaning to the term in the local government milieu.

The genesis of contemporary concern with local government financial sustainability in Australia occurred in the Commonwealth Grants Commission (CGC 2001) annual report *Review of the Operation of Local Government (Financial Assistance) Act 1995.* The CGC (2001, pp. 52-53) identified five main reasons for the acute level of financial stress faced by many Australian local authorities, especially in non-metropolitan areas: (a) The devolution of responsibility for service delivery from higher tiers of government; (b) 'cost shifting' from higher tiers of government onto local government; (c) the increased complexity and standard of local government services mandated by state government regulation; (d) 'raised community expectations' of municipal services; and (e) 'policy choice' involving the voluntary improvement and expansion of municipal services by local councils themselves.

This analysis is by no means complete. For example, as Johnson (2003) has observed, the CGC (2001) list does not include the fact that local councils have also added to these financial problems by artificially holding their rates and charges at unsustainably low levels. The CGC (2001) list also ignores 'internal' governance and management factors that are potentially crucial. Nevertheless, the CGC report did serve to lay the foundations for subsequent investigations into local government financial sustainability.

In the Australian local government context, the pioneering PriceWaterhouseCoopers (PWC 2006, p.95) *National Financial Sustainability Study of Local Government* offered a useful definition of 'financial sustainability': 'The financial sustainability of a council is determined by its ability to manage expected financial requirements and financial risks and shocks over the long term without the use of disruptive revenue or expenditure measures'. This involves two elements: (a) Councils should maintain 'healthy finances', given current expenditure and revenue policies and foreseeable future developments; and (b) councils must ensure infrastructure expenditure 'matches' asset planning.

With respect to the practical application of this definition, PWC (2006) applied it to a stratified sample of 100 local authorities using five financial KPIs:

- 'Operating surplus' represented 'total operating revenue less total operating expenses'. If an operating deficit exceeded 10% of total revenue, then it placed the local council at financial risk.
- 'Interest coverage' measured a council's ability to pay interest on its debt and was calculated as the ratio of 'Earnings before Interest and Tax' (EBIT) to 'borrowing costs'. A ratio value below 3 indicated financial unsustainability.
- 'Sustainability ratio' (or the ratio of capital expenditure to depreciation) measured changes in the asset base of councils. If the ratio exceeded unity, then the asset base was increasing. However, the PWC Report (2006, p. 97) stressed that the sustainability ratio must be 'interpreted with care' due to inconsistent asset valuation procedures.
- 'Current ratio' (or the ratio of current assets to current liabilities) measured a council's capacity to meet its short-term debt obligations. A sustainable council must have a current ratio at least equal to unity.
- 'Rates coverage' represented total rates revenue as a proportion of total costs. An arbitrary 'benchmark' of 40% indicated 'adequate self-funding'.

The PWC (2006) national report found that there was a national local government infrastructure backlog ranging between $12.0 billion and $15.3 billion, with an annual shortfall in expenditure on existing local infrastructure renewal of between $0.9 billion to $1.2 billion. This implied that between $1.8 billion and $2.3 billion per annum would be required to address the (then) deficit in maintenance spending on existing infrastructure and eliminate the current local infrastructure backlog. This represented the equivalent of between $2.6 million and $3.3 million per council per annum, which was far beyond the financial capacity of the vast majority of Australian local councils in 2006.

A substantial scholarly effort has also investigated financial sustainability in local government at a system-wide level and at the local municipal level (see, for example, Dollery, Kortt and Grant 2013; Farvacque-Vitkovic and Kopanyi 2014; Bisogno, Cuadrado-Ballesteros and García-Sánchez 2017; Dollery, Kitchen, McMillan and Shah 2020, for surveys of this literature). Although financial sustainability involves almost all dimensions of local government, the scholarly literature has concentrated on the empirical investigation of certain aspects of financial sustainability, especially operating performance,

financial flexibility, financial solvency and liquidity management, despite the potential impact of other factors, such as administrative intensity. Australian empirical research has covered all of these dimensions of financial sustainability, including a recent study of the impact of administrative intensity on financial sustainability in NSW local government (Yarram, Tran and Dollery 2024),

Empirical scholars have examined the impact of the 2016 NSW compulsory municipal amalgamation program on the financial sustainability of NSW local councils, especially those local councils that were forcibly merged (Drew, McQuestin and Dollery 2021; 2023). Drew, McQuestin and Dollery (2021) found that after four full financial years, the NSW forced amalgamation program had clearly damaged the financial sustainability of affected councils, especially in terms of significant and persistent increases to unit costs.

In the material that follows, we present some graphs drawn from data that gives us grounds for grave concern regarding financial sustainability in contemporary NSW local government. All these graphs were obtained from Professor Drew who has compiled an extensive database for the period 2008 to 2023 inclusive. The data is sourced from the notes of audited financial statements, OLG time series data on number of assessments, Grants Commission data on road lengths and demographic data from the ABS *Data by Region* reports. Professor Drew explains each graph in detail in the relevant videos at his YouTube channel *Professor Joseph Drew*. It is noted that this is a community service that Professor Drew offers in his own time with his own resources and does not form part of his remunerated academic duties.

The graphs are presented for the entire state of NSW and then disaggregated to (a) urban councils and (b) rural councils. This classification of councils is in accordance with the Australian local government classification system and is important because urban and rural councils differ markedly in terms of both the services they provide, as well as their potential sources of revenue to fund these services.

The first set of graphs that we will examine relate to the level of unrestricted cash typically held by NSW local governments [Professor Drew explains these graphs in the video at https://www.youtube.com/watch?v=6T2bWQp2FVU]. Unrestricted cash refers to those funds not earmarked for a particular purpose or not restricted by law. In essence, it represents money that local governments might use to plug deficits or meet unexpected expenses. A general rule of thumb is that councils ought to have two to three months of

cash expenses available in their unrestricted cash. However, it is alarming to note that a number of councils in NSW currently have negative unrestricted cash.

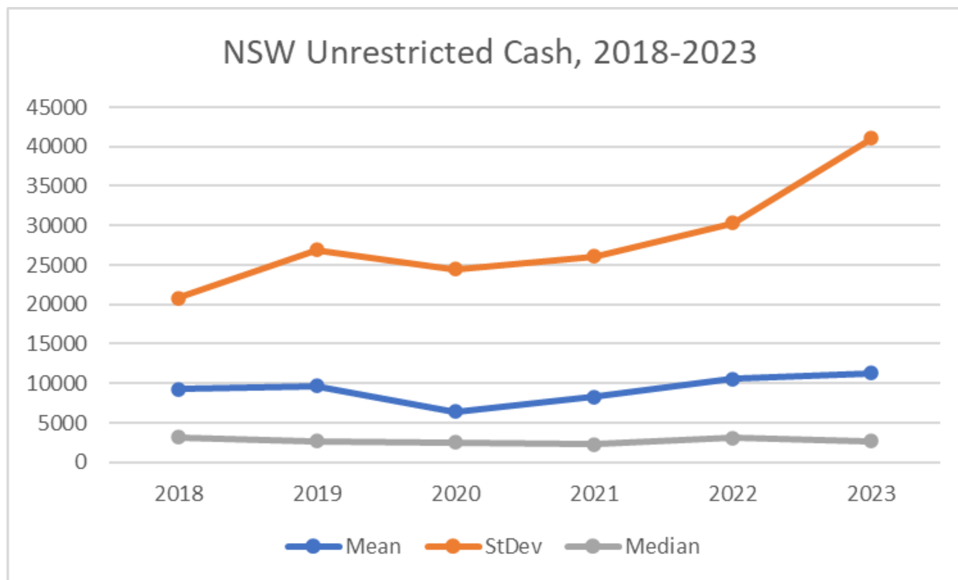
Figure 2 presents the data in nominal terms for the whole state for a period of six years. Three measures relating to central tendency are used to provide a comprehensive picture. The median (grey line) is the middle number after putting all the data in ascending order. When data is skewed by particularly large or small data points, then the median tends to be the most reliable measure of typical performance. The mean or average (blue line) is the sum of all the data points for a given year, divided by the number of councils. We note that for the most recent year we are still missing the data for twelve councils due, for the most part, to extraordinary and inexplicable delays by the NSW Auditor-General. This is very concerning because the councils which are still missing audited financial data (more than nine months after the completion of the relevant financial year) tend to be the ones in the most difficult position. The orange line is the standard deviation, which in simple terms is a measure of the average spread in the data. The standard deviation provides important information regarding the distribution of individual councils with respect to the mean; when the standard deviation is high (as it is in Figure 2), then it tells us that there is a great gulf between the councils at the bottom end of the distribution and those at the top. Otherwise stated, with a large standard deviation we know that results will diverge significantly from the average.

Figure 2 shows us that there is a relatively large gap between the mean and the median, which suggests skewing by some particularly high or low numbers. This is reinforced by the standard deviation that is extremely high and further suggests that there is a wide gulf between the councils at the bottom end of the distribution relative to those at the top. With respect to the councils at the bottom end of the distribution, we note that there are far too many councils with negative unrestricted cash and that these entities are in a perilous situation, especially if they are projecting or recording deficits. Indeed, we wonder why these councils are not taking strident measures to reverse matters and indeed are not being provided with intensive mentoring and advice from the OLG or IPART.

In general, the data should be a cause for concern because cash levels ought to be increasing, at least in line with inflation. There is even more reason to be concerned when one reflects on the fact that there are still a large number of councils which are not restricting prepaid Financial Assistance Grants (FAGs)(according to the 1995 Commonwealth legislation).

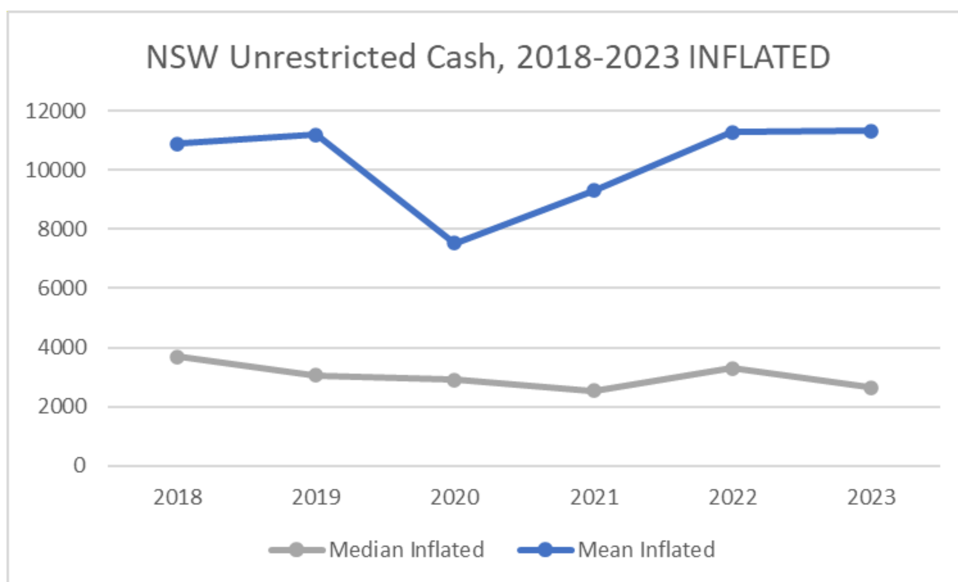
Moreover, as noted earlier, we are missing some twelve councils due to audit delays and these councils tend to be struggling.

Figure 2



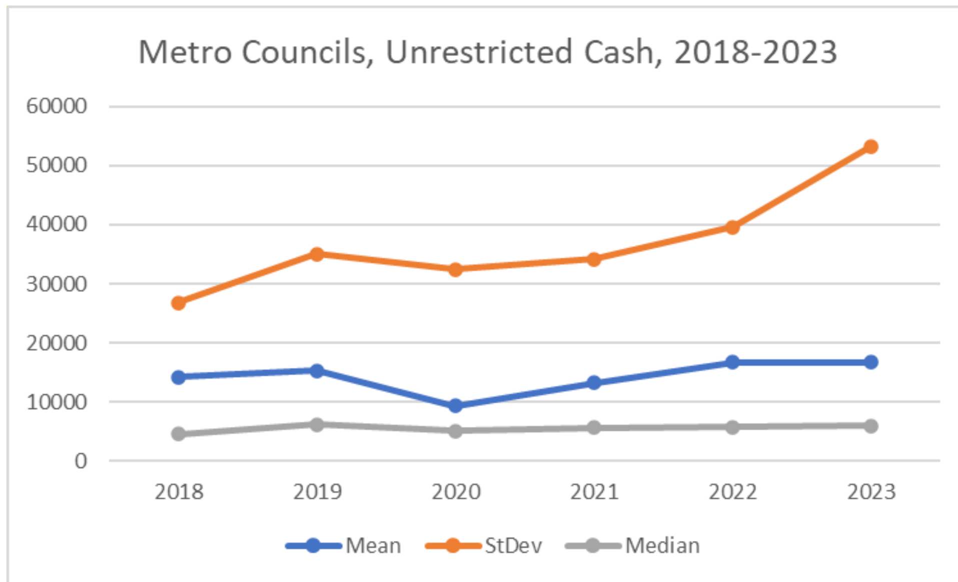
To make matters clearer, in Figure 3 we have inflated data to 2023 dollar terms using the appropriate ABS index numbers. It is now clear that matters are deteriorating at an alarming rate.

Figure 3



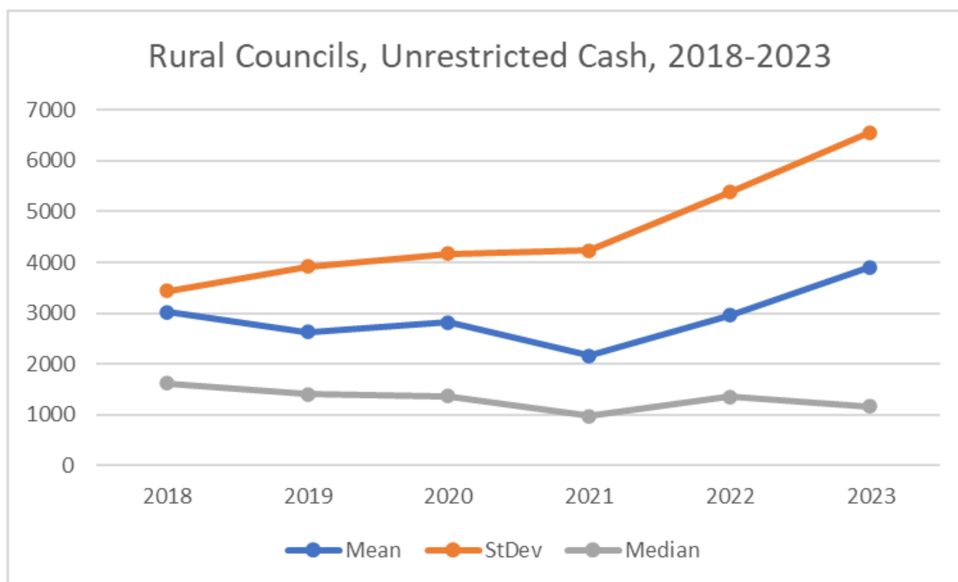
In Figure 4, we look at just the urban councils, which are characterised by a good deal of spread that has widened substantially in recent years. This confirms that there is a significant difference between councils relative to the typical result.

Figure 4



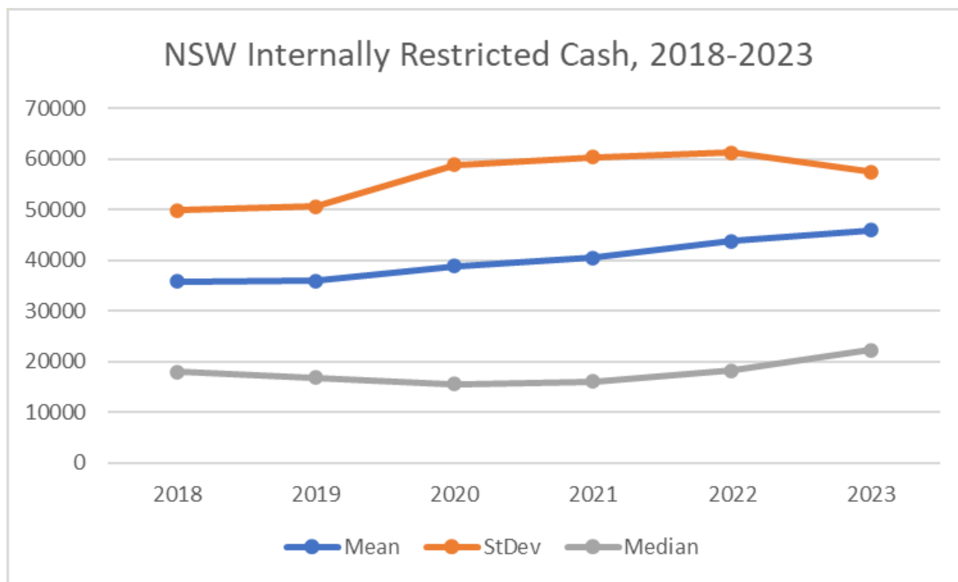
In Figure 5, we present the data for rural councils. It should be noted that the axis (in thousands of dollars) is around ten times smaller in magnitude. In addition, it is clear that skewing is a much bigger problem for the rural cohort, in common with the gap in the distribution of results.

Figure 5



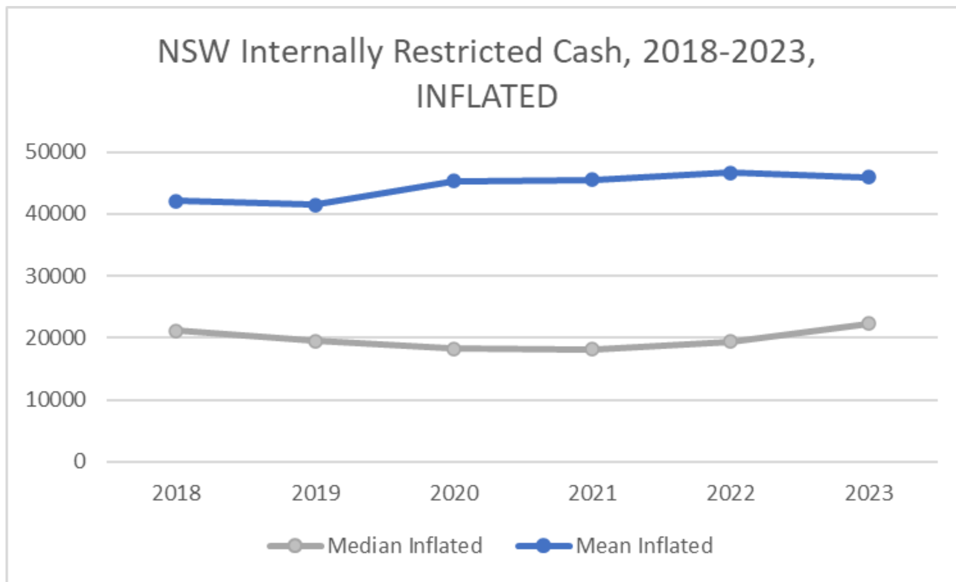
In Figure 6, the standard deviation for internally restricted cash is higher than it is for unrestricted cash, although so are the mean and median. Internally restricted cash includes important items such as staff entitlements and garbage tip remediation monies. Many councils also internally restrict prepaid FAGs and, given recent stretches to the duration of these, we would expect upward sloping lines. Once again, there is a noticeable difference between the median and mean that suggests a good deal of skewing.

Figure 6



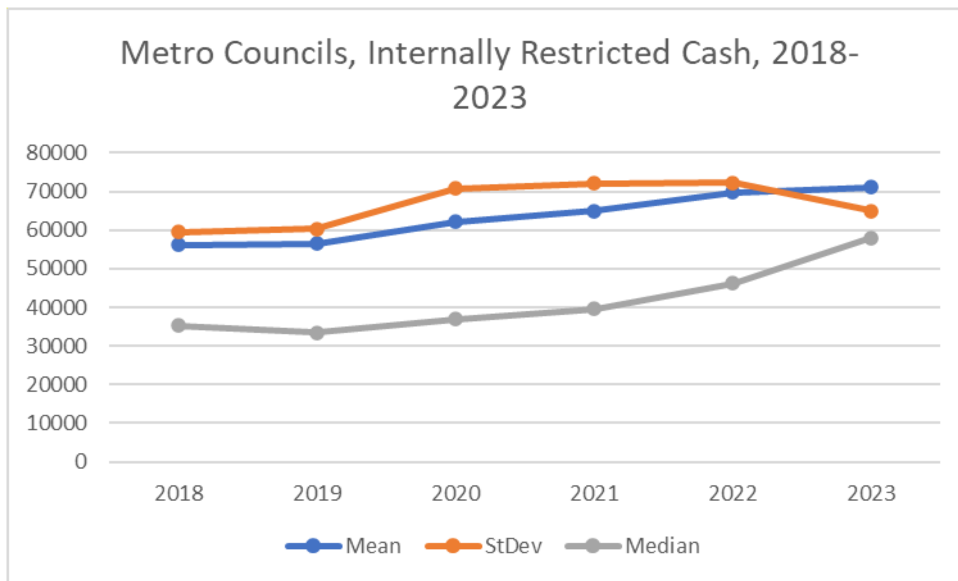
When we inflate the nominal data, as we can see in Figure 7, we quickly find that things are for the most-part flat, which is a big concern given the prepayment of FAGs, as well as the fact that staff liabilities tend to increase in line with pay increases which have been significant of late.

Figure 7



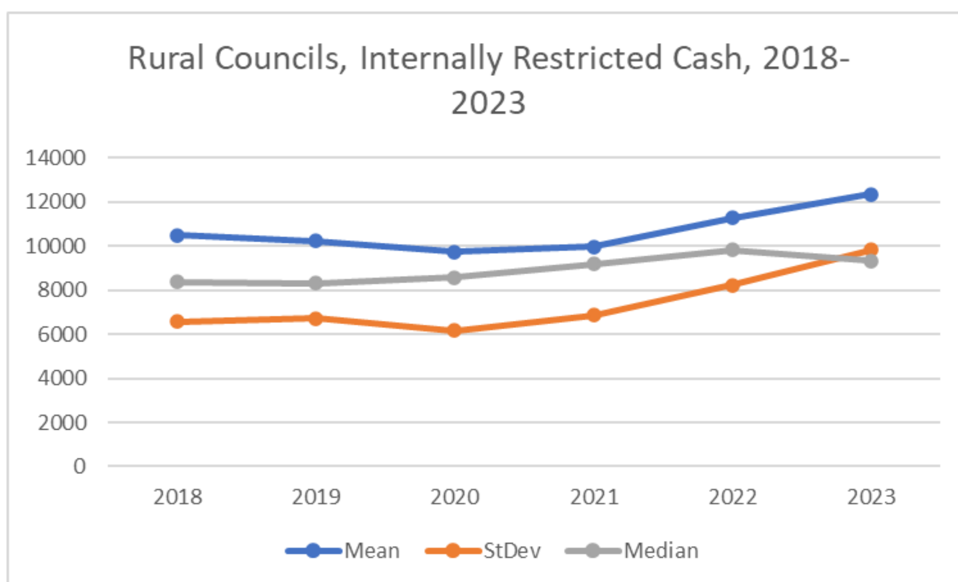
For urban councils, the most notable feature in Figure 8 is a narrowing in the gap between the mean and the median, echoed by a decline in the standard deviation. In general, this particular part of the trend is desirable – unlike with unrestricted cash, we are not seeing the ‘have nots’ decline at the same time as the ‘haves’ grow.

Figure 8



In Figure 9, the effect is even more noticeable in rural councils, which is broadly to be expected given their particular characteristics. However, setting aside the pleasing convergence between individual councils, the overall picture for internally restricted cash is still concerning.

Figure 9



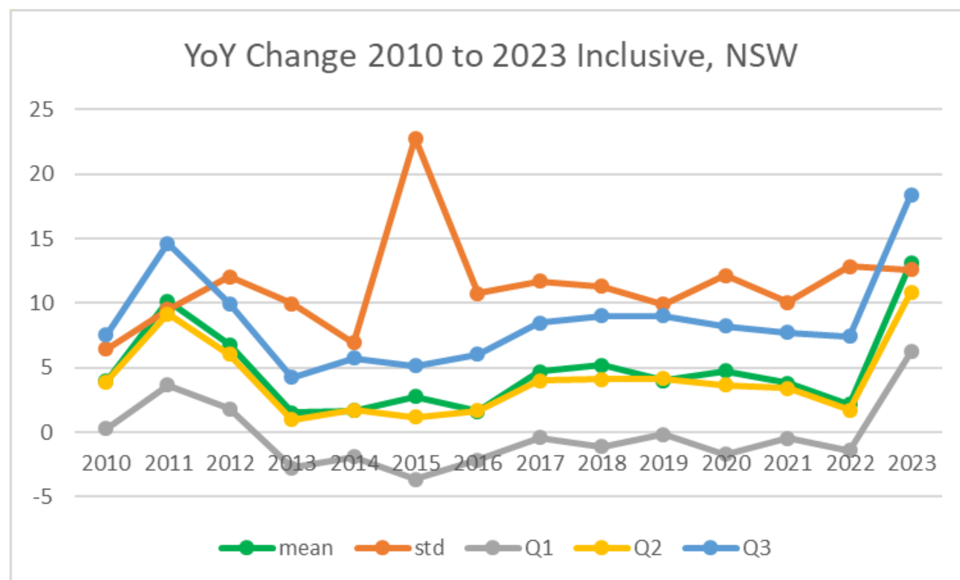
What is even more concerning is the dramatic increase in unit costs, which have not been matched at all by increases in rates or grants. [Professor Drew presents this data at https://www.youtube.com/watch?v=CL989GPoW98].

Unit cost is best measured for an analysis of this kind by dividing cash expenses by the total number of assessments. A complete analysis would employ Data Envelopment Analysis (DEA) or Full Disposable Hull (FDH) analysis, but this has not yet been undertaken.

Figure 10 provides various measures of central tendency relating to an account of the year-on-year percentage change in unit costs. The low is notable for occurring proximate to the Fit For The Future (FFTF) debates which dampened spending in line with the prevailing focus at the time on financial sustainability and prudent stewardship (although there was also a good deal of manipulation of accounting accrual data around this time as evidenced in Drew (2017) and Drew and Grant (2017)). The recent spike in the most recent financial year data is extremely concerning and it is the highest since at least 2010. It should also be recalled that we are missing the data from some dozen councils because of NSW Auditor-General delays.

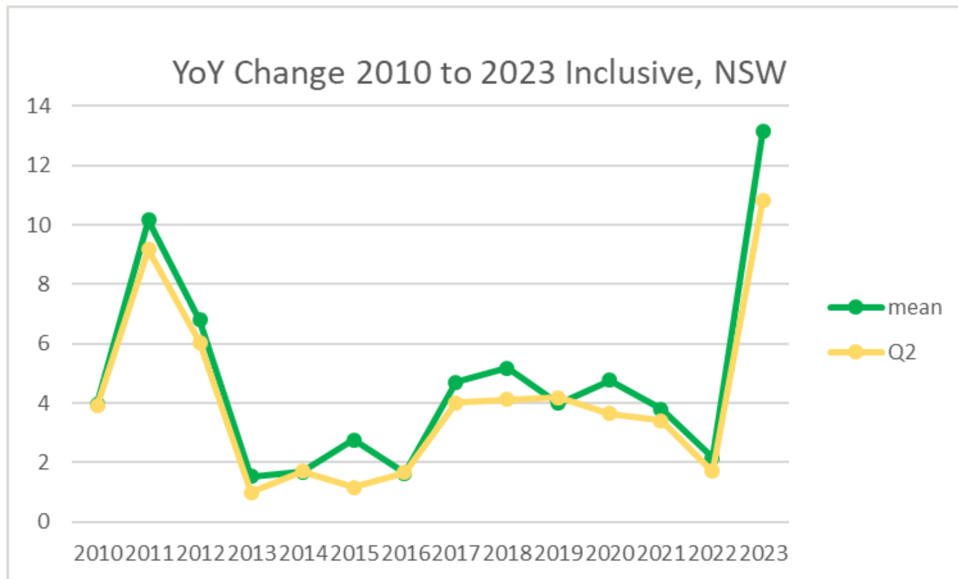
Needless to say that revenue increases have not kept pace with expenditure, which explains much of our earlier data on cash levels. This disparity cannot be accommodated over the long-term without a crisis occurring for many councils, or indeed the sector as a whole. Please note here that Q1 is quartile 1 (the middle point of the first half of the data whereby twenty-five percent of data points fall below this level) and Q3 is quartile 3 (the middle point of the top half of the data which is exceeded by twenty-five percent of councils).

Figure 10



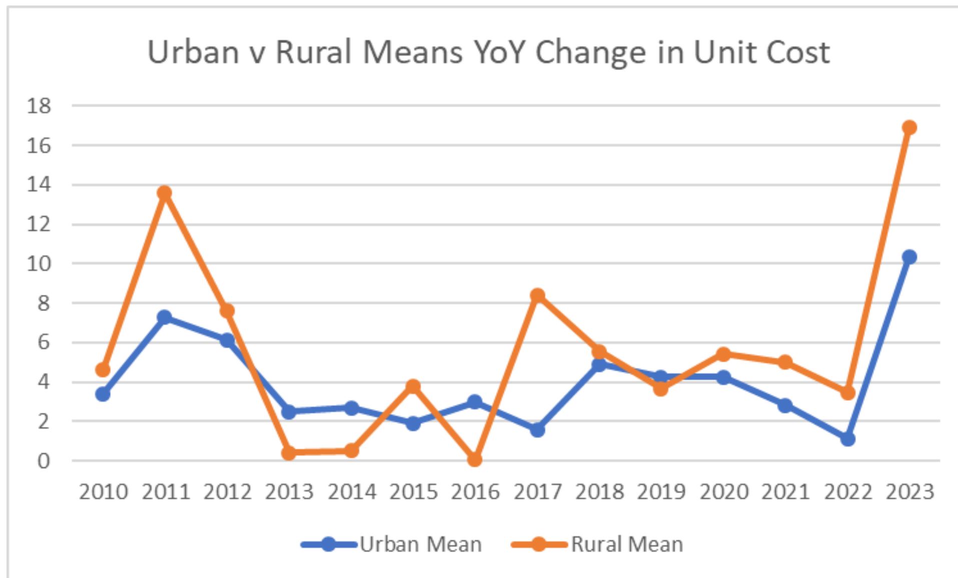
Stripping out the various additional measures of central tendency (Figure 11) renders matters even starker. It is noteworthy that here the median corresponds closely to the mean, which suggests that both are good measures of typical outcomes in this particular case.

Figure 11



In Figure 12, we present a comparison of the means for urban and rural councils respectively, with respect to year-on-year change in unit cost. A common theme throughout these graphs is that rural councils are suffering disproportionately relative to their urban peers. Proportionately larger infrastructure responsibilities (mostly roads), less potential to extract non-rate revenue, chaotic and dysfunctional grant allocation, and the rural forced amalgamations have hit this part of the sector especially hard and many councils are now well on the way to fiscal ruin. However, it should be noted that several peer reviewed studies have shown that rural councils are, on the whole, considerably more technically efficient than their urban peers (see, for example, Drew (2022)).

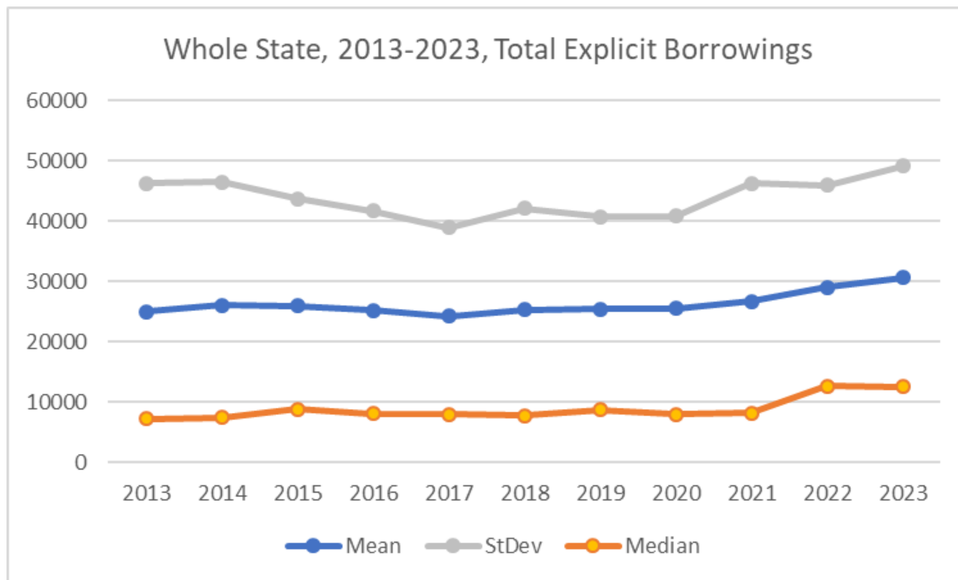
Figure 12



Professor Drew has also examined the changes to total explicit borrowings [his video on this topic can be found at https://www.youtube.com/watch?v=SnMJAmJYHrs]. It is important to note that this data refers to explicit borrowings only and not the much more worrying implicit debts carried by NSW local governments (Drew 2022). Implicit liabilities, such as neglected road sealing, are much more worrying because the debt is likely to be far greater than the value of the maintenance foregone. For example, if roads are not resealed on time, and the whole structure consequently needs to be dug-up and re-laid, then the cost is approximately eight times larger than it would have been had matters been dealt with in a timely fashion. Moreover, the data relating to implicit debts is significantly subject to distortion, which means we can only guess at the extent of the ticking time bomb.

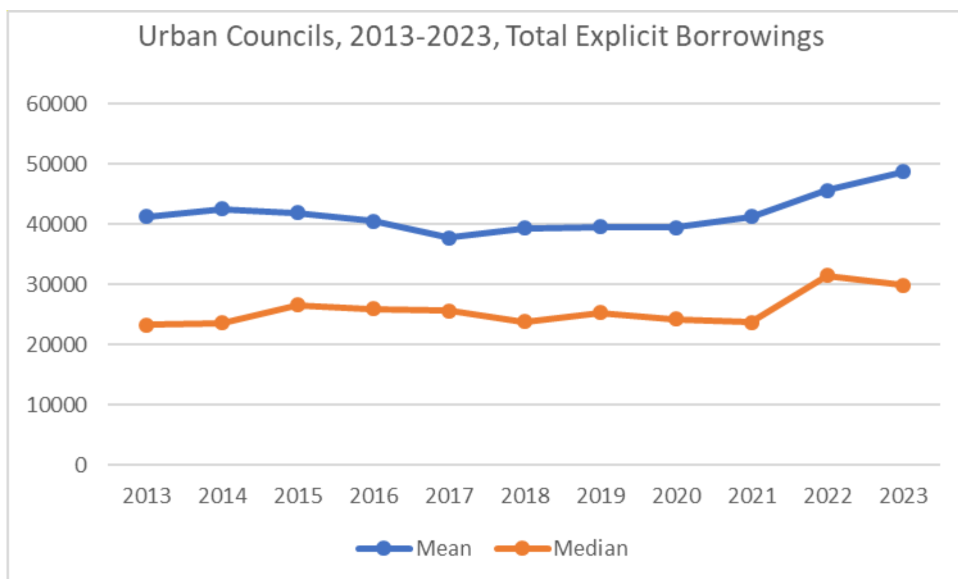
Figure 13 illustrates key measures of central tendency and spread for the whole state with respect to total explicit borrowings (which is the sum of current and non-current liabilities as per the audited financial statements). We would expect this figure to grow slightly over time in line with the time value of money. What is concerning is the sudden uptick in explicit liabilities in the last few years which echoes much of the data that we have already presented.

Figure 13



In Figure 14, it is noteworthy that the uptick is more pronounced for urban councils. Some of this is to fund new infrastructure to accommodate population growth consequent upon immigration, whereas other debt is more a reflection of stimulus efforts in the wake of COVID-19.

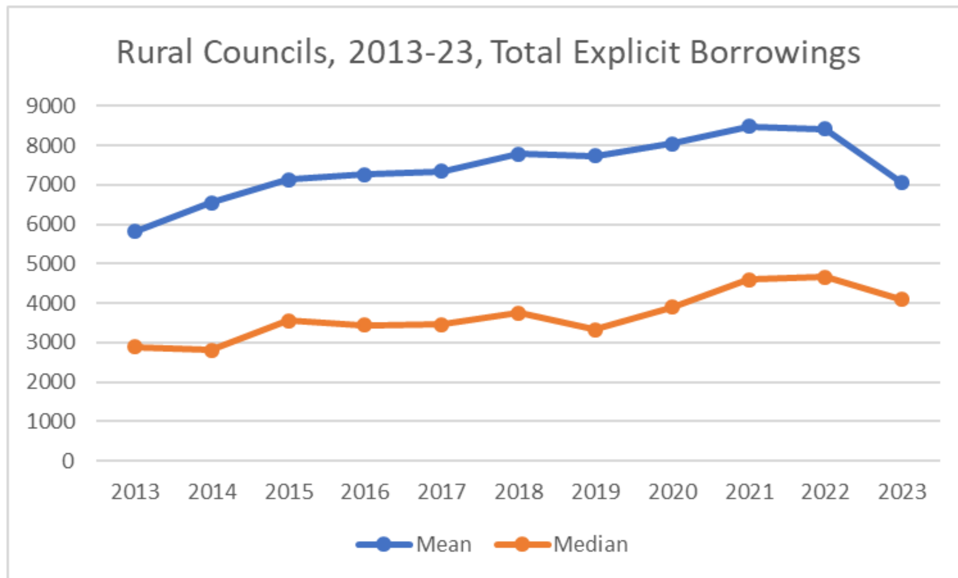
Figure 14



In Figure 15, explicit debt levels at rural councils are much lower, which reflects the debt aversion that is typical in rural areas. Debt aversion is not necessarily bad since it can lessen

the risk of intergenerational inequity. As Drew (2022) argues, significant scaffolding is required for the morally licit use of debt. There is a pronounced moral hazard associated with taking out debt for the next generation to repay, especially given the political attractiveness of this option over other policy options, such as increasing rates or fees. It is also interesting to note that rural councils seem to have put far more effort into paying down the face value of their debt, relative to their urban peers.

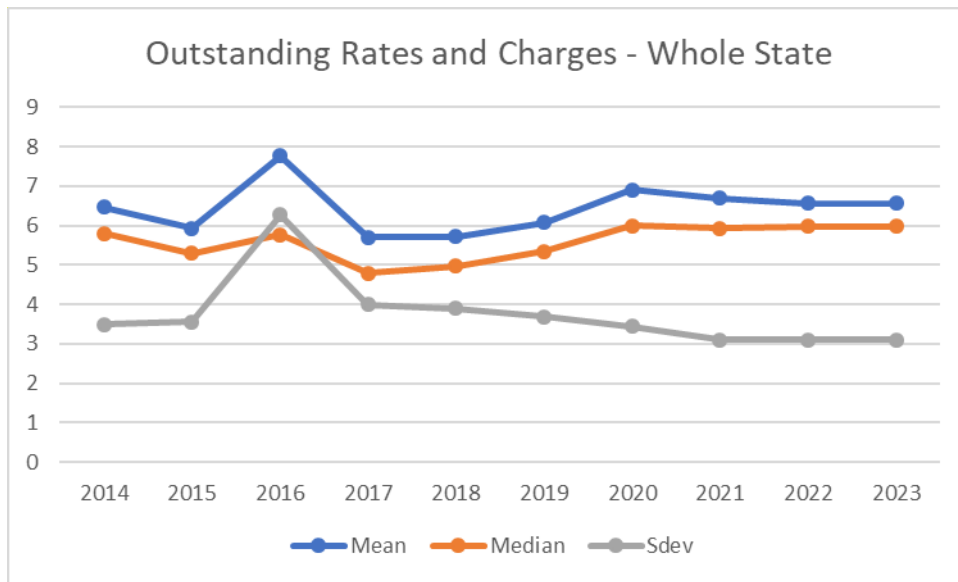
Figure 15



There is no single remedy to alarming declines in financial sustainability of the kind found in contemporary NSW local government, but certainly increases to taxation must be considered. [Professor Drew investigates ten years of outstanding rates and fees data in his video available at https://www.youtube.com/watch?v=_mt9PjOg5CY].

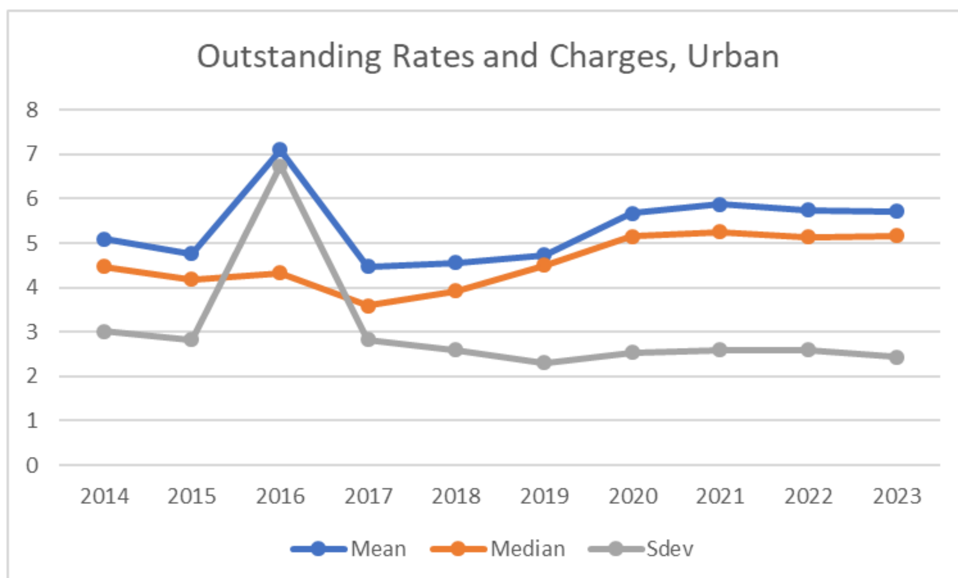
Despite much ado about the cost-of-living crises and complaints at every SRV round, the data which closely reflects capacity to pay tells a somewhat different story (Figure 16). Outstanding rates and charges did increase in the wake of the COVID-19 interventions, but probably far less than most might expect. Moreover, average percentages of outstanding revenues have been decreasing marginally since that time. We also need to be mindful that not all councils exert the same efforts in recovering revenues that they are owed, with some clearly more effective than others.

Figure 16



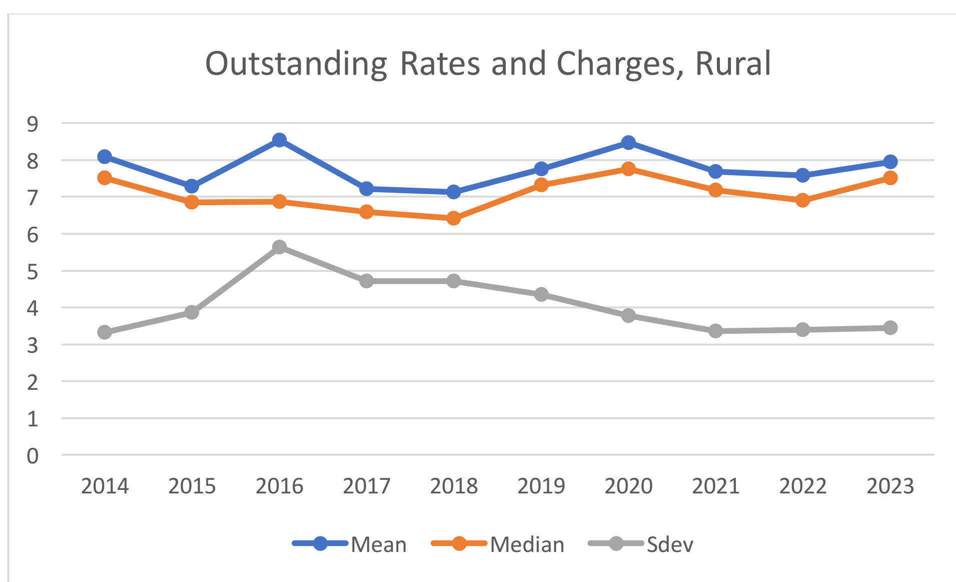
Outstanding rates and charges are considerably lower for urban councils (Figure 17), relative to their rural peers. This is in line with the findings of scholarly work which has shown that the revenue effort practiced by urban councils is considerably lower; that is, on the whole, urban councils extract a much lower proportion of the incomes accruing to residents than rural councils (Drew and Dollery 2017).

Figure 17



In Figure 18, we see this starkly when the rural data is stratified. In addition, to a considerable disparity in revenue effort, rural councils also tend to be more subject to economic shocks, especially fluctuations in the prices of commodities and adverse weather. Moreover, they often encompass land of little economic value (so-called ‘bush blocks’), where the cost benefit of paying land taxation may be significantly different to what it is in towns or cities. In sum, there may be scope to increase rates and charges in urban areas, but relatively less scope to do so in rural areas.

Figure 18



As we noted at the outset of this section of our discussion on financial sustainability in NSW local government, we have presented only a small subset of the data required to get a comprehensive picture of financial sustainability. However, the empirical material we have employed certainly gives solid cause for concern and underlines the importance of funding robust scholarly work to (a) empirically quantify our present financial sustainability situation, (b) monitor financial sustainability over time, and (c) use the data derived from these exercises to suggest evidence-based policy solutions.

An alternative perspective on the parlous state of financial sustainability in contemporary NSW local government can be gathered from the number of local councils that have sought Special Rate Variations (SRVs) in recent years in order to remain financially viable. Table 1 summarises the SRV approvals for the 2023/24 fiscal year:

Table 1: 2023/24 Special Rate Variation Approvals

Council	Amount	Purpose
Armidale	58.8% over 3 years	
Bega Valley	48.3% over 2 years	
Bellingen Shire	31.06% over 4 years	
Canada Bay	32.53% over 4 years	
Federation Council	39.2% over 2 years	Partial approval only
Hornsby Shire	31.05% over 4 years	
Junee Shire	32.19% over 2 years	
Lithgow	45.78% over 1 year	
Liverpool Plains	18.1% over 1 year	
Port Stephens	31.29% over 3 years	
Queanbeyan-Palerang	64.3% over 3 years	
Snowy Monaro	52.48% over 4 years	
Strathfield	92.83 over 4 years	
Tenterfield	43% over 1 year	Partial approval only
Tweed Shire	6.35% over 1 year	
Walcha Council	57.74% over 3 years	
Woollahra	22.23% over 2 years	

Source: Professor Joseph Drew (2023)

The financial plight of local councils forcibly amalgamated under the 2016 compulsory municipal merger program is illustrated in Table 2 showing the SRVs granted to compulsorily consolidated councils following the lifting of the rate freeze in the aftermath of the amalgamation program.

Table 2: SRVs for Amalgamated Councils since Rate Freeze Lifted

Local Government	Tax Increase Approved	Year Applied
Armidale	58.8% over 3 years	2023-24
Federation	39.2% over 2 years (temporary only approved; permanent 75% rejected)	2023-24
Snowy Monaro	52.48% over 4 years	2023-24
Central Coast	15% temporary for 7 years	2022-23
Snowy Valleys	35.95% over 2 years	2022-23
Armidale	10.5% over 1 year	2021-22
Canterbury-Bankstown	36.34% over 5 years	2021-22
Central Coast	15% temporary for 3 years	2021-22
Cootamundra-Gundagai	53.5% over 4 years	2021-22
Federation	8% over 1 year	2021-22
Georges River	32.6% over 5 years	2021-22

Source: Professor Joseph Drew (2023)

Taken together, the information on SRVs in Table 1 and Table 2 is striking in at least two respects. Firstly, the extent of property tax increases approved far exceeds earlier rate increases granted in SRVs, with the Queanbeyan-Palerang increase at 64.3% and the Armidale increase at 58.8% setting new records! Similarly, the sheer number of SRVs is exceptional. These features of recent SRVs serve to illustrate the acute financial sustainability problems in contemporary NSW local government.

Cost Shifting in Local Government

In *Australian Local Government Economics*, Dollery, Crase and Johnson (2006, p. 238/9) contend that cost shifting in the Australian municipal milieu has four broad components:

(a) Grant Funding: Local government grants from federal and state governments have fallen in real terms. Moreover, ‘this is compounded by the fact that grants have failed to keep pace with changing responsibilities’.

(b) Service Gaps: Local government has had to fill ‘the gap left by state and federal governments either withdrawing services or their failure to implement/provide services required by the community’. Furthermore, ‘local government has been required to “pick-up” services as a result of the direct transfer of “ownership” of infrastructure from another sphere of government’, such as aged care facilities in NSW.

(c) Agency Fees: Fees imposed by higher levels of government have increased as ‘state and Commonwealth agencies have sought to recover a range of costs by increasing fees, license contributions and other charges imposed on councils’.

(d) Legislative Requirements: Australian local councils have faced ‘major increases in accountability and compliance requirements without adequate recognition of the attending costs’. In addition, ‘legislation has required councils to provide concessions and rebates, with no compensation payment’; ‘services have formally referred to, and/or have been assigned to local government through legislative and other state and/or federal instruments, without corresponding funding’; local councils have been required to be ‘the sole provider of essential/important local services’; new services that ‘have no historical funding precedent have been mandated’; and fees and charges that ‘local government is permitted to apply, for services prescribed under state legislation or regulation, have little if any correlation to the cost of providing the service’.

Given the complexities of defining and measuring the impact of cost shifting on local government, in practice the optimal method of approaching the problem considers specific and incontrovertible examples of cost shifting that are amenable to measurement and are not beset by definitional problems or a blurring of responsibility between the different levels of government. It is thus difficult to derive aggregate estimates of cost shifting.

Nevertheless, an important case of this kind is the spatial impact of the provision of pensioner rate concessions by local authorities in NSW under the *Local Government Act 1993*. In terms of this legislation, a person meeting the definition of an eligible pensioner can claim various rebates on the rateable charges levied on their principal place of abode.

These rebates are constant across NSW local government jurisdictions, regardless of the differential ability to pay of both beneficiaries and local councils. Dollery, Johnson and Byrnes (2008) examined the uneven spatial impact of this form of cost shifting on different NSW councils with different fiscal capacities and different demographic characteristics.

Dollery, Johnson and Byrnes (2008) found that substantial differences existed between different categories of local government. In general, the burden of the NSW pensioner rate concession fell most acutely on municipal jurisdictions with the lowest ability to meet this impost in terms of both average earnings and rateable capacity. Moreover, although the NSW Local Government Grants Commission takes into account the financial circumstances of individual councils in its grant calculations, severe constraints on the magnitude of actual grants paid to councils means that grant compensation for rate concessions falls far short of their real cost.

Dollery, Johnson and Byrnes (2008) argued that, for designated recipients of pensioner rebates who are not in fact able to pay their full rates bill, other possibilities existed apart from the present NSW council-administered and part-funded pensioner rate concession. Firstly, the standard theory of fiscal federalism prescribes that the central government should carry out macroeconomic redistributive measures, not lower tiers of government (Oates 1972). This prescription is already embodied in most Australian income redistribution programs, like unemployment benefits and the age pension. Accordingly, the Commonwealth government should thus assume responsibility for pensioner rate concession programs, and not the present combination of state and local government, as in NSW.

A second alternative approach derives from the presumption that pensioner rate concessions are regressive. Following this assumption, it can be argued that the eligible categories of pensioner in NSW should fund their own rate concessions through the capital gain they may reap on the sale of their homes. Put differently, they could deduct the amount of the rate concession they received during the ownership of their residence from the capital gain accrued on the disposal of their residence, either upon their death or their transfer to another location. This is generally referred to as a ‘reverse mortgage’. Under this funding arrangement, a pensioner would be loaned money on the argument that while they may be ‘income poor’, they may simultaneously be ‘asset rich’.

Recent examples of new cost shifting devices include the move to centralised auditing, the mandatory establishment of Audit Risk and Improvement Committees (ARIC), the efforts to include the Red Fleet on local government books for accounting accrual purposes, and the fiscal stimulus programs during COVID.

Firstly, the centralisation of the auditing functions was supposed to improve the delivery of the service, including consistency in reporting. However, it also increased audit costs considerably, which in many councils more than doubled (McQuestin *et al.* 2021). It is ironic that some councils still have precisely the same auditor doing the work that they had prior to centralisation, largely because the Auditor-General's office outsources much of the activity. In addition, the speed of auditing has slowed tremendously. For instance, as mentioned, as at the end of March 2024, there were still some dozen councils that did not have audited financial statements publicly available for the period ended 30 June 2023. We note that s428 of the Act (NSW) requires audited financial statements to be available by the end of November each year. We cannot recall a time since the advent of centralised auditing when this requirement has indeed been universally satisfied.

Furthermore, the quality of the central auditing is questionable. For instance, the Auditor-General failed to discover the substantial problems at Central Coast Council in three successive audits. In addition, the notes of financial statements often miss important information. Furthermore, the efforts to bring greater consistency to depreciation accrual practice may have gone too far, and now likely run counter to the intent of Australian Accounting Standard 116 (McQuestin *et al.* 2021; Drew 2022). We are also aware of serious complaints against the Auditor-General (including what appears to be a legitimate dispute raised by Cessnock Council). Moreover, the financial sustainability report produced by the Auditor-General's office employs flawed metrics. It thus has much potential to distort decision-making, in addition to adding little value. In sum, fees for auditing have increased substantially whereas the quality of the work has declined alarmingly, putting the financial sustainability of the sector at greater risk.

Secondly, the Red Fleet, introduced by the Auditor-General's office, is a vexed issue. We agree with various missives by LG Solutions, and the remarks made by various Councils, as well as Professor Drew, that the Auditor-General is in error on this matter. The Australian Accounting Standards are quite clear; local governments do not possess unfettered control over these assets. It is thus wrong to require councils to account for the

assets on their consolidated statements. Doing so effectively transfers additional expenses onto councils.

Thirdly, the mandatory ARIC Committees are another bone of contention. We have worked with many councils where the ARIC committee has failed to perceive serious financial sustainability predicaments, or failed to offer useful advice to senior decision-makers to improve matters. We cannot see how most ARIC committees add value to the existing audit process governed by the Australian Auditing Standards. However, they do add considerable cost. Moreover, it is not simply the direct pecuniary costs, but significant indirect costs for staff to produce reports, attend meetings and chase down various rabbit holes (that distract them from more important tasks). We are yet to meet an ARIC committee that justifies this diversion of scarce resources.

Finally, fiscal stimulus during COVID could also be seen as an example of cost shifting. State and federal governments promoted stimulus programs for which they largely took the credit. Grants were then provided for work that invariably cost more to deliver than the funds granted. Local governments in most cases were required to fund the gap.

(d) Assess the social and economic impacts of the rate peg in New South Wales for ratepayers, councils and council staff over the past 20 years and compare with other jurisdictions.

Three major empirical studies have examined the impact of rate-capping in the Australian local government context. Firstly, Drew and Dollery (2015a) examined rate-capped NSW local government relative to (then) uncapped Victorian councils in order to determine the likely impact of a proposed rate-pegging regime on Victorian local government. Three dimensions of municipal performance were compared. Firstly, Drew and Dollery (2015a) tested inter-municipal revenue effort equity by assessing residential tax effort. Residential tax effort measures the proportion of residential rates paid as a percentage of the total annual incomes accruing to residents in a given local government area. Drew and Dollery (2015a) found that rate-capping in NSW had reduced inter-municipal equity, possibly because of the compounding effects of a rate-cap where initial residential tax effort differed between councils.

Secondly, Drew and Dollery (2015a) investigated the impact of rate-capping on financial sustainability by considering local government liabilities per household for NSW and Victorian councils over the period 2009/2013. They found that NSW had much higher

levels of council debt per household. They also examined the average infrastructure renewal ratio in NSW and Victoria as a measure of the infrastructure backlog and established that NSW had a substantially larger local infrastructure backlog.

Finally, Drew and Dollery (2015a) tested the claim that rate-pegging obliged councils to become more efficient. In fact, using data envelopment analysis (DEA) to examine the relationship between inputs and outputs, Drew and Dollery (2015a, p. 145) found empirical evidence indicating a 'slightly higher average municipal efficiency for Victorian councils'.

Following the methodology employed by Drew and Dollery (2015a), Dollery and McQuestin (2017) empirically examined the likely impact of the imposition of a rate-cap in South Australian (SA) local government by comparing the performance of SA local government with its NSW counterpart on three separate key measures (revenue effort, financial sustainability and efficiency) for the period 2013 to 2016. Dollery and McQuestin (2017, p.84) established that for revenue effort 'the results from our stratified sample show that rate-capping in NSW has not served to reduce inter-municipal revenue effort inequities'. Moreover, rate-pegging is thus 'most unlikely to minimise these inequities in SA local government'. Secondly, they found that the 'claims made by advocates of rate-pegging that it improves financial sustainability are rebutted by our findings'. Using council debt per capita as a proxy for financial sustainability, Dollery and McQuestin (2017) demonstrated that 'NSW local authorities have much higher debt than their SA counterparts despite the four decade long rate-pegging regime in NSW'. Dollery and McQuestin (2017, p.84) further found that the operational efficiency of councils did not improve under rate-capping. Employing municipal expenditure per capita as a measure of the operational efficiency of local authorities, Dollery and McQuestin (2017, p.84) demonstrated that 'rate-pegging does not increase the efficiency of local councils: for each year in our sample, the efficiency of NSW councils falls well below SA councils'.

Dollery and McQuestin (2017, p.84) concluded that 'on all three dimensions of local government examined in our empirical analysis, we find SA councils performed better than NSW local government notwithstanding the latter's longstanding rate-pegging policy'. Given these findings, Dollery and McQuestin (2017, p.84) determined that 'the empirical evidence presented in the paper demonstrates that rate-pegging should not be

imposed on SA local government and instead other more promising policies [should be] considered'.

Finally, Yarram, Tran and Dollery (2021) employed expenditure data covering the period 2014/15 to 2017/18 to investigate empirically the short-term impacts of rate-capping on municipal expenditure in the Victorian local government system to determine whether it had differential effects on expenditure in different types of local authority. Yarram, Tran and Dollery (2021, p.11) found that 'it is clear that the impact of rate-capping varies between urban and rural councils'. Moreover, 'rural councils that generally rely more on rates are unsurprisingly unable to incur higher expenditure following a rate-capping'. This contrasts with urban councils 'that are able to increase total expenditure, perhaps through other sources of funding'. In addition, with respect to the impact of rate-capping on different kinds of municipal expenditure, Yarram, Tran and Dollery (2021, p.11) found that 'rate-capping reduces outlays, especially on aged and disabled services, in both rural and urban councils'. Furthermore, they established that 'there is a reduction in expenditure on family and community services in urban councils'.

Yarram, Tran and Dollery (2021, p.17) concluded their paper by placing it in the context of the earlier empirical analyses of the impact of rate-pegging on Australian local government. They noted that 'the findings of this study are broadly consistent with the previous results of Drew and Dollery (2015) who found that rate-capping in NSW made its local councils more constrained compared to councils in Victoria before the rate-capping'. In addition, they observed that 'our findings are also consistent with Dollery and McQuestin (2017) who established that NSW councils under a rate-capping regime suffered in terms of unsustainable financing and lower operational efficiency compared to councils in SA, which did not have any rate limitations'.

In addition to this scholarly literature, in a report entitled *Rate-pegging in NSW Local Government: An Analysis of the Empirical Evidence*, Dollery (2022) considered the major arguments in the ongoing debate in NSW local government over the impact of rate-capping, theoretical considerations on the nature of property tax limitations and their regulation, the international empirical literature on the impact of property tax limitations, the empirical literature on the impact of rate-capping in Australian local government, as well as the findings of recent inquiries and official reports on rate-pegging in NSW local government. Dollery (2022) argued that 'it is clear that the existing rate-capping regime

in NSW local government has had deleterious effects on municipal performance, especially the continuing inadequacy of revenue from rates, related ongoing problems with the financial sustainability of NSW local government and associated insufficient infrastructure maintenance and renewal'.

Given these problems, Dollery (2022) proposed two 'alternative approaches to improving the NSW local government rating system'. Firstly, Dollery (2022) argued that a 'first-best' approach would be for the NSW Government to simply abolish rate-pegging and thereby give local authorities the latitude to strike their own rates and be held accountable by their own local residents. This approach would accord with both economic theory on optimal municipal property taxation and the weight of international and Australian empirical evidence on property tax limitations.

Secondly, Dollery (2022) proposed an 'alternative "second-best" approach would recognise the realities of political barriers in NSW to the abolition of rate-capping and instead focus on removing the worst features of the rate-pegging regime'. This would contain three main elements: (a) a rate-peg would be set for a minimum of three years in advance to facilitate financial planning by local councils; (b) the process of determining the rate-cap would be modified to include input from a panel of local government experts as well as a more accurate method of determining cost escalations in NSW local government than the current misconceived IPART methodology; and (c) the process of applying for SRVs should be eased further to automatically grant SRVs unless there are compelling grounds to the contrary.

(e) Compare the rate peg as it currently exists to alternative approaches with regards to the outcomes for ratepayers, councils and council staff.

Under (d) above, we briefly outlined the peer-reviewed research on the impact of rate-pegging in Australian local government. As we have seen, three main empirical papers have investigated the effects of rate-capping in Australian local government. Without exception, all three studies found that property tax limitations in the form of rate-pegging had deleterious effects across those state local government systems in which they had been imposed. For example, as we have seen, in their study of the NSW local government compared to the (then) uncapped Victorian local government system, Drew and Dollery (2015a) found that NSW local councils had suffered from three main problems:

(a) NSW local government had reduced inter-municipal equity, possibly because of the compounding effects of a rate-cap where initial residential tax effort differed between councils.
(b) NSW local councils had much higher levels of council debt per household and a substantially larger local infrastructure backlog.
(c) Victorian councils had a 'slightly higher average municipal efficiency' than their NSW counterparts.

Similarly, as related earlier, in their comparison of the uncapped SA local government system with its NSW counterpart on three separate key measures, Dollery and McQuestin (2017) examined revenue effort, financial sustainability and efficiency over the period 2013 to 2016. They established that NSW local government fared badly by comparison with SA local government in three respects:

(a) In terms of revenue effort, rate-capping had failed to reduce inter-municipal revenue effort inequities in NSW local government.
(b) Using council debt per capita as a proxy for financial sustainability, Dollery and McQuestin (2017) found that NSW local councils had 'much higher debt than their SA counterparts' despite the four decade long rate-pegging regime in NSW.
(c) The operational efficiency of councils did not improve under rate-capping; the efficiency of NSW councils was in fact well below the efficiency of SA councils.

Finally, as noted, Yarram, Tran and Dollery (2021) examined whether rate-capping in the Victorian local government system had had differential effects on expenditure by different types of local council. They found that rate-pegging affected rural councils more than their urban counterparts because rural councils generally relied more on rates rather than other types of own-source revenue. By contrast, urban councils could use other sources of funds, like fees and charges, to offset rate-capping restrictions on income.

In sum, while further research into the impact of rate-capping on Australian state and territory local government systems is required, the three extant studies are unanimous in concluding that rate-pegging has deleterious effects on local councils and their local communities. This is especially evident in terms of municipal debt levels and infrastructure backlogs. Moreover, rate-capping discriminates against rural councils whose socio-economic characteristics mean they are more heavily dependent on rates as an own-source income.

(f) Review the operation of the Special Rate Variation process and its effectiveness in providing the level of income councils require to meet the needs of their communities.

The SRV process in NSW local government has several positive characteristics. It employs sound criteria in its assessments of the financial viability of local councils. Moreover, when a local council prepares a SRV submission in a thorough manner, this typically provides a useful 'reality check' for its councillors and senior management on its financial circumstances.

However, the SRV process in NSW can be improved in at least five ways. Firstly, the composition of the rate-cap determination panel, together with the SRV assessment panel, should include at least one scholarly local government expert. Familiarity with property tax limitation theory and sophisticated empirical techniques is vital for the determination of a sound cap. Moreover, scholars enjoy greater independence and can bring fresh insights. Many of the problems associated with recent changes to the IPART rate-cap methodology may not have occurred if an informed scholar had been on the deliberative panels.

Secondly, IPART must achieve a much faster turnaround period in its SRV assessment process. In many cases, earlier notification of SRV application outcomes can provide valuable information to local councils that are experiencing severe financial difficulties, thereby enabling them to take remedial action in a timely manner.

Thirdly, it is important that IPART establish sensible timelines for SRV nomination dates and applications. At present, the current timeline for SRVs could hardly be worse. As Table 3 illustrates, it contributes to a range of avoidable costs. In practice, this often means that local councils are breaking 'bad news' to their local communities immediately prior to Christmas. In the most recent year of delayed elections, the early nomination date meant that many councils delayed their SRV application by an additional year. This may well have caused serious financial sustainability problems. Moreover, the current timeline increases stress on council staff who often have to give up customary extended periods of leave taken over the festive season. Furthermore, it adds to any consultant costs because consulting companies are often obliged to pay premiums to their staff to work during the festive season.

By contrast, in the Victorian local government system sensible dates apply, as Table 3 shows. Notification of intent to apply is purely optional, as it should be. Furthermore, the applications can be submitted over a long period that allows for much better assessment

turnaround times. Furthermore, it is likely that applications are assessed on their own merits rather than being sub-consciously compared with other applications.

Table 3: Special Rate Variation Key Dates for NSW and Victoria in 2022

Event	NSW Date	Victorian Date	Recommendation
Notification of Intent to apply for a SRV	26 November	31 January*	End of January (optional)
SRV application due date	7 February	1 February until 31 March	Should be submitted any time prior to mid-April
Determinations announced	May 2022	Within two months of receiving the application	Within six weeks of application

* Note this is only an option in Victoria. It is not mandatory to give notice of intent.

Fourth, we recommend that 'automatic triggers' should be employed for SRVs. A significant problem with the current NSW rate-peg regime is that it has high political costs. This explains why many local councils are hesitant to indicate intent to apply for an SRV in election years. The problem with delaying SRVs is that a council may fail financially in the interim. Moreover, it may mean that eventual increases need to be higher to compensate for foregone rate revenue for the year(s) deferred.

By contrast, political costs associated with local councils making SRV applications might be reduced by making SRV applications mandatory when certain triggers are met. This would signal to the local community in question that the SRV is required by fiscal prudence rather than by political choice. It would also mean that the rate-cap regime would not add further to the appalling record of local government financial failure in the NSW local government system (Drew 2022).

Any financial triggers should contain standard ratios already in use. However, they would require the NSW Office of Local Government (OLG) to employ reasonable benchmarks based on empirical evidence (rather than the current apparently arbitrary numbers). In

particular, the following ratios are suggested: Operating ratio (over three years), unrestricted current ratio (with a more suitable benchmark), debt ratio (with a more appropriate benchmark), cash expense ratio (using a more appropriate benchmark) and rates outstanding (currently there is no benchmark and a ceiling, rather than a floor, would be best to protect ratepayers).

Note that we have specifically excluded asset maintenance ratios because they are typically too unreliable at present. Moreover, their use may exacerbate the already high levels of distortion in these numbers.

Given that SRV applications are publicly available (and should be based on evidence of need according to prescribed criteria), the burden of proof should rest with the SRV assessment panel or those who object to the proposal to provide compelling reasons as to why an SRV should be rejected or reduced. This is particularly the case when local councils have drawn on suitably qualified experts to assist in the preparation of the SRV and where they have provided robust empirical evidence in support of their claims. In sum, reversing the burden of proof along these lines would more appropriately respect the efforts of council staff and the deliberations of politically accountable councillors.

(g) Any other related matters

Structural Impediments to Security for Local Government Workers and in Infrastructure and Service Delivery.

In common with all employers, local government has had adapt to significant changes over the past four decades, with some based on legislation and others based on ideology. However, the extent and nature of change has differed across the different Australian local government systems. For instance, local government in NSW has not faced the degree of corporatisation and privatisation evident in other local government jurisdictions and other tiers of government in the Australian federation. In many cases, local services have simply been privatised or contracted out. This has seen an emphasis on profit maximisation and cost minimisation over service delivery and employment conditions and job security.

NSW local government has largely escaped corporatisation and privatisation due to vigorous action by local government unions. In particular, ongoing action by the Municipal Employees Union (MEU), which in 2003 became the United Services Union (USU), has

been effective. The USU currently has approximately 30,000 members drawn from NSW local government employees, who total around 50,000 workers.

The Local Government Association in NSW (LGNSW) has also been active. It has generally worked pragmatically and cooperatively with the USU and other industry unions in modernising the NSW Local Government Award. The NSW Local Government Award now combines over half a dozen pre-1992 NSW Local Government Industry Awards in a single Award, which is based on flexibility, innovation and skills. The Award has a skills-based salary system instead of the previous prescriptive awards that did not encourage or recognise flexibility or multi-skilling. This new modernised Award first came into being on the 8th June 1992 as a consent Award, achieved by negotiation and cooperation rather than by conflict and industrial action.

The practice of renegotiating each new Award as the previous consent Awards were due to expire has seen successive NSW Local Government Industry consent Awards re-negotiated in 1995, 1997, 2000, 2001, 2004, 2007, 2010, 2014, 2017, 2020 and 2023. The current Award commenced on the 1st July 2023 and runs until the 30th June 2026. A new re-negotiated Award will come into effect from the 1st July 2026 for the maximum permissible 3-year period allowed under current NSW Industrial Relations legislation.

The NSW Local Government Award represents best practice in Australian local government. For example, clause 2 serves to demonstrate the efficacious nature of the NSW Local Government Award. Clause 2 'Statement of Intent' states the following:

'The parties to the Award are committed to co-operating positively to increase the productivity, structural efficiency and financial sustainability of Local Government and to provide employees with access to more fulfilling, varied and better paid work by providing measures to for instance:

- Improve skill levels and establish skill-related career paths;
- Eliminate impediments to multi skilling;
- Broaden the range of tasks which a worker may be required to perform;
- Achieve greater flexibility in workplace practices;
- Eliminate discrimination;
- Establish rates of pay and conditions that are fair and equitable;
- Work reasonable hours;

- Promote job security;
- Ensure and facilitate flexibility for work and family responsibilities;
- Ensure the delivery of quality services to the community and continuous change;
- Encourage innovation;
- Promote cooperative and open change management processes; and
- Promote the health and safety of workers and other people in the workplace'.

In common with many other clauses in the NSW Local Government Award, Clause 2 demonstrates the pragmatism and positive working relationship between the Award parties. These positive features have existed for more than three decades of negotiating industry consent Awards. They demonstrate that the various parties have worked together to improve the NSW local government industry.

The NSW industry Award parties also negotiated an Industry COVID-19 Splinter Award early during the COVID restrictions period. It was renewed annually for 3 years until no longer required. It served to provide certainty and employment protection for municipal employees in NSW during the COVID period. This was crucial at the time since the (then) Australian Government funding to protect workers impacted by COVID did not cover local government employees.

The NSW COVID-19 Splinter Award was better than any other industry-negotiated protections during the Covid-19 restrictions period. It saw the parties agree to waive certain Award conditions regarding work locations and work duties to provide meaningful access to work to ensure essential local services continued to operate during lockdowns and restricted travel periods.

In essence, the NSW Local Government Award is far superior to the Federal Modern Award equivalent that only generally applies to local government in those state systems that surrendered their state industrial responsibilities to the Australian Government in the past.

The NSW Local Government State Awards are generally negotiated for a 3-year period. Each new Award seeks to include changes required to enhance efficiency, as well as to meet the needs of both the workers and the employers. The Award also provides both the employers and employees with 3 years of certainty regarding annual Award salary

increases. Pay increases occur in the first pay period in July each year. This facilitates local council budgeting and forward planning for each financial year.

As a result, NSW councils and their employees know what their salary increases and their wage costs will be up to 3 years in advance. This provides a degree of financial certainty for both parties. This contrasts with what workers in the Federal Award must endure, who must wait each year for the annual Fair Pay Commission decision.

In contrast to the certainty over annual staff salary increases enjoyed by NSW local councils, they face annual uncertainty regarding what their rate-peg will be for the next financial year. This is only revealed a few months prior to the forthcoming financial year, severely limiting the required time to finalise their annual budgets.

Similarly, NSW Government road funding is also generally only announced to NSW councils annually, as well as any increases in NSW Government levies imposed on NSW councils, such as the Waste Levy for example. In addition, Australian Government financial transfers to local councils, such as Financial Assistance Grants (FAGs) grants, are also allocated annually and without any clear commitment as to what the next financial year or successive years' funding allocation will be.

This practice of only committing and confirming state and federal funding on an annual basis inevitably generates problems. For instance, local councils must often make inaccurate assumptions in their forward planning and budgeting.

This financial uncertainty occurs simultaneously with significant cost shifting onto local government. As a result, local councils must frequently undertake to maintain or provide local services to their local communities previously provided by state and/or federal governments. This has a significant negative financial impact on many local councils, especially in regional, rural and remote areas. Indeed, it is not uncommon to see twenty percent or more of a council's annual budget expended on providing or maintaining services due to cost shifting. In this regard, the NSW Upper House has recently announced an inquiry into council funding, which includes in its terms of reference rate-pegging, cost shifting and funding in general.

In addition, many local councils are also faced with significant numbers of migrants and others relocating to their local government areas. This places significant strain on existing local services and infrastructure, much of which is ageing and in need of maintenance and

repairs. It also necessitates the construction of new infrastructure. Moreover, problems arise from the continuing cost of ongoing maintenance and of staffing costs for new infrastructure funded by one-off grants to build the new infrastructure, but with no ongoing necessary funding provided to maintain and staff new infrastructure.

As we have seen, the FAG process is problematic, especially since the percentage GDP allocated to these grants has experienced significant reductions and fluctuations over the past three decades. During the Hawke/Keating Government period, FAG grants exceeded 1% of GDP, at times reaching as high as 1.3%. However, under successive governments they have fallen to 0.33% of GDP under the Abbot Government and then risen to 0.55% of GDP under the Morrison Government. There is industry consensus in the local government sector, including unions and employer associations, that FAG grants must be increased to a minimum at least 1% of GDP.

In all Australian local government systems, local councils have a limited capacity to raise their own funds, especially in NSW and Victoria, where they operate under rate-pegging. However, even the abolition of rate-pegging would not make many local councils financially sustainable. For example, many local councils in regional, rural or remote areas have neither the population nor rate base to generate sufficient funding for essential local services, new infrastructure and adequate staffing. As we have seen, this has led *inter alia* to a massive local infrastructure backlog across all Australian local government systems.

In NSW local government, which suffers under a longstanding rate-pegging regime, there is ongoing discontent about the decision-making process of IPART. For example, IPART regularly approves significantly higher increased fees and charges to state-owned corporations, such as Sydney Water and Hunter Water, which possess massive capacity and scale compared to NSW council operated water and wastewater services. In 2023, for instance, IPART approved 7% increases in charges for Sydney Water and Hunter Water. This increase was almost double the rate-peg limit of 3.7% that financial year for over a hundred NSW councils providing the same water and wastewater services to their local communities. These councils not only had much lower populations and fewer paying consumers, but also provided infrastructure over much larger geographical areas, while inflation was running at double the rate-peg limit. This demonstrates *inter alia* that NSW councils, which provide water and wastewater services, must be substantially more efficient than the much larger state-owned corporate entities - Sydney Water and Hunter Water -

even factoring in the dividends paid by the state-owned corporations back to the NSW Government.

NSW Government owned, locally owned and run county councils/energy distributors represent a further example of the rationalisation and privatisation of public assets and services failing to deliver cheaper and more efficient services. In 1997, 27 NSW power distributors were forcibly amalgamated into four entities. This resulted in thousands of redundancies and a loss of local services and knowledge in many communities, thereby preparing the sector for privatisation. However, the net result did nothing to reduce costs, improve services, or even maintain the same level of services for the consumers. Instead, it provided the (then) future private owners with significantly reduced staffing levels and lower costs that assisted them in generating greater profits for shareholders rather than focusing on cheap, reliable access to energy provided by local service providers and the retention of local jobs.

To ensure the ongoing viability and financial security of local government adequate long-term state and federal funding, cost shifting and the ability of councils to decide local rates and local fees and charges must be addressed. Moreover, the current massive local infrastructure backlog must be tackled with sufficient funding.

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