

IN WHOSE INTEREST? AN ASSESSMENT OF THE NEW SOUTH WALES GOVERNMENT'S POST-AMALGAMATION RATE PATH FREEZE POLICY

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ABSTRACT

As part of its controversial forced amalgamation program, the Baird Government announced that merged councils would fall under a rate path freeze for a period of four years. During that time, merged municipalities would face the same rate increases they would have experienced had they not been amalgamated. The NSW Government also requested the Independent Pricing and Regulatory Tribunal (IPART) to offer recommendations on how the rate freeze policy should best be implemented and IPART released *Freezing Existing Rate Paths for Newly Merged Councils* in August 2016. This paper examines the rate freeze policy and the IPART report and demonstrates that they would impose serious efficiency, equity and financial sustainability problems on compulsorily consolidated councils.

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I. INTRODUCTION

Despite the ubiquitous use of forced municipal mergers as an instrument of local government reform in all Australian local government systems, except Western Australia, compulsory council consolidation remains controversial and electorally unpopular.¹ Given the ongoing controversy it has generated, as well as the related by-election loss in Orange in October 2016, the current forced amalgamation program in New South Wales (NSW) is no exception and the Baird Government has imposed a freeze on rates in newly merged councils to ameliorate public concern, notwithstanding the inevitable equity and financial sustainability problems associated with the freeze. This paper examines the freeze together with the Independent Pricing and Regulatory Tribunal's (IPART) recommendations for implementing the freeze.²

The controversial *Fit for the Future* NSW local government reform program had its genesis at the *Destination 2036 Workshop* held in Dubbo on 19th August 2011 which *inter alia* led to the establishment of the Independent Local Government Review Panel charged with providing recommendations for reform of the NSW local government system. In April 2013, the Panel released its interim report *Future Directions for NSW Local Government* recommending a radical program of compulsory council consolidation.³ These recommendations were largely replicated in its final report *Revitalising Local Government* published in October 2013.⁴ The NSW Government accepted the Panel's arguments for forced amalgamation and initiated the formal process of municipal mergers in December 2015, though with a significantly modified list of targeted councils.⁵ As part of this process, the Minister for Local Government determined that – for a four-year period after compulsory consolidation – affected councils would function under the rate increase trajectory already decided prior to the forced mergers.⁶

¹ Brian Dollery, Bligh Grant and Michael Kortt, *Councils in Cooperation: Shared Services and Australian Local Government*, (Federation Press, 2012).

² Independent Pricing and Regulatory Tribunal (IPART), *Freezing Existing Rate Paths for Newly Merged Councils* (2016).

³ Independent Local Government Review Panel (ILGRP), *Future Directions for NSW Local Government: Twenty Essential Steps*, (2013).

⁴ Independent Local Government Review Panel (ILGRP), *Revitalizing Local Government* (2013).

⁵ Glenn Fahey, Brian Dollery and Joseph Drew, *When Push Comes to Shove: The Process of Forced Amalgamation in New South Wales Local Government* (2016), unpublished manuscript, Centre for Local Government, University of New England, Table 1. Table 1 provides details of the changing nature of the list of councils recommended for amalgamation over the course of the *Fit for the Future* process.

⁶ Joseph Drew and Brian Dollery, 'Less Haste More Speed: The Fit for Future Reform Program in New South Wales Local Government' (2015) 75(1) *Australian Journal of Public Administration* 78, 88.

In Chapter 6 of its *Revitalising Local Government*, the Independent Panel called for a full inquiry into the long-standing policy of rate-capping in NSW local government.⁷ In particular, it proposed that the NSW IPART be commissioned to review the NSW rating system, especially with respect to 'options to reduce or remove excessive exemptions and concessions that are contrary to sound fiscal policy and jeopardise councils' long term sustainability' (Recommendation 6.2) and whether to 'either replace rate-pegging with a new system of 'rate benchmarking' or streamline current arrangements to remove unwarranted complexity, costs, and constraints to sound financial management' (Recommendation 6.5).⁸

In late 2015, the NSW Government duly instructed IPART to conduct a review of the local government rating system in NSW.⁹ As part of this review, IPART was requested to report on the NSW Government policy of 'freezing' the existing rate paths for four years of new forcibly amalgamated local authorities and to make policy recommendations to effectively implement this 'rate path trajectory freeze' policy.

The NSW Government's rate path freeze policy has two main element ingredients: (a) compulsory council consolidation must not change the existing rate paths already decided for local councils in newly merged entities on grounds that this would provide 'ratepayers with certainty about their rates', and (b) ratepayers in the newly-amalgamated municipalities would have their rates protected against future increases during the rate path freeze period.¹⁰ The intended net effect of (a) and (b) is that ratepayers will pay no more for their rates for the four-year period than they would otherwise have done had their council not been forcibly merged. In addition, the NSW Government indicated that its four-year rate path freeze policy would assist in obliging merged councils to improve operational efficiency through cost savings which would in turn serve to place downward pressure on property taxes in the longer term.

As part of its deliberations, in April 2016 IPART published its *Review of the Local Government Rating System: Issues Paper* which sought community comment.¹¹ In June 2016 it submitted an interim report on the question of implementing the NSW Government's rate path freeze policy to the Minister for Local Government entitled *Freezing Existing Rate Paths for Newly Merged Councils*. This report was subsequently made public on 1st August 2016. This paper seeks to provide a critical assessment of *Freezing Existing Rate Paths for Newly Merged Councils*.

⁷ Independent Local Government Review Panel, above n 4.

⁸ Independent Local Government Review Panel, above n 4, 16.

⁹ Joseph Drew and Brian Dollery, 'A Fair Go? A Response to the Independent Local Government Review Panel's Assessment of Municipal Taxation in New South Wales' (2015) 30 *Australian Tax Forum* 471, 489.

¹⁰ Independent Pricing and Regulatory Tribunal, above n 2.

¹¹ Independent Pricing and Regulatory Tribunal (IPART), *Review of the Local Government Rating System: Issues Paper*, (2016).

A substantial worldwide literature exists on the analysis of local government reform by means of municipal mergers (for surveys of this literature see, for example, Dollery, Garcea and LeSage; Dollery and Robotti; Faulk and Hicks; Lago-Penas and Martinez-Vazquesz¹²). Given the comparatively heavy emphasis placed by Australian local government policy-makers on forced amalgamation as an instrument of structural reform, this literature has a substantial Australian strand.¹³ This body of work has been recently been augmented by research on the current NSW compulsory council consolidation program, which includes an assessment of the Panel's recommendations on rating in NSW local government.¹⁴ The present paper thus seeks to add to this literature.

The paper is divided into three main parts. Section 2 provides a synopsis of the recommendations offered by IPART in its *Freezing Existing Rate Paths for Newly Merged Councils*.¹⁵ Section 3 offers a critical evaluation of the rate freeze policy and recommendations contained in the IPART report. The paper ends with some brief concluding remarks in section 4.

II. IPART RATE PATH FREEZE POLICY IMPLEMENTATION APPROACH

A. *General Principles Guiding Rate Path Freeze Policy Application*

IPART's *Freezing Existing Rate Paths for Newly Merged Councils* begins with an attempt to operationalise the NSW Government's four-year rate path freeze policy.¹⁶ In essence, IPART argues that the policy centres on the rate of increase of 'general income' of each council forcibly merged into a larger entity over a four-year period. General income is defined in accordance with the NSW *Local Government Act 1993* (as amended) as revenue from 'ordinary rates, special rates and specified annual charges', which does not include 'special rates and charges for water and sewerage'.¹⁷ Accordingly, in terms of IPART's interpretation of the rate path freeze policy, the policy means that 'for the four years after a merger, rates

¹² Brian Dollery, Joseph Garcea and Edward LeSage (eds.), *Local Government Reform: A Comparative Analysis of Advanced Anglo-American Countries* (Edward Elgar, 2008); Brian Dollery and Lorenzo Robotti (eds.), *Theory and Practice of Local Government Reform* (Edward Elgar, 2008); Dagney Faulk and Michael Hicks, *Local Government Consolidation in the United States* (Cambria Press, 2011); Santiago Lago-Penas and Jorge Martinez-Vazquesz (eds.), *The Challenge of Local Government Size: Theoretical Perspectives, International Experience and Policy Reform* (Edward Elgar Publishers, 2013).

¹³ See, for example, Dollery, Grant and Kortt, above n 1.

¹⁴ See, for instance, Drew and Dollery, above n 5.

¹⁵ Independent Pricing and Regulatory Tribunal, above n 2.

¹⁶ Independent Pricing and Regulatory Tribunal, above n 2.

¹⁷ *Local Government Act 1993* (NSW), s 505.

for each individual ratepayer would continue to be set so that their rate path follows the same trajectory as if the merger had not occurred'.¹⁸

Since the 'rate path freeze applies to the general income at the pre-merger council level', IPART argues that 'this general income would only be adjusted for external factors'.¹⁹ Moreover, a new compulsorily consolidated council 'should not be allowed to equalise rates across its pre-merger council areas using mechanisms that lead to rate increases' since this would be 'inconsistent with the rate path freeze policy'.²⁰ Rate equalisation in a newly merged municipality thus cannot be sought by (a) 'imposing special variations on only one pre-merger council area' or (b) 'rebalancing' the burden of rates through increasing rates in one pre-merger council area.²¹ In terms of feedback to its *Review of the Local Government Rating System: Issues Paper*, IPART found that 'in general, stakeholders supported our interpretation of the rate path freeze policy' and it thus determined 'to adopt this interpretation'.²² Under this interpretation, 'the general income in a pre-merger council area would only increase by external factors'.²³

Against this background, IPART proposed Recommendation 1:

'That the general income for a pre-merger council area should be adjusted annually by the following external factors:

- the rate peg OR any special variation approved for that pre-merger council area
- the expiry of any temporary special variations during the rate path freeze period, that apply in the pre-merger council area and are not renewed using a permitted special variation (see Recommendation 6), and
- other external factors permitted under the Local Government Act 1993 (i.e., 'above the peg' growth in general income, catch-up or excess income from the previous year and valuation objections).²⁴

IPART stresses that new net increases in rates above the rate path freeze should not be permitted by arguing as follows: 'Allowing a new council to change its existing rate paths, solely in response to the merger and in a way that increases rates for some ratepayers, conflicts with the rate path freeze policy'.²⁵

This leads IPART to Recommendation 2:

¹⁸ Independent Pricing and Regulatory Tribunal, above n 2, 9.

¹⁹ Ibid.

²⁰ Ibid.

²¹ Ibid.

²² Ibid.

²³ Ibid.

²⁴ Independent Pricing and Regulatory Tribunal, above n 2, 9, 10.

²⁵ Independent Pricing and Regulatory Tribunal, above n 2, 11.

‘That new councils should not be permitted to equalise rates across their pre-merger council areas by:

- applying for new special variations, or
- rebalancing the allocation of rates between pre-merger council areas by increasing rates in any pre-merger council area.²⁶

However, IPART contends that a new compulsorily consolidated council should be entitled to attempt to equalise rates across pre-merger council areas by setting rates ‘below the peg’ within a given general income path rise. Under this arrangement, a pre-merger council’s rate path represents a ceiling on these rate increases. Put differently, ‘a new council would be free to set rates at lower levels within any pre-merger council area in any rating category, which might have the effect of equalising rates across its pre-merger council areas’.²⁷

This led IPART to its Recommendation 3:

‘That new councils should continue to be allowed discretion to set rates below the rate cap ceiling during the rate path freeze’.²⁸

B. *Exceptions to General Principles on Rate Path Freeze Policy*

Notwithstanding this general policy guideline for implementing the rate path freeze policy of the NSW Government, in Chapter 3 of its Freezing Existing Rate Paths for Newly Merged Councils, IPART nonetheless proposed five defined circumstances under which rates could be set which exceeded the rate path freeze:

- (a) ‘Where there is a critical short-term financial need’;
- (b) ‘To fund new infrastructure by levying a special rate’;
- (c) ‘To renew an expiring temporary special variation that currently funds a service’ and ‘the council demonstrates the service would be discontinued if the special variation was not renewed’;
- (d) ‘For unrecovered development contributions that are ‘above the cap’ under the Environmental Planning and Assessment Act 1979 (NSW)’; and
- (e) ‘Where former Crown Land has been added to a council’s rate base during the rate path freeze period’.²⁹

IPART justifies these exemptions by noting that while ‘our recommendations provide a high degree of rate certainty to ratepayers, which is consistent with the Government’s policy’, they simultaneously enable local authorities to ‘address critical or unexpected financial

²⁶ Independent Pricing and Regulatory Tribunal, above n 2, 12

²⁷ Independent Pricing and Regulatory Tribunal, above n 2, 9.

²⁸ Independent Pricing and Regulatory Tribunal, n 2, 14.

²⁹ Independent Pricing and Regulatory Tribunal, n 2, 15.

sustainability issues', stimulate the 'development of new infrastructure and urban renewal', and allow for the maintenance of 'existing services'³⁰.

We now consider each of these five exceptions to the general rule and the recommendations which stemmed from them.

In the first place, IPART argues that a newly merged municipality should be entitled to a 'temporary special variation' provided it is 'financially unsustainable' as a consequence of (a) 'one or more of its pre-merger councils having an existing rate path that is financially unsustainable, and merger savings and government funding are insufficient for the new council to achieve sustainability' and (b) an 'external factor that occurs during the freeze', such as natural disaster.³¹ IPART specifies four criteria which must be met:

(a) The new council is 'financially unsustainable' because (i) 'at least one of its pre-merger councils is financially unsustainable and the new council is 'forecast to remain so post-merger' or (ii) the newly-amalgamated entity 'becomes financially unsustainable due to an external shock'.

(b) 'Merger savings and government funding are insufficient to rectify the sustainability issue'.

(c) The 'new council is unable to use debt financing to address the financial need'.

(d) The 'special variation relates to an immediate need' which cannot wait for the end of the rate path freeze'.³²

These considerations led IPART to its Recommendation 4:

That a new council be permitted to apply for a new temporary special variation where there is a critical financial need for the special variation, according to the criteria set out in Table 3.1.³³

Secondly, IPART argues that 'new councils should be able to apply for a special variation to fund new infrastructure' on grounds that 'while such special variations may reduce certainty for some ratepayers about the amount of their rates during the rate path freeze period, the alternative may cause councils to reduce their infrastructure development to below efficient levels'.³⁴ However, IPART contends that 'this special variation would be granted only in very limited circumstances' where (a) 'it is used to fund new infrastructure' (b) 'using a special rate' where (c) the special rate would only be levied on parcels of land that benefit from the infrastructure'.³⁵

These considerations led IPART to its Recommendation 5:

³⁰ Ibid.

³¹ Independent Pricing and Regulatory Tribunal, n 2, 16.

³² Independent Pricing and Regulatory Tribunal, n 2, 17.

³³ Independent Pricing and Regulatory Tribunal, n 2, 18.

³⁴ Independent Pricing and Regulatory Tribunal, n 2, 20.

³⁵ Ibid.

*'That a new council be permitted to apply for a new special variation to fund new infrastructure in its area by levying a special rate under section 495 of the Local Government Act 1993 (NSW).'*³⁶

Thirdly, IPART argued newly merged municipalities should be entitled to seek a temporary special variation to renew an expiring special variation but only under circumstances where (a) the expiring levy currently funds a service and (b) the levy will expire during the rate path freeze period resulting in the service in question being discontinued by the new council. IPART contends that 'a special variation for this purpose is consistent with our interpretation of the rate path freeze policy' since it would 'only be levied on ratepayers in the pre-merger council area that benefit from continuing the service.'³⁷ These arguments led IPART to its Recommendation 6:

*That a new council be permitted to apply for a new temporary special variation: to renew an expiring special variation that currently funds a service in a pre-merger council area, and the council demonstrates that the service would be discontinued if the special variation were not renewed.*³⁸

Fourthly, IPART contended that a newly amalgamated municipality should be eligible to seek a special variation to 'levy unrecovered development contributions that are 'above the cap' under the Environmental Planning and Assessment Act 1979 (NSW)', with the caveat that these contributions 'would only be recovered through a special rate on parcels of land that will benefit from the proposed new infrastructure'.³⁹ IPART rationalised this claim on the argument that 'development contributions are payments by developers to councils that are used to fund local infrastructure that meet an increased demand arising from new developments' and under existing regulation 'if a council's development contributions for an area exceed the relevant cap' then the council 'may seek to fund the gap by applying for a special variation'.

These considerations led IPART to its Recommendation 7:

*That a new council be permitted to apply for a new special variation for unrecovered development contributions that are 'above the cap' under the Environmental Planning and Assessment Act 1979 (NSW).*⁴⁰

Finally, IPART argued that a new compulsorily consolidated council should be allowed to raise its general income when 'Crown Land is added to its rate base during the rate path freeze period' since this is currently permitted through a special variation under section 508(2) of the *Local Government Act 1993*.⁴¹ However, IPART noted that this special variation

³⁶ Independent Pricing and Regulatory Tribunal, n 2, 18.

³⁷ Independent Pricing and Regulatory Tribunal, n 2, 22.

³⁸ Independent Pricing and Regulatory Tribunal, n 2, 18.

³⁹ Independent Pricing and Regulatory Tribunal, n 2, 23.

⁴⁰ Independent Pricing and Regulatory Tribunal, n 2, 24.

⁴¹ Ibid.

should only apply to the general income of the council whose pre-merger area now includes the former Crown Land. The justification for this exception was set out by IPART as follows: 'Adding former Crown Land to a new council's rate base may lead to higher demand for its services, an increase in its costs and a loss of ex-gratia payments from governments' and newly merged councils should possess the 'discretion to apply for a special variation to their general income (above the rate peg limit) to take account of this cost increase or revenue loss'.⁴²

These arguments led IPART to its Recommendation 8:

*That a new council be permitted to apply for a new special variation where former Crown Land has been added to its rate base during the rate path freeze period.*⁴³

It is worth stressing that in addition to calling for these exceptions to be made to rate trajectory freeze policy, in Table 3.2 in Chapter 3 of *Freezing Existing Rate Paths for Newly Merged Councils*, IPART explicitly ruled out several other important exemptions to the rate path freeze which stakeholder councils had sought in their submissions to the IPART Review of the *Local Government Rating System: Issues Paper*. In particular, four categories of items were unambiguously excluded from being exempt from the rate path freeze: (a) additional funding to 'equalise services across the pre-merger council areas'; (b) income to 'address a specific need identified by the community or through the IPR (i.e. Integrated Planning Review) Process'; (c) extra remuneration to 'respond to an exceptional circumstance'; and (d) income to 'recoup revenue lost from a boundary change as a result of the merger'.⁴⁴ While (c) has been partly addressed under Recommendation 4, as we shall see in section 3 of this paper, some of these other exclusions are problematic.

C. IPART Approach to Implementing the Rate Path Freeze Policy

Given its approach to determining the general income of each pre-merger council area in the newly amalgamated entity, in Chapter 4 IPART advances its approach to the problem of how rates should be set within each 'old council' area in the merged municipality. To this end, IPART enunciates two general principles: (a) the new amalgamated municipality must not be able to 'redistribute its rating burden between pre-merger council areas' and (b) 'rates within a pre-merger council area are no higher than they would have been under its existing rate path'.⁴⁵ In terms of normative economic analysis, as we shall see, these principles effectively imply that the Pareto Principle should apply in new merged councils for the four-year period.

IPART proposes five main implementation guidelines which reflect these two principles:

⁴² Ibid.

⁴³ Independent Pricing and Regulatory Tribunal, n 2, 18.

⁴⁴ Independent Pricing and Regulatory Tribunal, n 2, 26.

⁴⁵ Independent Pricing and Regulatory Tribunal, n 2, 27.

- (a) *The rate path freeze policy should be applied 'at the rating category level for a pre-merger council area, but not at the subcategory level';*
- (b) *Councils should be permitted to raise the 'base and minimum amounts in a pre-merger council area by the rate peg (adjusted for any permitted special variations)';*
- (c) *The NSW Local Government Act 1993 (s513) fifty percent limit on base amounts should be waived to newly amalgamated councils over the rate path freeze period⁴⁶;*
- (d) *A 'safety valve mechanism' should be included in the NSW Local Government Act 1993 to enable a new municipality to 'rebalance rates between categories in a pre-merger council area if external factors excessively impact on rates within a category'; and*
- (e) *The rating burden from general land revaluations within each pre-merger council area should be calculated using 'a relative change or the fixed share method'.⁴⁷*

We now briefly consider the formal recommendations flowing from the application of the five main implementation guidelines.

In the first place, with respect to guideline (a), IPART proposes two refinements: (i) an amalgamated municipality 'not be permitted to rebalance rates across the rating categories in a pre-merger council area', such as from business to residential properties and (ii) it should be 'permitted to rebalance rates across the subcategories that comprise a rating category in a pre-merger council area', like from one given business subcategory to another business subcategory.⁴⁸

These considerations led IPART to propose Recommendation 9 and Recommendation 10:

Recommendation 9: 'That the rate path freeze policy should apply to the rating categories (i.e. Residential, Business, Farming or Mining) of a pre-merger council area, but not its subcategories'.⁴⁹

Recommendation 10:

'That a new council would only increase the general income of each rating category of a pre-merger council area annually by the rate peg (subject to any adjustments to general income permitted under Recommendation 1, or special variations permitted under Recommendations 4 to 8), unless: the pre-merger council had approved and implemented a pre-existing rate plan for rebalancing rates between categories, in which case the new council could (subject to IPART approval) set rates for these categories in accordance with the plan, or there is a general land revaluation, and the pre-merger council area does not have a pre-existing rate plan, in which case the new council should set rates in accordance with Recommendation 14.'⁵⁰

⁴⁶ The NSW Local Government Act 1993 (s513) imposes restrictions on increases in categories of rates, such as on the rate base in specific rating categories, such as 'farmland' and 'residential', in order to prevent councils from unreasonably imposing big increases on a specific category to the exclusion of other categories.

⁴⁷ Ibid.

⁴⁸ Independent Pricing and Regulatory Tribunal, n 2, 28.

⁴⁹ Independent Pricing and Regulatory Tribunal, n 2, 29.

⁵⁰ Ibid, 39. See below for definition of Regulation 14.

Secondly, the application of guideline (b) by IPART whereby councils be allowed to raise the 'base and minimum amounts in a pre-merger council area by the rate peg (adjusted for any permitted special variations)' led to its Recommendation 11:

That a new council should increase the minimum and base amounts for a pre-merger council area annually: by the rate peg (subject to any adjustments for special variations under Recommendations 1 and 4 to 8) during the rate path freeze, unless the pre-merger council had approved and implemented a pre-existing rate plan for minimum or base amount increases, in which case the new council could (subject to IPART approval) set minimum and base amounts in accordance with the plan.⁵¹

Thirdly, guideline (c) (i.e. 'the NSW Local Government Act 1993 fifty percent limit on base amounts should be waived to newly amalgamated councils over the rate path freeze period') led IPART to its relatively straightforward Recommendation 12:

That new councils be exempt from the 50% maximum limit for revenue collected from base amounts for the duration of the rate path freeze period.⁵²

Fourthly, in regard to the proposed 'safety valve mechanism' in the NSW *Local Government Act 1993* to permit the rebalancing of rates between categories, IPART advanced Recommendation 13:

That if, as a result of external factors (such as a significant change in the number of rateable properties in a category), the average rating burden within a pre-merger council area's rating category will change by more than 5% plus the rate peg (or any applicable special variations), the new council can apply to IPART to rebalance the rating burden across all categories in the pre-merger council area.⁵³

Finally, with respect to implementing guideline (e), IPART proposed Recommendation 14:

That when allocating the rating burden from land revaluations: the new council should allocate it to different rating categories in each pre-merger council area using either the relative change method or the fixed share method, unless the pre-merger council had approved and implemented a pre-existing rate plan for rebalancing rates between categories, in which case the new council could (subject to IPART approval) set rates for these categories in accordance with the plan.⁵⁴

D. Regulatory Change Necessary to Implement the Rate Path Freeze Policy

In contrast to Chapter 4, Chapter 5 of *Freezing Existing Rate Paths for Newly Merged Councils* focused on how best to adjust existing regulations to facilitate the implementation of the rate path freeze policy. In its *Review of the Local Government Rating System: Issues Paper*, IPART had earlier canvassed three broad 'options' for regulatory change:

⁵¹ Independent Pricing and Regulatory Tribunal, n 2, 33.

⁵² Independent Pricing and Regulatory Tribunal, n 2, 35.

⁵³ Independent Pricing and Regulatory Tribunal, n 2, 37.

⁵⁴ Independent Pricing and Regulatory Tribunal, n 2, 39.

(a) An amendment to the NSW Local Government Act 1993 to provide 'instrument making power' for the Minister for Local Government.

(b) An amendment to the NSW Local Government Act 1993 in order to expand the proclamation power of the NSW Governor.

(c) Make amendments to Chapter 15 of NSW Local Government Act 1993.⁵⁵

In *Freezing Existing Rate Paths for Newly Merged Councils* IPART simply endorsed its earlier 'preferred option' (a) in proposing Recommendation 15:

*That the Local Government Act 1993 be amended to provide the Minister for Local Government with an instrument-making power that enables the Minister to implement the rate path freeze policy for new councils. This power should be subject to a sunset clause and expire at the end of the rate path freeze period on 30 June 2020.*⁵⁶

III. CRITICAL EVALUATION OF RATE FREEZE APPROACH

While IPART should be commended for tackling a thorny policy challenge in a thorough manner, this cannot in any way disguise the fact that it has been handed a poisoned chalice by way of a rate path trajectory freeze policy which is almost entirely politically motivated in its intent. We now consider some of the numerous efficiency and equity problems associated with the rate path freeze policy and its proposed application to compulsorily consolidated councils.

A. Political Basis for Rate Path Freeze Policy

Given the fact that IPART is a public sector agency and thus bound by the long-standing Westminster tradition of an apolitical civil service, it is hardly surprising that neither the IPART (2016) *Review of the Local Government Rating System: Issues Paper* nor *Freezing Existing Rate Paths for Newly Merged Councils* considers why the NSW Government has enunciated its four-year rate freeze policy in the first place. This policy became effective in April 2016 when the NSW Premier announced the constellations of councils selected for compulsory consolidation. It will thus expire well after the next NSW general election.

Even the most gullible political observer can hardly fail to notice that April 2020 is a most politically opportune time for the governing Liberal National Party Coalition since it must face a general election in March 2019, almost a full year before the four-year rate freeze policy expires. This means *inter alia* that all the pent-up financial problems accumulated by

⁵⁵ Independent Pricing and Regulatory Tribunal, n 8. These three amendment options would allow for the imposition of a rate freeze on merged councils. IPART recommended option (a) since it offered the maximum flexibility to policymakers.

⁵⁶ Independent Pricing and Regulatory Tribunal, n 2, 42.

forcibly merged municipalities will not yet be evident to ratepayers and in any event cannot be translated into substantial rates and fees and charges increases until April 2020.⁵⁷

Given these facts, all the carefully contrived rhetoric surrounding the purported need to 'protect' ratepayers in merged councils from rate increases above those agreed prior to April 2016, as well as sharp fees and charges rises, should be viewed through the prism of the forthcoming general election in March 2019. Put differently, the Liberal National Party Coalition is primarily 'protecting' its own chances of re-election rather than advancing any public interest.

In sum, the four-year rate freeze policy offers the Baird Government three substantial political advantages:

- It made the process of 'selling' the controversial forced amalgamation program to a reluctant and unconvinced electorate easier than it otherwise would have been since at least the prospect of extraordinary rate increases was postponed until 2020.
- It meant that the inevitable financial pressures and other stresses on compulsorily consolidated councils would not be visible to the public in terms of inordinate rate, fee and charge increases until 2020. These financial pressures and stresses derive not only from the substantial costs of amalgamation, but also from the forgone rates income as well as standard increases in the operational costs of running councils.
- It at least partly neutralises the controversial and unpopular forced amalgamation question until after the 2019 election thereby boosting the Baird Government's re-election prospects.⁵⁸

B. *Cost Savings and Efficiency Gains from Forced Mergers*

Notwithstanding the strong political motivation for the four-year rate freeze policy, in its *Freezing Existing Rate Paths for Newly Merged Councils* IPART nonetheless observed that the rate freeze rested on three main planks: to 'provide ratepayers with certainty about their rates', to 'protect ratepayers against future rate increases' and to 'allow merger savings to place downward pressure on rates'.⁵⁹ Furthermore, IPART makes frequent references to the

⁵⁷ Empirical evidence from the aftermath of the post-amalgamation rate freeze in Victorian local government in the 1990s demonstrated starkly that the net effect of the freeze was simply to postpone (and not avoid) longer run increases in rates to compensate for the freeze. See, for example, Joseph Drew and Brian Dallery, 'Breaking Up is Hard to Do: The Costs of the De-amalgamation of the Delatite Shire Council' 2015 15(1) *Public Finance and Management*. Much the same was observed after the 2008 Queensland mergers. It is thus reasonable to expect that NSW councils will also be obliged to increase rates after the lifting of the freeze in order to pay for the costs of the mergers as well as meet normal increases in operational costs. Since the freeze also applies to fees and charges, which are in any event largely regulated by IPART, councils cannot increase fees and charges to compensate for the rate freeze.

⁵⁸ The political unpopularity of the NSW amalgamation program was starkly revealed when the National Party lost the seat of Orange in an October 2016 by-election. Orange had been comfortably held by the Nationals since World War Two.

⁵⁹ Independent Pricing and Regulatory Tribunal, n 2, 1.

likelihood of cost savings flowing from mergers and their attendant efficiency gains.⁶⁰ For instance, IPART noted that the ‘rate path freeze policy allows new councils more time to achieve merger savings, which will reduce the need for any future rate increases’.⁶¹ Similarly, IPART contended that ‘nearly all new councils may have positive OPRs [Operating Performance Ratio] over the long term, once merger savings are factored into the analysis.’⁶² Furthermore, IPART makes various extravagant claims on the extent of ‘merger savings’, such as observing that ‘mergers are forecast to lead to improvements in councils’ expenditure and financial sustainability’, which was ‘evident during the *Fit for the Future* process, where business cases submitted by councils suggested that merger savings from Sydney Metropolitan mergers could be at least \$1.8 billion over a 20-year period’⁶³!

Apart from contentious estimates of future savings in politically charged council submissions, no independent evidence was presented by IPART to substantiate these claims over merger savings, except to point to the KPMG *Local Government Reform: Merger Impacts and Analysis* report⁶⁴ – prepared on behalf of the NSW Government – which claimed the proposed mergers would generate a net financial benefit to councils of around \$2.0 billion across over the next 20 years.⁶⁵ However, KPMG is awash with error, not least KPMG’s mistaken assumption that local government general staff in NSW are covered by the federal award and not the *Local Government (State) Award*.⁶⁶

Had *Freezing Existing Rate Paths for Newly Merged Councils* bothered to consult the wealth of empirical evidence available on forced amalgamation, IPART would have been much less sanguine about making exaggerated claims on cost savings. We now briefly summarise recent empirical work on cost savings and efficiency in developed countries, including Australia.

Most empirical work on amalgamation has occurred in American local government.⁶⁷ In general, American researchers found that mergers have not met expectations in terms of

⁶⁰ Independent Pricing and Regulatory Tribunal, n 2, 13.

⁶¹ Ibid.

⁶² Ibid.

⁶³ Independent Pricing and Regulatory Tribunal, n 2, 51. Under the *Fit for the Future* process councils were obliged to submit estimates of cost savings under merger and ‘stand alone’ scenarios.

⁶⁴ KPMG, *Local Government Reform: Merger Impacts and Analysis* (2015).

⁶⁵ See, Independent Pricing and Regulatory Tribunal, n 2, 51.

⁶⁶ New England Education and Research (NEE&R), *Review of KPMG (2016) Outline of Financial Modelling Assumptions for Local Government Merger Proposals Technical Paper* (2016). NEE&R showed that KPMG (2016) had made serious errors in its calculations, especially with respect to redundancy costs, in the order of tens of millions of dollars.

⁶⁷ See, Suzanne Leland and Kurt Thurmaier, ‘Lessons from 35 years of City-County Consolidation Attempts’, in *The Municipal Yearbook 2006* (International City/ County Management Association, 2006); Suzanne Leland and Kurt Thurmaier (eds.), *City-County Consolidation: Promises Made, Promises Kept?* (Georgetown University Press, 2010); Faulk and Hicks, n 9; Dagny Faulk and Georg Grassmueck, ‘City-county Consolidation and Local Government Expenditures’ (2012) 44 *State and Local Government Review* 196, 205.

efficiency gains and cost savings. For example, in an assessment of empirical work on whether consolidation produced greater efficiency, Feiock concluded that mergers had not generated savings but rather had led to increased expenditures.⁶⁸ Similarly, in their review of the impact of city-county consolidation programs, Martin and Schiff found little evidence that municipal consolidation enhanced performance, including through reduced costs.⁶⁹ Leland and Thurmaier examined nine case studies of amalgamated and comparable unmerged local authorities and they concluded that cost savings and other efficiency gains were not generally observed.⁷⁰

These findings have been echoed in the Canadian literature. For instance, Reese established that remuneration levels in merged Ottawa councils increased in post-amalgamation, with a rise in overall expenditure.⁷¹ Similarly, Vojnovic studied the effects of consolidation on five councils and found that aggregate costs typically increased.⁷² European scholars have arrived at analogous conclusions. For example, contributors to Dollery and Robotti considered amalgamation in France, Germany, Italy and Spain and they found that it had not achieved its intended effects in economic terms.⁷³

A small but growing Australian empirical literature has investigated the impact of municipal mergers on council performance.⁷⁴ With some exceptions, the Australian literature is uniformly pessimistic of municipal mergers as a means of improving local government performance. For example, in the case of NSW local government, Bell, Drew and Dollery empirically investigated the outcomes of the 2000/2004 NSW council amalgamation program by comparing merged and unmerged peer councils: They found no difference in performance.⁷⁵

Similarly, work by Drew, Kortt and Dollery has demonstrated that the projected efficiencies attendant upon the 2008 Queensland amalgamations largely failed to materialize.⁷⁶ Indeed, the net effect of the Queensland mergers was to increase the level of diseconomies of scale

⁶⁸ Richard Feiock 'Do Consolidation Entrepreneurs Make a Deal with the Devil?', in Jered Carr and Richard Feiock (eds.) *City-County Consolidation and its Alternatives Reshaping the Local Government Landscape* (M. E. Sharpe, 2004).

⁶⁹ Lawrence Martin and Jeannie Schiff, 'City-county Consolidations: Promise versus Performance' (2011) 43 *State and Local Government Review* 167, 177.

⁷⁰ Leland and Thurmaier, above n61.

⁷¹ Laura Reese, 'Same Governance, Different Day: Does Metropolitan Reorganization Make a Difference?' (2004) 21 *Review of Policy Research* 595, 611.

⁷² Igor Vojnovic, 'The Transitional Impacts of Municipal Consolidations' (2000) 22 *Journal of Urban Affairs* 385, 417.

⁷³ Dollery and Robotti, above n 9.

⁷⁴ See, Dollery, Grant and Kortt, above n 1.

⁷⁵ Brian Bell, Joseph Drew and Brian Dollery, 'Learning From Experience? An Empirical Evaluation of the 2000–2004 Municipal Mergers in New South Wales' (2016) *Economic Papers*, DOI: 10.1111/1759-3441.12136.

⁷⁶ Joseph Drew, Michael Kortt and Brian Dollery, 'Did the Big Stick Work? An Empirical Assessment of Scale Economies and the Queensland Forced Amalgamation Program' (2016) 42 *Local Government Studies* 1, 15.

in local government service provision. It should be added that the inefficiency resulting from over-scale forcibly merged councils was a significant factor in motivating the large number of bids for de-amalgamation in Queensland.

A further example of the improbable 'efficiency claims' by proponents of the NSW forced mergers derives from the operating results from the Sunshine Coast Regional Council (SCRC) in Queensland which was formed by the compulsory consolidation of Caloundra, Noosa and Maroochy in 2008. In this regard, Drew and Dollery observed that 'the combined operating results of the three councils prior to amalgamation were: surplus of A\$152.8 million in 2007, A\$159.05 million surplus in 2006 and A\$160.78 million surplus in 2005'. By way of contrast, 'operating results for the SCRC in 2010, 2011 and 2012 were A\$126 million surplus (2010 financial year), A\$372 million deficit (2011 financial year) and A\$80 million surplus (2012 financial year), excluding asset revaluations'.⁷⁷ It is thus hardly surprising that SCRC residents voted 81% in favour of de-amalgamation.⁷⁸

However, the bulk of Australian evidence on the outcomes of amalgamation programs in state and territory local government systems derives largely from public inquiries into local government.⁷⁹ The most relevant of these reports in the contemporary NSW context is the Queensland Treasury Corporation's (QTC) *Review of Local Government Amalgamation Costs Funding Submission: Final Summary Report*.⁸⁰ QTC gathered information from councils forcibly merged in Queensland in August 2007. Reported 'first-round' costs were '\$9.3 million (mean) for metropolitan councils and \$7.994 million (mean) for regional/rural councils'.⁸¹ Ongoing amalgamation costs include expenditure arising from wage parity, increased senior management costs, and a reticence to make existing staff redundant.⁸² The mean of claimed one-off amalgamation costs for the 2007 Queensland amalgamations was \$8.1m and this did not include ongoing costs.⁸³

C. *Economic and Financial Impact of the Rate Path Freeze Policy*

As we have seen, throughout *Freezing Existing Rate Paths for Newly Merged Councils* IPART maintains the fiction that not only will net cost savings emerge across the four-year rate path freeze, but also that these cost savings will exceed the transformation and transactions costs

⁷⁷ Joseph Drew and Brian Dollery, 'Separation Anxiety: An Empirical Evaluation of the Sunshine Coast Regional Council De-amalgamation' (2014) 34 *Public Money & Management* 217.

⁷⁸ *Ibid.*

⁷⁹ Dollery, Grant and Kortt, above n 1.

⁸⁰ Queensland Treasury Corporation (QTC), *Review of Local Government Amalgamation Costs Funding Submission: Final Summary Report* (2009).

⁸¹ Drew and Dollery, above n 5, 3.

⁸² Queensland Treasury Corporation, n 74, 22.

⁸³ Queensland Treasury Corporation, n 74.

attendant upon forced amalgamation.⁸⁴ No empirical evidence was adduced by IPART in support of this assumption, apart from citing various politicised estimates in municipal submissions to *Fit for the Future* and the flawed KPMG report.⁸⁵

Quite apart from the findings in the QTC report on the short-run costs associated with the Queensland amalgamations over 2007/08 and the international experience with municipal mergers, Victorian experience with a rate freeze following its forced amalgamation in the early 1990s is salutary. As part of its draconian forced merger program in October 1994 the Kennett Government imposed a freeze on residential rates as well as fees and charges, which was further compounded by a reduction in council rates by 20 per cent and a peg on future rate increases.⁸⁶ In 1996, the Victorian Government proclaimed savings of some \$323 million in municipal outlays as a consequence.⁸⁷ However, Dollery and Wijeweera examined the relative performance of Victoria rates compared with other Australian local government systems and demonstrated that – once the rate peg was lifted – Victorian rates increased the most rapidly. Table 1 is reproduced from Dollery and Wijeweera⁸⁸:

Table 1: Percentage Rate Increases by Australian State Jurisdiction, 1995/96 to 2003/04

State or Territory	Per cent Council Rate Increase
New South Wales	29.2%
Australian Capital Territory	35.2%
Tasmania	36.3%
South Australia	55.1%
Queensland	55.6%
Western Australia	64.8%
Victoria	66.1%
Gross Domestic Product	61.8%

⁸⁴ Independent Pricing and Regulatory Tribunal, above n 2.

⁸⁵ KPMG, above n 58.

⁸⁶ Brian Dollery and Albert Wijeweera, 'Time for Change? An Assessment of Rate-Pegging in New South Wales Local Government' (2010) 6 *Commonwealth Journal of Local Governance* 56, 76.

⁸⁷ Victorian Government, Performance Reporting in Local Government (2008).

⁸⁸ Dollery and Wijeweera, above n 80, 69.

Table 1 provides a striking demonstration of how the Victorian rate freeze simply delayed inevitable expenditure, especially on the costs of amalgamating. Moreover, it dispels the myth that Victorian municipal mergers generated lower rates in the long term. It follows that if the objective of the NSW Government's rate path freeze policy is to prevent a future rate 'shock', then this demonstrates that – at best – it will simply defer the shock for four years.

Given the heavy transaction and transformation costs imposed on compulsorily consolidated councils by amalgamation, together with the sharp impost related to the need to 'harmonise' local service delivery across newly amalgamated municipalities, it is obvious that the four-year rate path freeze will have a deleterious effect on the financial sustainability of the new councils. In essence, at the same time that they are being asked to incur additional expenditure to harmonise services and pay amalgamation expenses, councils will have around a third (34%) of their revenue frozen through the rate path freeze.⁸⁹

In addition, the timing of the expiration of the rate path freeze in April 2020 could hardly be worse. It coincides with likely sharp reductions in Commonwealth Financial Assistance Grants (FAGs) when the four-year freeze expires.⁹⁰ Thus, in addition to being exposed to rate shock deriving from councils playing 'catch-up' on the four-year rate path freeze, residents will also likely be exposed to increases in rates to cover significant reductions in FAG receipts. However, it should again be stressed that this will occur after the next NSW election which will mitigate its political impact.

D. *Equity Considerations of the Rate Path Freeze Policy*

As we have seen, in its interpretation of the NSW Government's rate path freeze policy, IPART advanced two normative principles to guide rate-setting in the requisite four-year post-merger period:

- The new amalgamated municipality must not be able to 'redistribute its rating burden between pre-merger council areas'.
- 'Rates within a pre-merger council area are no higher than they would have been under its existing rate path'.⁹¹

In the standard normative economic analysis of public policy this is equivalent to invoking the well-known Pareto Principle which holds that no person should be made worse off under a policy change than they would have otherwise have been had no policy change occurred.⁹²

However, if we consider the NSW Government's rate path freeze policy in the context of all NSW local authorities – and not simply those which have been compulsorily consolidated – then it becomes clear that IPART has not thought through the inequitable consequences of

⁸⁹ Australian Bureau of Statistics (ABS), *Government Finance Statistics*, Australia, 2014–15 (2016).

⁹⁰ *Local Government (Financial Assistance) Act 1995* (Cth), proclamation under subsection 6(4), 2006.

⁹¹ Independent Pricing and Regulatory Tribunal, above n 2, 27.

⁹² Edward Mishan, *Introduction to Normative Economics* (Oxford University Press, 1981).

the rate path freeze policy. In the first place, if we compare forcibly merged councils with their unmerged counterparts, then it is clear that the equity consequences of the rate path freeze policy are problematic. For example, why do some ratepayers in NSW get their rates frozen as at the trajectory determined in April 2016 whereas other ratepayers in unmerged councils remain exposed to very large increases? In what sense is this equitable from a system-wide perspective? Secondly, in what respect is the rate path freeze policy equitable when local authorities which had applied for - and been granted - Special Rate Variations (SRVs) prior to forced amalgamation remain stuck with the increases, whereas residents in councils which had only planned (but not yet applied) for SRVs will not face increases until at least April 2020?

A universal feature of both voluntary and forced municipal mergers resides in the need to modify the characteristics of local service delivery of the pre-merger councils so that local residents across the new local authority enjoy comparable levels of services.⁹³ While in some cases where rural shires are forcibly combined with regional centres differentiated services persist, in general equity considerations demand that all residents of amalgamated councils receive an equal level and quality of local services. This obviously requires the 'harmonisation' of services.

However, under the IPART stipulation that (a) the new amalgamated municipality must not be able to 'redistribute its rating burden between pre-merger council areas', the equity consequences of service harmonisation generate glaring inequities.⁹⁴ For example, in the case of a newly merged council comprised of, say, council A and council B, if council A had an SRV accepted prior to the amalgamation of ten per cent per annum, whereas council B had no SRV, it is obvious that service harmonisation will place council A residents in invidious and worsening inequitable circumstances. By contrast, inhabitants of council B will enjoy a 'free lunch' for the four-year rate path freeze. It is thus apparent that the IPART approach to the rate freeze policy can lead to sharp inequities which are bound to generate bitterness and division in the new councils.

IV. CONCLUSION

In this paper we have carefully considered both the interpretation of the NSW Government's rate path freeze policy by IPART in its *Freezing Existing Rate Paths for Newly Merged Councils* and IPART's approach to the implementation of the policy over its proposed four-year life to April 2020.⁹⁵ We have been at pains to stress the overtly political nature of the rate path freeze policy and the political advantages which it confers on the NSW Government. In

⁹³ Dollery, Grant and Kortt, above n 1.

⁹⁴ Independent Pricing and Regulatory Tribunal, n 2, 27.

⁹⁵ Independent Pricing and Regulatory Tribunal, n 2.

essence, the rate freeze policy is designed to enhance the political fortunes of the Baird Government rather than advance the public good by improving NSW local government.

The analysis of IPART's *Freezing Existing Rate Paths for Newly Merged Councils* conducted in this paper has demonstrated that its approach to the NSW Government's rate path freeze policy is severely flawed in at least four major respects.⁹⁶

Firstly, as we showed in section 3.1 of the paper, IPART has perforce ignored the political foundations of the NSW Government's rate path freeze policy. This means that it has misinterpreted the underlying motivation for the policy. Secondly, in section 3.2 we have marshalled available empirical evidence to show that the purported cost savings flowing from the forced merger program are illusory and will in any event be swamped by the cost of amalgamation. Thirdly, in section 3.3 we have evaluated the economic and financial impact of the rate path freeze policy on the future financial sustainability of local authorities. In so doing, we have demonstrated that the onerous transaction and transformation costs of compulsory council consolidation imposed on compulsorily consolidated councils by amalgamation, in combination with the expenses associated with local service harmonisation across new councils, will have an adverse impact on the financial sustainability of the new councils. Finally, in section 3.4 we showed that the application of the rate path freeze policy advocated by IPART will have inequitable consequences not only for residents of the amalgamated councils, but also for people living in unmerged municipalities.

⁹⁶ Independent Pricing and Regulatory Tribunal, n 2.