

26 August, 2002

Mr David Hawker MP

Chairman

House of Representatives Economics, Finance and Public Administration Committee

Parliament House

CANBERRA ACT 2601

Dear Mr Hawker

Inquiry into Local Government and Cost Shifting

The NFF welcomes the opportunity to make a submission to this inquiry, which we believe is timely and opportune.

The provision of services to rural and regional Australia is naturally a key issue for the NFF.

There is much evidence to suggest that services to regions are being diminished over time. It is becoming harder to obtain services such as banking, medical care, education, and transport in many non-urban areas. Local governments are under pressure to deliver or support these services, as companies and other governments reduce their involvement in service provision.

In addition, local communities are demanding new and improved services as new technologies are developed, such as the internet. There are also legislated requirements on local government, such as reporting, environmental and governance regulations.

While it may be inappropriate for local governments to undertake some of these activities, often it may be better for some spending to occur at the local government level, so that services can be tailored to local needs and wishes. The NFF is mainly concerned that local governments are frequently not provided with appropriate funding to meet these new challenges. Consequently, the current allocation of financing and spending to local government funding may be unsustainable in the long run.

The NFF therefore supports a more sustainable funding and spending model for local government. In particular, the NFF argues that local government social spending (eg on health and education services) is better funded through federal taxes (the traditional funding source for social policy) rather than through the often inequitable rates system.

This inquiry is a useful forum to explore these issues and thus ensure that quality services will be delivered in an efficient and timely manner to all Australians.

The importance of agriculture to Australia

Agriculture is a very important part of Australia's society and economy.

- While rural production makes up around 3 percent of Australia's GDP¹, it provides around 21 per cent (\$34.0bn) of our goods and services exports².

1. Source: ABS, *Agriculture (Cat no 7113.0)*, table 1.3

- Many rural communities depend upon agriculture for their prosperity. Agriculture contributes more than 30 per cent of employment in 66 per cent of small non-coastal towns³.
- Farmers are vital custodians of the land, with agricultural activities covering 60% of the Australian landmass⁴.
- Agriculture is one of the largest employers in Australia, providing around 320,000 jobs – a level which has actually increased in the past five years, even with substantial improvements in productivity over this timeframe⁵.
 - Agricultural productivity increased by 3.3 per cent per year between 1988 and 2000, well above the average of 1.2 per cent and the second highest in the market sector (after communications)⁶.
 - This fact in particular should dispel the myth that the agricultural sector is ‘old economy’. Farmers have been adopting new technologies and improving practices with fervour.
- Agriculture also represents a significant input into many other industries, particularly the food processing industry, which had a turnover of \$51.2 bn and a value added of \$14.2 bn in 1999-2000. Food processing is the largest industry subdivision of total manufacturing, both by value added and by employment. It also provides over \$11 bn of exports⁷.

The extent of the problem

Spending

The Victorian Farmers’ Federation (VFF), in its submission to this inquiry, has indicated that there is evidence of cost shifting in libraries, home and community care, kindergartens, maternal and child health and school crossing supervision. The experience in Victoria has been that many councils, especially rural municipalities, are now placing an increased focus on regional development, tourism services and environmental management, including Landcare support and pest, animal and weed control. The VFF notes that councils are not resourced professionally nor financially to undertake these additional responsibilities.

The Commonwealth Grants Commission has found⁸ that local government expenditure has increasingly been focussed on human services and away from property-based services

2. Source: ABARE, *Australian Commodities*, table 5

3. Agriculture contributes more than half of total employment in 28 per cent of small non-coastal towns. Source: ABARE, *Country Australia*, p38

4. Source: ABS, *Agriculture (Cat no 7113.0)*, table 5.1

5. Source: ABS, *Agriculture (Cat no 7113.0)*, table 1.4, which also shows non-owner employment increased by over 6,000 between 1996 and 2000.

6. Source: OECD, *Economic Surveys – Australia 2000-01*, p82

7. Source: ABS, *Manufacturing Industry, Australia, (Cat no 8221.0)*

8. Commonwealth Grants Commission, *Review of the Operation of the Local Government (Financial Assistance) Act 1995*, p53.

(particularly roads). Expenditure on education, health, welfare, public safety, recreation and culture and housing and community activities has increased in relative importance.

Regulation and compliance

Local government is also being asked to undertake more compliance and regulation activities because of state or federal government legislation. These activities often have to be funded from existing sources of revenue, placing increasing pressure to raise rates and charges.

The VFF, in its submission to this inquiry, has outlined some significant increases in regulatory requirements placed on local government, including codes of conduct, compulsory competitive tendering, public registers, reviews, property revaluations and increased regulation of council elections and candidate donations, planning, resource management and entrepreneurial activities.

Rural areas are harder hit

The financial challenges facing local government are pronounced for rural councils. In its submission to this inquiry, the VFF has indicated that Victorian rural councils have higher rates than metropolitan councils (relative to both property valuations and household incomes). Rural and regional councils also spend more per resident (\$867) than do metropolitan councils (\$624), with small rural shires spending \$1,123 per resident. Road expenditure by rural councils averages \$406 per head whereas metropolitan councils spend \$102 per head.

The current financial year is likely to be challenging for farmers. The current drought conditions in much of Australia have led to forecasts of large falls in farm production and income. In June, ABARE forecast that production would fall by 9% from 2001-02 to 2002-03 and income would fall by over 40%. In addition, it is likely that these forecasts will be revised downwards in the near future. Meanwhile, many farm costs are rising, including interest rates, insurance and of course council rates.

Local government spending in theory

There is nothing wrong *per se* with particular activities being undertaken by local governments instead of state or federal governments. In fact, it may be better for local government to undertake some activities, particularly where they need tailoring to local needs or circumstances. This can include environmental programs or local transport.

In addition, there are many situations where local communities have different priorities from state or national governments. If some spending powers are devolved to local levels, then this provides greater opportunity for local spending to be tailored to local needs or wishes. It also reduces the need for central bureaucracies to determine local needs (even if services are provided by federal or state governments, they may still need to be tailored to local circumstances).

However, if activities are transferred to local governments, it is generally inappropriate for the local governments to be forced to take these activities on; instead it is better for the transfer to be on a mutually agreed basis. In many examples of cost shifting, there has been

little or no discussion with the local council over the new responsibilities. The general problem is that costs are shifted to local government without a corresponding shift in funding. Clearly, local governments would be much more willing to accept new roles and responsibilities if they received adequate funding.

However, not all cost shifting issues can be solved by allocating responsibilities fully to one jurisdiction. This is because some activities naturally fall across jurisdictional boundaries, such as road investment. Currently all three levels of government are involved with roads, with spending by one jurisdiction affecting others. This makes cost shifting more likely.

Local government funding

If the responsibilities of local government are to be increased, then it is only reasonable that they have the funding sources to meet these new responsibilities. The Commonwealth Grants Commission argues (p. 55) that:

“Where the source of the financial pressure is the result of changing policies or actions of other spheres of government (the State or the Commonwealth), it would be appropriate for that sphere to acknowledge the effect of its actions on local government. Where these actions impose extra functions on local government greater financial assistance could be appropriate.”

In general, this can occur through increased taxes, charges or funding by other governments.

Increasing local government taxes

Increased costs on local government have often meant an increase in taxes, particularly rates on land. While this may be acceptable if other taxes and charges are cut, generally this has meant an increase in the overall tax burden. The NFF does not support this approach.

Even if other taxes were reduced, there are significant problems with the land tax that local governments have to rely on. While an ideal land tax is economically efficient, it is unlikely that an “ideal” land tax can and would be imposed. In addition, land tax can be very inequitable:

- Land is of course a vital input into agricultural production. Thus land taxes can hit farmers heavily. Other industries can adjust land use in response to land taxes, whereas farmers generally cannot.
- Land value can be a poor indicator of an individual taxpayer’s capacity to pay. Land ownership is only one form of wealth and does not include the owner’s income or debt position. Income and consumption taxes are reduced when the taxpayer is less well off.
- Fixed revenue requirements from land taxes will often mean that land tax rates have to be higher in rural areas. A particular land tax rate in a city will raise much more revenue than the same land tax rate in rural areas, where property prices are lower. Thus a farm that lies in a mainly urban council may have much lower rates than a property next door that lies in a largely rural council.
- While land taxes may reflect some of the costs of services provided by a local government, this is becoming less true over time. Land taxes are more appropriate for the provision of property-based services, such as the construction and maintenance of

roads (as long as these services are not also charged for through fuel taxes). As the services provided by local government have increasingly shifted from property-based services to social services, so should the funding mechanisms. It is generally considered that social programs should be funded from taxes that reflect the capacity to pay. Land taxes generally do not meet this criterion.

- While rates have increased for funding social programs, local governments are simultaneously increasing user charges. This is inequitable for land holders who are paying for some services twice; first through rates and secondly through user charges.

That said, the NFF may be willing to examine a tax mix switch if it meant a reduction in very inefficient taxes such as stamp duty or fuel excise. Another issue that should be explored is whether there are alternative taxation sources for local government.

Funding from other levels of government

As noted above, social spending by local governments should be funded by income and consumption taxes, not land taxes. These services have been historically and appropriately funded from income and consumption taxes, which are more reflective of equity and ability to pay.

However, the increasing level of social responsibilities put on local government is not matched by increased funding from state and local governments. Too often, costs are being shifted by stealth onto local government, so that increased council funding does not occur. While this improves the budget balance of the other jurisdiction, local governments have to respond often by increasing their taxes at an unsustainable rate. As noted above, mutually agreed shifting of responsibilities could alleviate or remove this problem.

A separate issue is whether federal or state governments should provide funding to local government. The NFF is not overly concerned with this issue, but notes there may be some inefficiencies from double handling of money that is passed from federal to state and then local governments.

User charges

Another actual and potential source of funding is from user charges. While user charges may be appropriate in certain circumstances, the NFF is concerned that there is increasing 'double charging' for services; that is, the services are paid for through taxes at the same time as charges are levied on the service. An example of this is road investment, which is at least partly funded through fuel taxes, while user charges are increasingly being imposed at the same time. The NFF does not support this development, and argues that there should be a significant reduction in fuel taxes and an increase in road charges where congestion occurs (see our submission to the fuel tax inquiry for further details). We do not support road funding through increased land taxes, as land value is not closely related to road use.

There are other examples of double charging for local government services. As noted above, the NFF is concerned that many social services are being funded through local government rates, while it is understood and expected that these services are paid for through federal taxes.

Governance of Local government

The decision about which level of government should provide particular goods or services depends on the quality of governance of the jurisdictions. Some concerns have been raised (rightly or wrongly); for example that local governments can be beholden to interest groups, particularly developers, or can be poorly managed. These concerns over local government need to be addressed. With increased responsibilities for local government come added responsibilities. Some solutions include:

- **Amalgamations:** Wider representation on councils can mean that it is less likely that individual businesses can sway decisions. There also can be efficiency benefits from larger councils. However, larger councils are further away from the local communities, thus defeating part of the reason for the devolution of power to the local level. The VFF has indicated that some farmers have felt disenfranchised by local government amalgamations, especially where municipalities are dominated by a major urban population and where farming community views are not given high priority by the council.
- **Increased formal recognition of local government (particularly constitutional recognition):** this is a long debated and complex issue.
- **Performance criteria for funding:** the Federal Government is setting performance criteria for funding to State governments. This approach could be extended to funding for local governments by all jurisdictions.
- **Increased regulation of local government activities, such as compulsory competitive tendering and reporting of donations:** as noted above, these new regulations can be a significant burden on local governments. The NFF trusts that these regulations are not being imposed unilaterally or frivolously, but are determined to be in the clear long run benefit of ratepayers.

Summary

The NFF has welcomed the opportunity to present its views on local government and cost shifting. We have noted that there are significant concerns that costs, particularly from social and environmental programs, are being shifted onto local governments. At the same time, funding is not being increased to reflect these new responsibilities. The NFF does not accept that the best solution is for local government to raise rates and charges; we instead argue that there should be increased funding from other levels of government as appropriate to meet these increased costs.

If you wish to discuss these issues any further, please contact Michael Potter, Policy Manager, Economics, at the NFF on 6273 3855.

Yours sincerely,

ANNA CRONIN

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