

**House of Representatives Inquiry into Local Government and Cost Shifting**

**Submission by the South Australian Government**

**August 2002**

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## **Introduction**

This report represents a submission to the Inquiry called by the Minister for Regional Services, Territories and Local Government - who has requested the House of Representatives Standing Committee on Economics, Finance and Public Administration to inquire into “Cost shifting onto local government by state governments and the financial position of local government”.

The Government of South Australia is pleased to participate in any process that will enhance the delivery of services to the South Australian community. It looks forward to recommendations from the Committee that will substantially enhance the capacity of Local Government to better serve its constituency.

## **Key Issues**

The South Australian Government offers the following as a summary of the key issues, which it advocates should be acknowledged by the Inquiry:

- There are significant pressures on the funds available to both Local Government and State Government for the delivery of services, and this is likely to increase in the future. In this regard the South Australian Government argues that:
  - In recognition of the unmet and increasing demand for services, the real amount of untied grants distributed to local and state government must be increased.
  - Even if no increase in overall funding is made, the relative cost disadvantages for South Australia and disadvantages in revenue raising capacity must be fully addressed through adoption of appropriate horizontal equalisation methodologies in the distribution of grants for local government, as well as for state government, if the public interest is to be served appropriately throughout Australia.
- It is critical for effectiveness in public sector service delivery that all three spheres of government have recognised legitimacy – have the scope to influence their jurisdiction, have a substantial degree of (financial) freedom and flexibility in decision making, and provide appropriate checks and balances against each other. Enhancing that legitimacy of Local Government, and effectiveness in operation are policy priorities of the South Australian Government, and these same priorities would be enhanced with an increased emphasis by the Commonwealth Government.
- Focussing on expressed concerns about cost shifting has the potential to limit relationships between the spheres of government, and as such, a comprehensive assessment of the issues involved is welcomed. In considering the issue the following factors must be recognised
  - The term “cost shifting”, while generally carrying a negative connotation, can refer to actions that have positive outcomes as well – reflecting a desire to allocate appropriate roles and responsibilities and improve efficiencies.
  - A simplistic analysis of financial data cannot always give a clear picture of the issues. An increase in expenditure does not necessarily mean that extra tasks

have been pushed onto local government – there are many other aspects to the relationships involved.

- There are ways in which activities of given spheres of government can be mutually enhanced. Sometimes this can be achieved without financial transfers, but rather through increased cooperation and strengthened relationships.

## **Background to the Inquiry**

The Terms of Reference for the Inquiry are as follows:

*“The Minister for Regional Services, Territories and Local Government has asked the Committee to inquire into:*

*Cost shifting onto local government by state governments and the financial position of local government. This will include an examination of:*

- 1. Local government's current roles and responsibilities.*
- 2. Current funding arrangements for local government, including allocation of funding from other levels of government and utilisation of alternative funding sources by local government.*
- 3. The capacity of local government to meet existing obligations and to take on an enhanced role in developing opportunities at a regional level including opportunities for councils to work with other councils and pool funding to achieve regional outcomes.*
- 4. Local government expenditure and the impact on local government's financial capacity as a result of changes in the powers, functions and responsibilities between state and local governments.*
- 5. The scope for achieving a rationalisation of roles and responsibilities between the levels of government, better use of resources and better quality services to local communities.*
- 6. The findings of the Commonwealth Grants Commission Review of the Local Government (Financial Assistance) Act 1995 of June 2001, taking into account the views of interested parties as sought by the Committee.*

*The inquiry is to be conducted on the basis that the outcomes will be budget neutral for the Commonwealth.”*

## **The Funding of Service Delivery Reductions in Funding**

Over recent years the States have become increasingly concerned at the decline in their share of national tax revenues, particularly in light of increasing expenditure requirements and limited State tax bases.

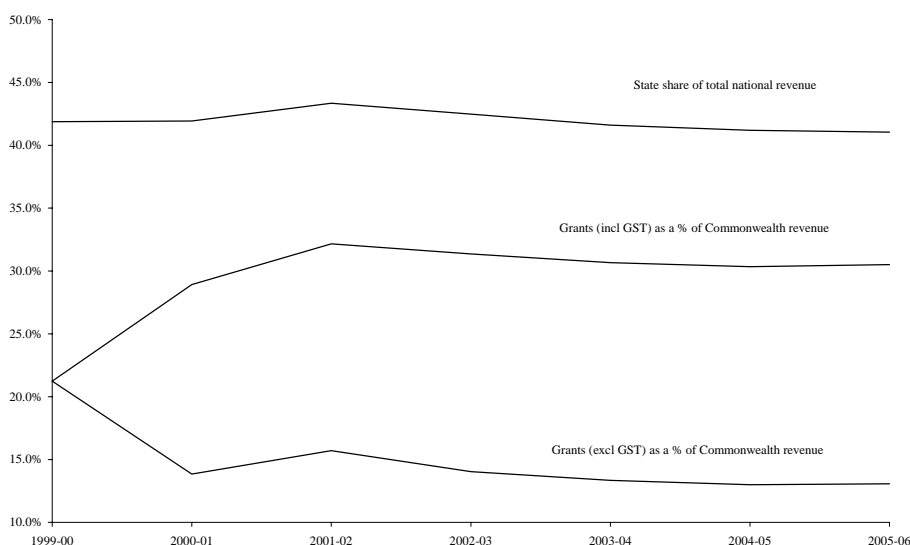
In the 10 years before national tax reform was introduced, the Commonwealth raised on average almost 80% of national revenue (the sum of Commonwealth and State revenues), while spending only around 60% of total own-purpose outlays (much in the social security system). The States have thus had to rely on Commonwealth grants as a major funding source (in 2000/01, the States' revenues incorporated \$1.40 of grants for every \$1 of own sourced revenues). These grants have fallen considerably as a share of Commonwealth

revenue in recent years. In turn this has restricted the States' ability to meet their expenditure commitments. At the same time, own taxation opportunities at the State level have been limited.

The funding arrangements provided under the inter-government agreement governing arrangements following the introduction of the GST are predicted to eventually make the States better off, with GST revenues expected to outstrip the guaranteed minimum amount (ie funding paid to States to ensure they are no worse off under the new arrangements) for all States by 2007-08. The new arrangements up till now have not, however, improved the budget position of South Australia or any other State.

If the Commonwealth maintains its current level of funding from sources other than the GST, the States' share of national revenue will, at best, remain unchanged (Figure 1). There will be no windfall gain to the States from the GST revenue; it will simply allow the States' revenue base to grow at around the same rate as that of the Commonwealth. It follows that the Commonwealth will continue to have a significant role in ensuring that States are adequately funded to provide services.

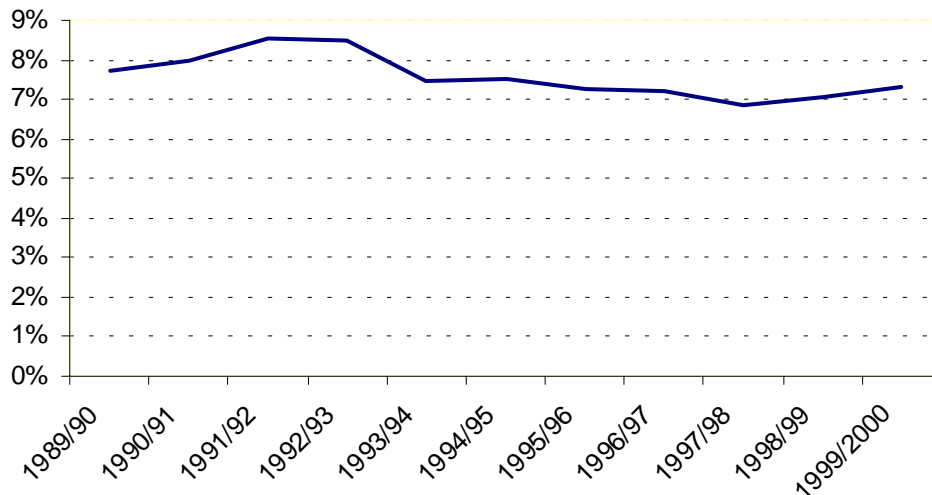
**Figure 1 State share of Commonwealth and national revenue**



Note: National revenue is the sum of Commonwealth and State revenue.  
Source: SA Budget Papers

This predicted experience in the next few years extends the history of the last two decades, when (as noted above) financial resources available to state and local government have been generally reducing relative to the size of the economy, and to the underlying level of taxation revenue. The experience with respect to grants (relative to Gross State Product) from the Commonwealth to State and Local Government in South Australia over the last decade is illustrated in Figure 2.

**Figure 2: Commonwealth Grants To State and Local Government in South Australia Proportion of GSP**



Source: ABS national accounts data

The proportion of centrally collected funds that has been distributed to state and local government for delivery of services has consistently fallen over two decades. Yet in our federal system, it is state and local government that are primarily responsible for service delivery – if defence and social security and welfare are taken out of the equation then the States are responsible for almost 60% of public sector expenditure.

The difficulties of the financial situation in South Australia have been made clear in the 2002/03 South Australian Budget. The State Government has had to make some difficult decisions in the interests of all South Australians, and Local Government outcomes must be considered in this context.

### ***Lack of Choice in Use of Funds***

One aspect of the decline in grants is that the Commonwealth Government has chosen to become more directly involved in regional affairs (eg directly allocating grant funds to community groups rather than allocating through State and Local Government). The consequence however, has been decreasing options for State and Local Government in funding increased demands for services in their own priority context. Services are to some degree imposed rather than chosen.

Indeed, it is noted that a “key” driver for this kind of inquiry is the desire of the sphere of government with greater control of financial resources (ie national) to impose their will on the level dependent on grant funds. This is achieved by moving from grants to direct funding, by moving towards specific purpose grants rather than general purpose (which also has been very much part of the funding picture), and by adding requirements to allocations (eg dollar for dollar requirements). These types of requirements represent a weakening in the legitimacy of each sphere of government.

Further, the bypassing of the Financial Assistance Grants process in supporting local government can lead to the introduction of inefficiencies. The issuing of competitive bids for sums of money may improve perceived accountability and consistency with the

Commonwealth's agenda. It can also involve significant resources allocated to the bidding process, which comes at significant additional cost to the community.

### ***Equity in the Provision of Community Services***

As noted above, state and local government depend heavily on Commonwealth grants to fund service provision. One of the justifications of the grants process is that central revenue raising allows for equity in access to public services across regions despite variations in revenue raising capacity and disadvantages in costs of service delivery (see arguments below). Therefore a key feature of the grants distribution process to the states is the use of fiscal equalisation.

In June 2001 the Commonwealth Grants Commission completed a review of the operation of the Local Government (Financial Assistance) Act 1995 on behalf of the Federal Minister for Finance and Administration. The review concluded that only minor changes were needed, mainly to improve transparency. At the time of the review the South Australian Government made a number of submissions, with the primary aim of preserving the principle of horizontal fiscal equalisation in the intrastate distribution of the general purpose grants. The review was explicitly prevented from examining the **interstate** distribution of the local government general purpose grants (currently made on an equal per capita basis) and the distribution of the local roads grants (currently made on an undefined historical basis).

The South Australian Government and local governing bodies have long been dissatisfied with the share the state receives of local roads grants. In particular, the distribution of funds based on historical shares, rather than on the basis of need, results in South Australia receiving less than a per capita share of such funds and a lower per capita and per road length amount than any other State.

The South Australian Government argues strongly that there is a sound case for distributing the local government financial assistance grants among the States on the basis of horizontal fiscal equalisation. It is an anomaly that equalisation is presently used (and indeed required by the Commonwealth on equity grounds) for allocating grants within States but not between States.

It is noted that the only significant reason given for not recommending full fiscal equalisation in the Grants Commission review was a "lack of funding".

During 1997-98, the South Australian Local Government Grants Commission conducted a comprehensive review of the methods used to distribute the grants within the State. This review was aimed at ensuring that the equalisation process was appropriately reflecting issues of cost differential and revenue capacity, thereby supporting the ability of Local Government in serving their community. The changes are being phased in over a seven-year period, concluding with the determination of grants for 2004-05, and have attracted interest as a model both nationally and internationally.

## **Improving the Effectiveness of Public Sector Service Delivery**

The Australian community has the right to expect that decisions as to the delivery of public services to them will be based upon maximising the effectiveness of that service. It is critical in this review that the issues of effective service delivery are paramount in the development of recommendations. This section of the submission summarises the South Australian Government's perspective on these issues.

### ***The Legitimacy of Local Government***

Following the state election early this year, the South Australian Government (through the Minister of Local Government) has identified the following policy themes and priorities for working with the Local Government sector:

- Open and accountable Government with a focus on probity and transparency
- Addressing Local Government with respect, recognising Local Government as a legitimate sphere of government in their own right in a more substantial way than has occurred in recent years
- Fairer and more equitable arrangements for funding local government
- Ensuring that Councils' employment practices and relations with employees reflect best practice, and
- Enhancing the capacity of elected members and senior managers in Local Government to provide leadership to their communities

These policy positions are clearly framed in the context of improving the effectiveness of service delivery, and reinforce the arguments introduced earlier of the need to ensure legitimacy of all spheres of government. Service delivery will be enhanced when recognising that each sphere of government has its own mandate and own constituency. The trends and patterns in Commonwealth grants and funding have had the effect of limiting this recognition, which muddles political accountability and distorts priorities.

As well as the finance issue, there is the question as to the way in which the levels of government interact, and the State Government – as demonstrated by its policy position – is committed to ensuring that the interactions between State and local government recognise the roles and functions of local government and works together in areas of shared priority.

A key benefit from this Inquiry would be if the Commonwealth Government also augmented its commitment to working with the other spheres of government to improving the legitimacy, interaction and roles of functions of all spheres.

### ***Historical Perspective***

The commitment of the South Australian Government is based on a recognition that recent years have seen significant change and reform in local government and its service delivery drivers. The key issues forcing reform in structure include:

- The changing nature of what constitutes a “local” area



- Changing demands in traditional local government areas (eg waste collection, with increasing state and national interests in disposal and its environmental implications)
- Changing capacity for user charges (technological change has increased the capacity for user charges to be introduced in discriminating ways without excessive cost)

In South Australia, Local Government has been pro-active in working with State Government in dealing with these drivers of change. The responses have included

- *Boundary reform* – voluntary Council amalgamations occurred in the late 1990's, reducing the number of Councils in the state from 118 Councils to 68. As well as introducing cost efficiencies in operations, boundary reform has produced benefits such as better planning for council activities, better use of equipment and technology, more community services and most importantly, a stronger Local Government sector and improved relationships between State and Local Government. The reform process still recognises the great diversity needed amongst Councils in geographic and population size necessary to ensure the basic principle of community representation.
- *Legislative reform* – a comprehensive rewrite of the Local Government Act 1934, saw a new Local Government Act coming into operation on 1 January 2000. This legislation gives Councils broad general powers to provide services to their community. It also expects Councils to participate in policy setting with State and national governments and to seek to coordinate with them in the planning and delivery of services in which those governments have an interest.<sup>1</sup>
- *Improving the relationships between State and Local Government* – A developing partnerships approach to finding better ways for both spheres of government to work together to enhance service delivery to the community, has been recently reflected in the development of a Minister's Local Government Forum, which will provide a mechanism through which the State and Local Government can together, in a spirit of mutual respect, tackle some of the difficult issues that lie at the interface between State and local activities.

In summary, the policy drivers for Local and State relations, and the historical reform process, has involved an aim of improving the legitimacy of Local Government in South Australia through:

- Achieving enhanced scope and efficiencies to allow for improved service delivery
- Achieving improved accountability to the community
- Achieving flexibility, by establishing strategic alliances, agreements and relationships to ensure services are delivered at the appropriate point.

That these directions have brought about an improvement in effectiveness of operations has been supported by independent review. A paper by the South Australian Centre for Economic

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<sup>1</sup> Section 8; see also section 122 in which councils are expected to have regard to the planning of the other spheres of government that affects their areas in developing their own strategic management plans.

Studies (SACES) commissioned by the Local Government Association of South Australia<sup>2</sup> concludes that “during the 1990s the structure of South Australian local government has been through a series of reforms designed to increase the capacity of local government to make strategic choices at the local level. This raises the prospect of local government taking a more active role in “non-traditional” fields of activity where these are seen as supportive of community development. These changes are a gradually occurring process.”

The conclusion that can be drawn is that South Australia has made substantial advances in improving the legitimacy and therefore effectiveness of Local Government – inroads achieved with strong Local Government involvement and support. To lose this in a simplistic argument of cost shifting would be a step back in time.

Again, the opportunity exists for the Inquiry to provide recommendations that will enhance the commitment of the Commonwealth in this regard – using the Inquiry to implement actions that reinforce the legitimacy of Local Government.

### **Current Legislation**

As noted most of the legislative framework for Local Government in South Australia has been updated as part of the second phase of the reform process. Local Government here is constituted under three major Acts.

The main Act is the *Local Government Act 1999*, which is a review and rewrite of the 1934 Local Government Act. The key theme of the revised Act is that as a basic principle, Local Government councils are primarily accountable to their communities. As such the Act:

- Prescribes broad powers to Local Government, clearly establishing the roles and functions of council
- Establishes the roles and functions of elected members of staff
- Requires Members’ Codes of Conduct and Registers of Interest
- Requires procedures for dealing with grievances

The Act presumes that Council meetings are open to the public, that associated documents are accessible and that Councils must produce audited financial statements.

One objective of the review of the Local Government Act 1934, was to ensure that provisions concerning regulatory regimes or public sector administration in which State and Local Government have a role should be located in the specific legislation that deals with the function. Major examples of such legislation include the *Development Act, 1993*; the *Public and Environmental Health Act 1987*; the *Road Traffic Act, 1961*; and the *Food Act, 1985*.

The other major Acts relating to Local Government include the *Local Government (Elections) Act, 1999* and the *Local Government (Implementation) Act, 1999*. Other, specific, legislation with local government implications includes the *City of Adelaide Act 1998*, the *Local Government Finance Authority Act 1983*, and the *Outback Areas Community Development Trust Act 1978*.

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<sup>2</sup> South Australian Centre for Economic Studies, *Financing Local Government’ Contribution to Community Development*, June 2002

## ***Theoretical Argument***

The issues discussed above have a clear framework in the theoretical justifications of the roles and responsibilities of the spheres of government. There is strong theoretical support for three spheres of government (local, regional (state) and national). This support is essentially summarised in two arguments as follows:

- The **functions argument** – which says functions of government should be delivered by a sphere based on issues of:
  - *Allocative efficiency* – in that the “provision of goods and services the benefits of which are regionally limited is rendered more efficiently by lower-level jurisdictions” (Musgrave and Musgrave<sup>3</sup> – p 458)
  - *Income Distribution* – where the principle is that “if policies aimed at adjusting the distribution of income among people are to be effective, they must be conducted primarily at the central or national level” (Musgrave and Musgrave p459) – argument based on mobility of population
  - *Distribution of Fiscal Capacity* - which supports an argument for central grants to fund local services, to equalise out access to services
  - “*Paternal view*” – taking a view that certain services are desirable for the individual good, regions have enforced levels of service that would not necessarily be chosen if left to the community. Therefore levels of service are imposed across all regions from a more centralised area of government, limiting local choice, but achieving outcomes desired by the central area.
- The **accountability argument** – recognising that debate between spheres is an important aspect of keeping information flowing to community

In the case of revenue raising there are also efficiency, equity and distributional arguments. The theoretical context suggests that revenue raising is generally “best” undertaken at the national level – or at least at the national level there are more options.

The theoretical construct thus supports a large component of service delivery being undertaken by the state and local spheres of government with revenue being collected more centrally. There should, therefore, be an adequate allocation of grants from higher levels to lower levels of government as the options for taxes at the local level are limited. The theoretical context presented also supports the principle of horizontal fiscal equalisation and of the major source of grants being untied and unmatched.

While the theoretical framework is applicable in the Australian and South Australian context it is not simple to apply. One of the main reasons is that defining the “local” level is increasingly difficult, particularly in the metropolitan context. People use recreational, industry and community services across a range of local jurisdictions – and often have joint interests (eg facilities where they work and where they live, or even on their “usual” routes of transport). This has required a greater complexity of relationships between all spheres, and

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<sup>3</sup> Musgrave and Musgrave, *Public Finance in Theory and Practice*, 5<sup>th</sup> Edition

also requires increased cooperation. But also it supports the need for grants to be increasingly untied rather than specified – which is something of the reverse to what has been the trend over the last few decades.

Given the complexity of modern life most public services will have some element of interest from all spheres of government – it is not possible to say for example that only state governments should have a role in roads. As noted above, the legislative framework in South Australia, and the establishment of relationships and alliances, is based on a recognition that there will be shared interest in service delivery across all spheres. Again it is important that this is couched in the context of accountability of each sphere of government to its constituency.

## **The Focus on Cost Shifting**

The term “cost shifting” – the key focus of this Inquiry – generally has negative connotations, used to refer to a range of activities that are of disadvantage to Local Government (in the context of this Inquiry). However the idea can also involve the allocation of activities in a way that can deliberately and positively improve service delivery outcomes, and so should not simply be considered negatively.

The issue is not a straightforward one of the shifting of costs – the underlying question is the allocation of tasks or responsibilities. This has a number of dimensions:

- Whether the (re) allocation of responsibilities is with revenue or without. In many cases the allocation of responsibilities also involves the transfer of revenue – sometimes with revenue raising power – sometimes as distributed grant funds. The aim is to ensure that responsibilities are exercised and tasks are undertaken at the area where they are most effective.
- Whether the allocation of responsibilities is a matter of choice, or is foisted upon Local Government. This argument extends into a view as to whether the element of choice is from above (ie a requirement of a higher sphere of government – as for example in issues of accountability) or from below (eg where state government “moves” out of what is considered to be an essential area, leaving little real choice at the local level). In this latter context it must be recognised that different levels of government can have different priorities, and the system requires both the flexibility for this to be developed and mechanisms through which shared priorities can be influenced and determined.
- Whether there is a justification for the allocation of responsibilities in terms of improved effectiveness and efficiencies, or not. This is a key issue that inter-relates with the revenue transfer issue above. The reallocation of responsibilities from one sphere of government to another is generally undertaken with consideration of the benefits and costs involved.

Another aspect is that there may be areas where Local Government is being given an enhanced role without having to take up the (full) cost.

The assessment of cost shifting must take full account of these issues – and they are clearly difficult to identify and evaluate. What is critical is that relationships between the spheres of government are in existence to allow full and accountable analysis of these issues and the development of agreements about them.

## **Claims versus Evidence re Cost Shifting**

### *The Basic Financial Case*

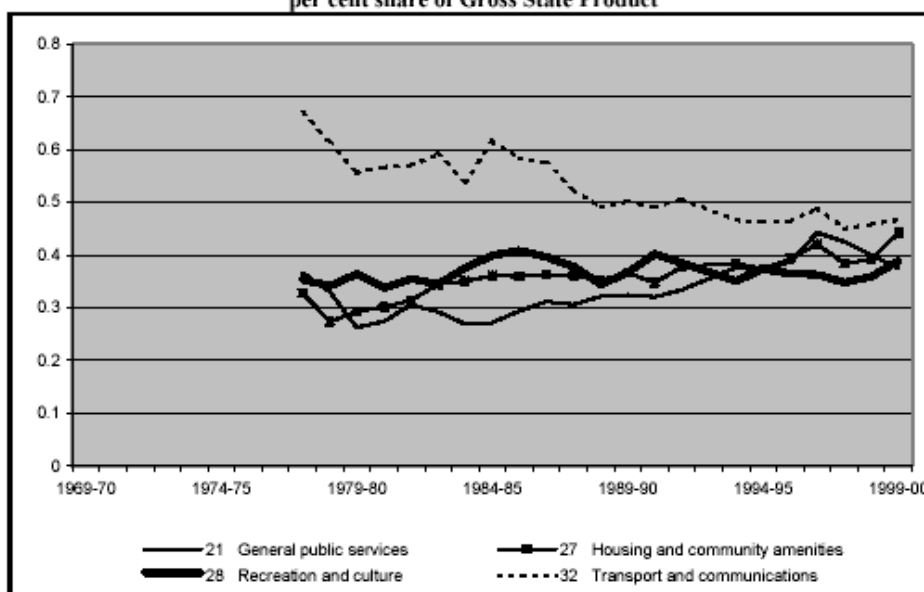
There are a number of recent reports that have analysed revenue and cost trends in Local Government, and this submission makes use of these rather than providing additional analysis.

The SACES report to the Local Government Association of SA noted above provided some analysis of these trends. The report draws the following conclusions with respect to Local Government expenditure trends in South Australia:

### **Expenditure**

- Local Government is currently running with an operating deficit (ie. operating expenses exceed operating revenues) – indicating that demand for services is in excess of funding.
- There is an upward trend in spending in real per capita terms, but expenditure remains relatively constant relative to Gross State Product (GSP).
- There has been a relative decline in transport and communications, with increases in housing and community amenities and general public services (as illustrated below in the chart sourced from the SACES report).
- There has also been a relative decline in capital spending, with an increase in recurrent expenditure.

**Figure 4: Trends in Local Government Expenditure in South Australia**  
 South Australian local government cash spending by purpose  
 per cent share of Gross State Product



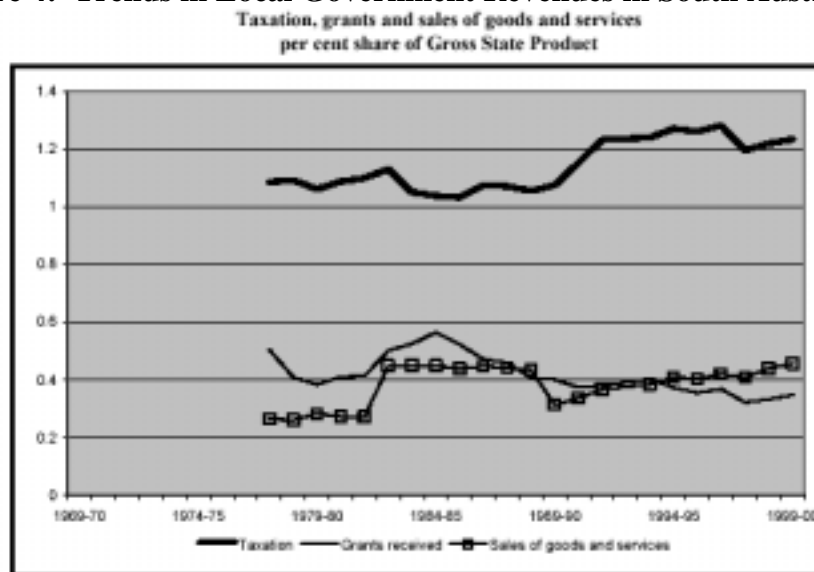
Source: SACES, *Financing Local Government' Contribution to Community Development*, June 2002

Again the major conclusions of the SACES report are that:

### Revenues

- A key issue facing Local Government is that since the mid 1980's there has been a steady decline in grants as a share of Gross State Product – as illustrated from the chart below – again sourced from the SACES report. The Commonwealth is the major source of grants for Local Government in South Australia, providing 85% of Local Government grants.
- There has been a corresponding increase in “own” taxation by Local Government in the state, to match the decline in grants
- There has also been an increase in “sales” or user charges by Local Government– but this has in part brought it back to levels of early 1980's

**Figure 4: Trends in Local Government Revenues in South Australia**



Source: Australian Bureau of Statistics, *Government Finance Statistics* unpublished data, *Consumer Price Index*, *Australian Historical Population Statistics*. SACES calculations. Estimates are believed to be anomalous and are therefore excluded for South Australia in 1992-93 and for Australia in 1995-96.

Sourced from: SACES, *Financing Local Government' Contribution to Community Development*, June 2002

The key concern that is raised in the SACES paper is that in the next decade there will be spiralling demand for services, and increasing pressure for expenditure - which the paper suggest will be caused primarily by:

- Community requirements for improved standards – some of which will be expectations based, and some imposed through legislation (eg in food safety)
- The demand for new services to meet community needs.
- An increasing asset refurbishment task – as a large range of assets reach the end of their economic life.

- The impact of cost shifting.

The South Australian Government shares the view that the future is likely to see spiralling demand for services, putting cost pressure on the operations of not only Local Government but also State Government where the majority of service delivery to communities occurs. However, as is the general case, the report does not consider that cost shifting has both negative and positive aspects. The issue of cost shifting, and its variable context, is discussed in more detail by use of examples below.

In the Commonwealth Grants Commission Review of the Operation of the Local Government Financial Assistance Act 1995, the conclusion is reached that “Local Government is increasingly being drawn into new areas of service provision. It has responded by increasing rates and user charges and spending proportionally less on roads”. In considering this claim it should be recognised that it is appropriate that over time the roles of Local Government and indeed all spheres of government will change to meet community needs. But a key implication of the Commission’s finding is that it is essentially demand for new services along with declines in grant funding rather than cost shifting per se that is creating financial pressure for Local Government.

### *Additional Issues*

#### **Efficiency Improvements**

There is little discussion or recognition in the cost shifting debate, or in considering expenditure patterns, about the impacts of productivity and efficiency improvements in service delivery, which in themselves should allow the accommodation of some of these increased demands. It is noted that over time productivity improvement is a key element of the development of the Australian economy, and the public sector is a part of this process.

As has been discussed, the government policy drivers and the reform process that has occurred to date have been aimed at improving efficiencies and accountability in the operation of Local Government in South Australia. Further, the drive to improve communication and better decide allocation of activities between spheres of government is partly aimed at effectiveness. A complete discussion of cost shifting should take account of the improvements in effectiveness that have occurred and that are generally debated in the allocation of functions from one sphere of government to another.

#### **General Financial Issues**

The commissioning of the SACES paper by the LGA was focussed on the options for Local Government to increase the extent of user charges in funding activities (in the face of declining grants). The argument is that extra revenues are needed because, as noted earlier, Local Governments are running operating deficits, which is resulting in the under-funding of infrastructure renewal. The conclusion reached by the report is that there is room and theoretical argument for extra user charges (maybe in areas of road use charges and use charges for environmental resources, with an over reliance on rates as a source of revenue), and this issue is being debated in South Australian Local Government at present and will also

need some consideration by State Government. Any increase in user charges would need to be fully assessed in terms of impact on the community.

But the emphasis in the paper is that to date the financial pressure is due to a reduction in grants rather than increased costs. The SACES Report also noted that in the absence of adequate grant funding, Council rates may be at least as good a general tax as other alternatives.

It is also to be noted that the perspective offered above also needs to be balanced by the following viewpoints:

- Budget outcomes in the Local Government sector in South Australia over the last 5 or 6 years have averaged an approximately zero net borrowing, something the State Government has as its fiscal target for the future. This is illustrated in the following table giving alternative calculations of outcome:

**Local Government Operating Statement based on a Simplified ABS  
Government Finance Statistics Accrual Based Framework**

	1996/97	1997/98	1998/99	1999/00	2000/01
Operating revenue	765	769	805	862	908
<i>Less</i> Operating Expenses	809	851	890	936	1,014
<i>Equals</i> Operating Deficit <sup>a</sup>	(44)	(82)	(85)	(74)	(106)
<i>Add</i> Capital Revenue	37	54	45	56	50
<i>Equals</i> Surplus/Deficit from Operations <sup>b</sup>	(7)	(28)	(40)	(18)	(56)
<i>Less</i> Net Cost of Acquisition of Non-financial assets <sup>c</sup>	11	(34)	(52)	(31)	(36)
<i>Equals</i> Net Lending/ (Borrowing) <sup>d</sup>	(18)	6	12	13	(20)

*a* Represents the excess of operating expenses (including depreciation - \$228 million in 2000/01) over operating revenue

*b* This measure is equivalent the "Net Operating Balance" measure used under the ABS Government Finance Statistics framework. It also represents the change in value of Net Assets of the Local Government Sector resulting from operations in the financial year

*c* Being capital expenditure, less proceeds from sale of assets, less depreciation. The negative amounts here reinforce the significant under-funding of expenditure on renewal and replacement of assets (ie assets are depreciating at a much greater rate than their renewal or replacement)

*d* Zero net borrowing would mean that the Local Government sector was funding all operating and capital expenditure from current revenues

**Source: SA Office of Local Government**

- The South Australian Government is aware of the study in 2001 which indicates that Local Government in South Australia is currently significantly under-funding infrastructure renewal. This has led to a call by the LGA of SA for efficiency gains by Councils through better asset management as well as for an improved revenue base for Local Government so that expenditure on infrastructure renewal and replacement can be increased. It is understood that the LGA of SA is canvassing the options to address this issue with Councils.



While dealing with this issue, the Local Government Association has also noted that net grants from the South Australian Government specifically amounted in 1999-2000 to \$16 million (which is primarily library and effluent disposal scheme related) and lay some of the financial pressure they are feeling on the fact that “South Australian councils receive the lowest national quantum of State Government grants at \$11 per person, followed by Victoria at \$17 per person” (LGA of SA, Circular 27.10). In media reports they have heavily publicised their problem, and noted that “South Australia’s councils get less funding from the commonwealth and state governments on a per capita basis” (Sunday Mail, July 21<sup>st</sup> 2002). The argument is supported on the basis of the following data:

**Local Govt Grants per capita (2000/01)**

	Comm Grants	State Grants
NSW	63.7	40.1
Vic	63.1	16.9
Qld	66.7	189.6
WA	77.9	79.0
SA	60.8	10.7
Ta	91.5	31.9
NT	92.7	139.0

Source: Derived from LGA Circular (based in turn on National Office of Local Government Data)

This perspective is at face value being taken to suggest that Local Government in South Australia is significantly disadvantaged relative to other states. However the South Australian government holds the view that the argument is over-simplified, in that:

- Roles and responsibilities differ from jurisdiction to jurisdiction. As noted in the paper *Financing Local Government*, Australian Urban and Regional Development Review, 1994 “there is significantly greater disparity in the set of functions performed by councils within states than in the set of functions performed by state governments within Australia” (p 13).
- The amounts identified do not cover all funds granted – for example the State Government provided funds to Local Government to support the reform process that has occurred in South Australia.
- Accounting differences limit the extent of comparison possible. These calculations are based on information reported by individual Councils to the ABS, and depending on accounting definitions used there can be variations relating to what is classed as a grant.
- As recognised in the National Office of Local Government report, the level of grants for some states (particularly Queensland), was abnormal – based on some once off payments.

*The Claims*

Within the context of the above, what is clear is that cost shifting has become a focus for the debate re financial pressure. Therefore the LGA of SA Circular 28.15 claims that “in simple terms councils have taken on additional responsibilities over the past two decades in the form

of new roles and responsibilities imposed by other governments or as a direct result of responding to community demands”.

What has been made clear in the above discussion is that the South Australian Government supports the concept of Local Government taking on more responsibilities wherever there is a justification in effectiveness and efficiency. This is increasingly important in the financial pressure that state and local government together are facing.

This process has been in place and supported by local and state government in South Australia – it is a cooperative arrangement, with substantial gains to be made. Specific examples of the approaches adopted include:

- In mid 2000 the State/Local Government Partnerships Program was established to coordinate development of new and better ways for State and Local Government to work together to improve service delivery to the community. This initiative was based on the premise that the current division of responsibilities between State and Local Governments in South Australia is not as efficient or effective as it could be, and that there may be significant opportunities for improvement. The challenges were and are still seen as identifying the best opportunities for improvement and finding innovative means of implementing enhanced service delivery across government, based on sound objective setting and strategic planning.
- More recently, the South Australian Government has established the Minister’s Local Government Forum. \$250,000 has also been allocated in the tight 2002-03 Budget, indicating that this Government is serious about its commitment to work cooperatively with the local government sector. The purposes of the forum are summarised as follows:
  - The Minister’s Local Government Forum will provide advice on key priorities where State and Local Government can work effectively together to achieve better outcomes for the community.
  - It will help harness the resources of both spheres of government and coordinate our efforts in key areas. It will bring new and imaginative solutions to shared problems.

In the context of these issues, it is essential that the Inquiry recognize that there are significant ways in which State and Local Government interact that cannot be fully reflected in the analysis of financial trends. This submission takes the approach of offering as examples some cases where there are issues for State and Local Government – and attempts to focus on cases that will be raised in other submissions. The cases provided are not exhaustive, and examples may fall into a number of categories, as listed below:

1. Services that are supplied by Local Government where the financial arrangements have changed over time

*Libraries – Local Government has been responsible for local level library management since the mid 1970’s. Local Government in South Australia claims that the initial agreed 50/50 funding approach has “shifted” to a 75/25 balance, therefore putting increased pressure on budgets and service delivery. There are*

*some issues involved as to whether the State Government should be responsible for Local Government decisions to build new facilities, and the increased maintenance costs etc that are involved. The long term provision of funds has been based on an equity of access argument for all communities. The original agreement was a dollar for dollar basis, but this has been reviewed from time to time. In particular a review in the 1990's resulted in reform aimed at improving the efficiency of services and achieving productivity based cost reductions, that have resulted in savings to the State Government. The reforms have been undertaken in full consultation with Local Government, and the agreement has just been renegotiated successfully. In discussing libraries it should also be noted that small country communities are "provided" with library services through school community libraries (46 such libraries operate in the state). This is additional to the funds discussed above, and the State Government is the major funder of these facilities.*

*The Local Crime Prevention program - as a result of the State budget, the Local Crime Prevention program was cut from \$1.4m in 2001-02 to \$600,000 in 2002-03 as a result of the State budget. It is acknowledged in this context that a state government funded program has been shifted to Local Government if it is to be maintained, as a consequence of the difficult financial choices that had to be made in the 2002/03 budget.*

*Roads funding is another case in point. The Commonwealth 2002/03 budget allocation involved an \$8 million reduction in funds for roads – which continues an ongoing trend in an area already under-funded (see discussion above). Access to road funds is an important concern of Local Government. It is not an issue of cost shifting – but the increased demand for services in the face of reduced funds. South Australia has a well-formulated division in responsibilities for road work requirements. Road funding has been significantly reduced while at the same time the Commonwealth is dismantling the national rail system – putting increased pressure on road networks.*

*Recreation and Sport Grants for facilities provision – previously allocated to significant facility development at regional/state level by the Commonwealth. The Commonwealth has withdrawn from providing this community infrastructure support and left funding of these facilities to State and Local Government.*

2. Instances where activities have been transferred as more appropriate/effectively delivered by local government, with appropriate financial arrangements

*The most obvious example in this context is that most country jetties have been transferred to Councils – with capital costs met by the State Government. The transfer is based on the fact that country jetties are generally of only local significance – for recreation purposes, and therefore decisions should be at a local level. Local Government is using this as an example of cost shifting (eg Sunday Mail July 21<sup>st</sup>, 2001). While being used in this context where the transfer has occurred, it was one of mutual agreement and in a couple of cases the State Government has retained full responsibility.*

*The STEDS program – the provision of residential effluent treatment options - is grant funded by the State Government, but administered through the Local Government Association as the most appropriate administering body. This program is currently under review to provide options for addressing excess demand for the service.*

3. Activities that have been taken up from local government, reducing pressure on their expenditure costs

*Emergency Services – the State Government has taken the full responsibility for funding emergency services – which includes the costs of use, maintenance and replacement of emergency service assets. Local Government previously had a statutory responsibility to fund some of these costs. The new arrangements led to significant expenditure reduction for Local Government (between \$15 and \$20 million at current service delivery levels). There was an increase in capital funding for emergency services in 2002/03 (up from \$4.4m in 2001-02 to \$5.6m) for the replacement of fire appliances for State Emergency services, MFS and CFS.*

*Cost transfers in this direction are rarely mentioned in a discussion of cost switching, and the above represents a significant flow.*

4. Supports that State Government provides that enhance Local Government effectiveness

*The State Government supports Local Government in a number of ways that enhance their abilities to serve their local community. Some specific examples include*

- *Local Government Disaster Fund – operated by State government to provide scale necessary for this fund to operate effectively*
- *Flood Mitigation Program - State Government provides matching funding to Local Government flood mitigation projects.*
- *Natural Disaster Risk Management Studies Program - State Government provides leadership and in-kind funding to the program, which is predominantly accessed by Local Government.*
- *Local Government Finance Authority – State Government acts as “guarantor”, without which Local Government costs would be substantially greater*
- *Local Government Association Mutual Liability Scheme – the Scheme is supported by commercial arrangements with the State Government’s insurer (SAICORP).*

*It should also be noted that public expenditures undertaken by the State Government have impacts on the revenue base of Local Government. For example expenditures in the area of urban renewal improved the capital value of residential base both directly and indirectly, therefore resulting in improved rates income. State Government*

*support of major projects, or provision of economic development services also improves the revenue potential of Local Government.*

5. Areas where Local Government is likely to experience increased demand in the future
  - *Aged care – an increased demand in regional areas, without sufficient commitments from Commonwealth and states – putting the burden on local government.*
  - *Community transport – reduction in rail networks at the Commonwealth level and an emphasis in the spending on public transport in the metropolitan area by the State will enhance this burden*
  - *Disaster Risk Management - the COAG Review of Natural Disaster Relief and Mitigation Arrangements has identified that Local Government is fundamental to achieving successful relief and mitigation outcomes. The Review identifies the role and responsibilities of Local Government as well as specific outcomes which include implementing disaster risk assessments and taking actions to mitigate identified risks. Note that the role/responsibilities and outcomes are consistent with Section 7, Local Government Act.*
  - *Local level environmental protection regulatory and inspection roles – with increased emphasis and demand for environmental outcomes, this role will fall heavily at a community level.*
  - *Capacity of local communities to support infrastructure in terms of maintenance and improvement. More leisure time, health impacts of physical inactivity is trending towards a greater demand for facilities within limited funding constraints.*
  
6. Decisions taken by State Government that have financial or cost implications for Local Government
  - *Planning applications – as a monopoly provider the State Government provides this resource at below full costs- and financial arrangements with Local Government means that it is also subsidized at that level. This implication needs to be reconsidered between local and state government,*
  - *New legislated food safety systems are another case in relation to the new Food Act(which was initiated at a national level). Local government has been strongly arguing that the administrative framework proposed under the Food Act does not allow for raising of sufficient funding to effectively implement the requirements imposed under the Food Act. It should be noted that there is a LGA/DHS task force that is working through the issues and currently draft Regulations are out for public comment that flag councils being able to raise inspection fees.*

7. Expenditures undertaken by State Government where Local Government has significant input/discretion

- *Regional Development Boards – are funded in a resource agreement between State and Local Government on a 3:1 ratio – with the State Government providing of the order of \$4.5 million in funds. Regional Development Boards’ decision making is at the local level – with Local Government board representation and input – aimed at enhancing the role of Local Government in this context*
- *Business Enterprise Centres – there are currently seven BECs located in metropolitan Adelaide and the Salisbury Export Centre, with each receiving approximately \$85,000 (2002/03) of State funding. The 7 BECs were established under the umbrella of Business Enterprise Centres SA, with both State and Local Government contributing to their operation. The BECs also receive funding from the private sector. Local Government contribution to each BEC varies in amount of support, both in cash or in-kind, depending upon region and the BEC however, in most instances it is less than the funding provided by State Government.*
- *Community Housing – CSHA funds are used to build housing, often managed by a regional community group – often with Local Government involvement (direct and indirect).*
- *Grants to local government/community groups to build, improve and maintain recreation and sport facilities.*

The above represent some key examples of the types of relationship factors that are occurring in the delivery of services at the local level. They are by no means exhaustive – but are provided to illustrate a major point that the South Australian government wishes to reinforce. The relationships, both financial and otherwise are complex, with many drivers of the factors. The aim of all spheres of government should be to enhance services to the community

## **Conclusions**

The key conclusions that the South Australian government wishes to reinforce to the Inquiry are summarised in the key issues section of this paper. In summary those conclusions include:

- There are significant pressures on the funds available to both Local Government and State Government for the delivery of services, and this is likely to increase in the future. In recognition of this pressure, the real amount of untied grants distributed to local and state government needs to be increased and the relative cost disadvantages for South Australia and disadvantages in revenue raising capacity must be fully addressed through adoption of appropriate horizontal equalisation methodologies in the distribution of grants for local government.
- The State and Local Government sector in South Australia recognise the importance of working together for most effectively delivering public services-

and indeed are pro-active in enhancing their capacity in this regard. Reform has been positively embraced, and communications emphasised. The South Australian Government invites the Commonwealth to become more participative in their relationships so that service delivery issues can be fully assessed and effective solutions developed.

- There are significant factors that will see an increase in demand for locally delivered services. Given a history of falling levels of grant funds, it is now time to recognise the needs that exist. That is cost shifting is not so much a problem now – but in the future there will be increasing demands on local and regional government that will significantly increase the cost pressures
- Cost shifting should not be seen just in a negative connotation. It can be about allocating roles and responsibility to the “best” place – therefore a key recommendation of the inquiry needs to be about setting up relationships and processes to facilitate this.
- Assessing roles and responsibilities is more complex than simple analysis of who gets what funds.