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The Parliament of the Commonwealth of Australia

# **At the Crossroads**

**- a discussion paper**

## **Inquiry into Local Government and Cost Shifting**

House of Representatives  
Standing Committee on Economics, Finance and Public Administration

February 2003  
Canberra

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# Contents

Preface.....	v
Membership of the Committee.....	vii
Terms of reference.....	viii
<b>1 Conduct of the Inquiry .....</b>	<b>1</b>
Inquiry process .....	1
The purpose of the discussion paper.....	1
Your feedback.....	2
<b>2 Context.....</b>	<b>3</b>
Local government in the federal system.....	3
What are the Commonwealth's interests?.....	5
How could the Commonwealth exercise greater influence? .....	7
<b>3 Key Issues .....</b>	<b>9</b>
Changing role of local government .....	9
Nature and extent of cost shifting.....	12
Local government's revenue base.....	14
Scope for Borrowing .....	17
Summary.....	18
Financial Assistance Grants.....	18
Quantum and inter-state distribution.....	19
Infrastructure maintenance and improvement.....	21
Regional cooperation.....	23

Scope for rationalisation .....	24
Capacity building and accreditation .....	26
<b>4 Some Options.....</b>	<b>29</b>
Overview .....	29
Finance and cost shifting.....	29
Infrastructure funding.....	32
Regional cooperation.....	33
Rationalisation .....	34
Capacity building and accreditation .....	34



## Preface

This Discussion Paper is being circulated to assist the Committee in the later stages of its Inquiry. It outlines key issues arising from submissions received and hearings conducted so far, poses questions to stimulate further discussion, and suggests a number of options for recommendations that the Committee **may** consider in preparing its final report.

Some of the comments made in this paper are deliberately challenging. The Committee appreciates the time and effort that has gone into submissions to the Inquiry, but feels that further thought needs to be given to **achievable solutions** to the problems raised. Clearly, Australian local government faces significant difficulties in addressing the financial and operational challenges of the 21<sup>st</sup> Century. On the evidence presented to date, the Committee has little doubt that intergovernment relations - both functional and financial - are an essential element in responding to those challenges. It is equally clear, however, that all governments face mounting pressures and that neither the Commonwealth nor the States and Northern Territory can provide a 'quick fix' for the problems to be overcome. More consideration needs to be given to how local government can best be enabled to help itself.

Having said that, the Committee is anxious to bring down a report that will make a positive contribution and help establish a broad strategic agenda for local government's ongoing development.

Although the 'headline' of this Inquiry might be read as suggesting a narrow focus on cost shifting to local government by the States, in fact the terms of reference are very broad. They amount to a wide-ranging examination of the position of local government in Australia's federal system focussed on:

- Its current roles, responsibilities and financial capacity (including the allocation of Commonwealth Financial Assistance Grants)
- Its relations with State and Commonwealth governments, and the scope for rationalisation of roles and responsibilities in order to achieve more efficient and effective delivery of services to local communities.

Cost shifting by State governments has been evident for many years and typically encompasses States funding a program through local government for a limited period then reducing or withdrawing funding and leaving local government to decide on its future.

There has been criticism that the terms of reference do not cover cost shifting by the Commonwealth and require the Committee's recommendations to be budget-neutral. The Committee notes, however, that some consideration of cost shifting by the Commonwealth - if significant - is not precluded, and that it is not unreasonable for those advocating increased Commonwealth expenditure in particular areas to also indicate how it might be funded.

The Inquiry offers a rare opportunity to take a hard look at Australia's third sphere of government, consider its future prospects, and articulate necessary change - both within local government and more broadly. The Committee hopes, while not necessarily endorsing, that this Discussion Paper will stimulate constructive debate at forthcoming hearings, and where necessary supplementary submissions to address the questions posed.

**David Hawker MP**  
**Chair**



## **Membership of the Committee**

**Chair** Mr David Hawker MP

**Deputy Chair** Ms Anna Burke MP

**Members** Mr Anthony Albanese MP Mr Mark Latham MP (to 11 December 2002)  
Mr David Cox MP (from 11 December 2002) Mr Gary Nairn MP  
Ms Teresa Gambaro MP Hon Alex Somlyay MP  
Mr Alan Griffin MP Dr Andrew Southcott MP  
Mr Peter King MP

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## Terms of reference

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.



## **Conduct of the Inquiry**

### **Inquiry process**

- 1.1 On 30 May 2002 the Committee resolved to conduct an Inquiry into Local Government and Cost Shifting. The Inquiry was referred to the Committee by the Hon. Wilson Tuckey MP, Minister for Regional Services, Territories and Local Government.
- 1.2 As at 13 February 2003, 338 submissions had been received in response to the invitation to comment on cost shifting onto local government and the financial position of local government.
- 1.3 The Committee took evidence at public hearings on 6 August 2002 in Perth, 4 and 5 September 2002 in Canberra, 7 October 2002 in Katherine, 8 October 2002 in Darwin, 9 October 2002 in Adelaide, 5 November 2002 in Alice Springs, and 6 December 2002 in Warrnambool.
- 1.4 Copies of all submissions and transcripts are available electronically from the Committee's web site at [www.aph.gov.au/house/committee/efpa](http://www.aph.gov.au/house/committee/efpa). Hard copies are also available from the Committee Secretariat.

### **The purpose of the discussion paper**

- 1.5 The evidence received so far points to some key issues, primarily related to the financial concerns of local government. There has been a strong case put in submissions and at public hearings that cost shifting from the States (and to a lesser extent, the Commonwealth) to local government is occurring. Further, there is concern about the roles and responsibilities of local government and the need to consider new arrangements.

- 1.6 The Committee believes it is appropriate to present a discussion paper at this time to stimulate debate and elicit further information. This discussion paper is not an agreed statement of the Committee's views and should not be taken as an indication of likely recommendations to government. Comments contained in this paper are based on submissions and other information currently available to the Committee. The Committee would welcome advice on any errors of fact or interpretation.
- 1.7 Chapter 2 establishes a context for the analysis of key issues and options, focussing in particular on why the Commonwealth might take a stronger interest in the future of local government, and the practical scope for Commonwealth involvement.
- 1.8 Chapter 3 highlights eight key issues and summarises the major points raised in evidence to the Inquiry. It also includes a number of questions designed to elicit additional information or prompt further debate on lines of investigation that the Committee would like to pursue over the next few months.
- 1.9 Chapter 4 sets out a number of options for action to tackle the key issues. Some of these options are deliberately controversial because the Committee is anxious to provoke fresh thinking on effective solutions to cost shifting onto local government and, more broadly, the place of local government in the system of Australian governance.
- 1.10 This discussion paper also provides a basis for the Committee to facilitate constructive discussions at forthcoming public hearings. Also, the Committee will continue to receive submissions to the Inquiry.
- 1.11 The Committee will consider all the issues again in a final report which will be presented in the second half of this year.

## **Your feedback**

- 1.12 Attached to this discussion paper is a questionnaire seeking responses to options in Chapter 4. You can also comment on related questions in Chapter 3 in the space provided. The Committee encourages all levels of government, non-government organisations and the public to respond to the questionnaire.
- 1.13 Hard copy responses to the questionnaire can be posted to the Secretariat. Otherwise an email response can be sent via the Committee's online questionnaire at [www.aph.gov.au/house/committe/efpa/localgovt/paper.htm](http://www.aph.gov.au/house/committe/efpa/localgovt/paper.htm)

## Context

### Local government in the federal system

- 2.1 Australia has some 720 local governments, including about 100 Indigenous community councils in Queensland and the Northern Territory. These are all democratically elected in some way. In addition, a small number of other 'local governing bodies' have been declared under the provisions of the federal *Local Government (Financial Assistance) Act 1995*. There is no separate system of local government in the Australian Capital Territory: the ACT Government provides municipal services as well as playing a similar role to State governments.
- 2.2 Overall, Australia's local government sector accounts for less than 4% of public sector revenue and less than 5% of expenditure. Nevertheless, across Australia local government revenues amount to some \$17 billion per annum, it employs around 140,000 people, and it plays a crucial role in key areas of service provision of particular importance to local communities. These include:
- Infrastructure, especially roads, but also drainage and (in Queensland, Tasmania and non-metropolitan NSW) water supply and sewerage;
  - Public health and, increasingly, environmental management;
  - Local economic development, including key support services in rural Australia (saleyards, showgrounds, aerodromes etc);
  - Planning and development control;
  - Waste disposal, and now recycling in particular; and
  - Recreation, culture and some aspects of community services.

- 2.3 Financially, local government is largely self-sufficient. It raises on average about 80% of its total revenue - although that figure is much lower among smaller rural councils which may rely on State and federal grants for 40-50% or more of their income.

Table 1 Changes in local government revenue sources in constant 1997-98 prices

	Rates	User Charges	Other	Federal Transfers	State Transfers
1974/5	54.1%	13.4%	7.2%	10.5%	14.8%
1997/8	47.2%	24.7%	8.8%	12.1%	7.1%
<b>Average Annual Growth</b>	3.0%	6.4%	4.5%	4.3%	0.4%

Source Commonwealth Grants Commission, *Working Papers for Review of the Operation of the Local Government (Financial Assistance) Act 1995*, June 2001, p. 172.

Note State transfers to local government include some Commonwealth grants paid through the States.

- 2.4 Since the mid 1970s the Commonwealth has supported local government with untied Financial Assistance Grants (FAGs). These are administered under the *Local Government (Financial Assistance) Act 1995* and now amount to around \$1.45bn per annum. The FAGs system recognises the diversity of local government and its primary aim is to equalise the capacity of different local councils to provide an adequate range of services. About two-thirds of total payments go to councils in rural and regional Australia, where many face disadvantages due to increased costs and limited capacity to raise revenue.
- 2.5 The steady growth in FAGs and other forms of Commonwealth funding to local government has been accompanied by a relative decline in State support (see Table 1). Over recent decades the Commonwealth has increasingly dealt more or less directly with local government matters of mutual interest, and councils receive substantial special purpose funding in addition to FAGs. Although total funding from the States appears to have continued to grow in real terms, there are significant differences in the pattern from one State to another and submissions from some States describe State government support for councils as 'negligible'. In effect, some of the Commonwealth's money intended to improve local services has been diverted to the States.
- 2.6 The expansion of local government's role over the past 30-40 years has not been matched by a commensurate increase in revenue. Local government revenues have grown at a significantly slower rate than those of Federal and, particularly, State governments. Equally significant, State government

transfers have declined relatively, while the Commonwealth transfers have grown. The implications may be significant and are discussed in Chapter 3.

- 2.7 One of the dominant features of Australian local government is its diversity. The majority of councils are quite small - populations of 10,000 or less - and located in rural and remote areas. Their resources are clearly limited, and many face static or declining levels of population and economic activity with consequent rationalisation of public and private sector services. However, in metropolitan areas, along parts of the coast, and in some major regional centres, Australia has a substantial number of large, often rapidly growing councils with the capacity or potential to play a very important role in the system of government. Some of these councils, such as the capital cities, are already active in international networks of cities and regions and have a clear vision of the significance of local government in a globalising world.
- 2.8 Throughout Australia local government has undergone significant reform during the last 10-15 years at significant cost, including structural changes (boundary adjustments and amalgamations of councils), new Local Government Acts requiring much more sophisticated planning and accountability frameworks, tendering and contracting-out of services, adoption of more business-like management practices, and application of Australia-wide measures such as AAS 27 (accrual accounting), enforcing State laws, and National Competition Policy. Local government now seems to be considerably more professional, efficient and attuned to local community needs.
- 2.9 Over recent decades the Commonwealth has increasingly dealt more or less directly with local government on matters of mutual interest, and councils receive substantial special purpose funding in addition to FAGs. Also, successive Federal Governments have supported local government representation on the Council of Australian Governments (COAG) and a growing number of Ministerial Councils and other intergovernment forums.
- 2.10 These arrangements persist despite lack of recognition of local government in the Australian Constitution. Local government's operations are subject to detailed prescription by State laws and councils can be dismissed and/or restructured without redress.

## **What are the Commonwealth's interests?**

- 2.11 The very fact that this Inquiry is taking place - plus the broad terms of reference - indicates that the Commonwealth has a keen interest in the viability and effectiveness of Australian local government. The Committee suggests that the following factors underlie that interest and point to areas in which it might make recommendations in its final report.

- The Commonwealth plays a leading role in ensuring continuing good governance for all Australians. Weaknesses in the system of local government could prejudice good governance and maintenance of Australia's strong democratic foundations.
- The Commonwealth also takes the lead in promoting sound economic and financial management, as well as an efficient and effective public sector overall. Whilst relatively small, local government makes a valuable contribution to the wider public sector and can also help to promote sustainable and equitable economic development.
- Through both the FAGs system and specific program grants the Commonwealth is the largest provider of funding support to local government.
- National policy agendas in areas such as regional development, transport and communications, environmental management (particularly salinity and water quality), some health and community services, cultural development, immigration and multicultural affairs, and programs for Indigenous peoples, all benefit from substantial local government involvement.
- There may also be benefits in expanded local government involvement in areas of national concern, such as trade promotion, overseas aid and perhaps some other aspects of international relations. Likewise, some believe local government should be more involved in other services such as health, welfare, education and safety.

2.12 These are powerful reasons for the Commonwealth to continue to engage with local government in a variety of ways, and to seek to ensure a healthy local government sphere that can contribute effectively to the federal system.

2.13 Currently, the *Local Government (Financial Assistance) Act 1995* requires the preparation of an annual report to Parliament addressing, amongst other things, the efficiency and effectiveness of local government bodies. In the recent past the Commonwealth has engaged with the States and local government associations to promote initiatives in areas such as performance benchmarking, adoption of best practice and structural reform, all aimed at enhancing efficiency, effectiveness and hence local government's capacity to deliver essential services. However, these initiatives have met with a mixed response and enjoyed only limited success.

2.14 The Committee raises the question whether that is a case for closer Commonwealth scrutiny of local government systems and performance to ensure value for the very large sums of taxpayer funds spent in supporting

councils. It is also interested in further discussion of opportunities for expanded local government participation in national programs.

## How could the Commonwealth exercise greater influence?

- 2.15 For the foreseeable future, local government appears certain to remain under the primary control of the States. The Committee has noted the large number of submissions calling for some form of federal constitutional recognition of local government, and acknowledges that this might help to consolidate local government's emerging role on the national stage. But there is no evidence before the Committee to suggest that any likely form of constitutional recognition would fundamentally alter existing arrangements.
- 2.16 However, the Committee sees that those arrangements have not prevented local government participating in federal forums, nor increasing direct links between local government and the Commonwealth. A good example is the way in which *Roads to Recovery* grants are being paid directly to councils.
- 2.17 The evidence indicates that, if the Commonwealth so wished, it could exert greater influence over the future of local government in a number of ways, such as:
- By the way it administers the system of Financial Assistance Grants (the Committee is specifically tasked with responding to the latest Grants Commission review of FAGs);
  - Through funding mechanisms such as *Roads to Recovery*;
  - Through agreements for other special-purpose grants programs (eg the Natural Heritage Trust agreements include local government to some extent);
  - Through the provisions of Commonwealth-State financial agreements (eg the agreement on National Competition Policy refers to local government);
  - By ensuring local government participation in relevant intergovernment agreements, forums and policy initiatives (eg the AusLink proposal for a tripartite intergovernment agreement, legislation guaranteeing local government involvement in the Australian Transport Council and the National Environment Protection Council Committee); and
  - By supporting capacity building and reform initiatives in local government (eg through the former Local Government Development Program and the continuing National Awards).
- 2.18 In drawing attention to these opportunities the Committee does not wish to imply that a case has been made for wholesale Commonwealth intervention - the Constitution would prevent such a move. Nevertheless, in addressing the issues raised by submissions it is important to take stock of the **practical**

scope for the Commonwealth to respond, beyond simply providing large amounts of additional funding. The mix of options discussed in Chapter 4 is based on this assessment of available mechanisms.



## Key Issues

### Changing role of local government

- 3.1 Local government's role over the past three or four decades has expanded substantially. Its responsibilities have both grown and diversified, particularly by adding a range of functions in planning, environmental management and community services to its traditional base in infrastructure and property services.

Table 2 Changes in local government expenditure 1961-62 to 1997-98

Function	Expenditure 1961-62		Expenditure 1997-98		Average Annual Growth
	\$ million	% of total	\$ million	% of total	
Transport	1,534	48.9	3,275	27.1	2.1%
General Public Services	651	20.8	1,539	12.7	2.4%
Education, Health, Welfare, Public Safety	120	3.8	1,403	11.6	7.1%
Recreation, Culture	248	7.9	2,217	18.3	6.3%
Housing, Community Amenities	341	10.9	2,348	19.4	5.5%
Services to Industry	30	1.0	188	1.6	5.2%
Other	210	6.7	1,121	9.3	4.8%
<b>TOTAL</b>	<b>3,133</b>		<b>12,090</b>		<b>3.8%</b>

Source Commonwealth Grants Commission, *Working Papers for Review of the Operation of the Local Government (Financial Assistance) Act 1995*, June 2001, p. 174.

- 3.2 The Commonwealth Grants Commission (CGC) has suggested five main causes for the substantial growth in local government's responsibilities:
- devolution – where another sphere of government gives local government responsibility for new functions;
  - 'raising the bar' - where local government is required to function at a higher standard;
  - cost shifting - where local government assumes increased responsibility or has to provide financial support for a service previously provided or funded by another government;
  - increased community expectations - demands for new or better local government services to which councils feel obliged to respond; and
  - policy choice - where councils deliberately choose to expand or improve services or expand their range of operations.
- 3.3 The Committee notes that changes during the last 10-15 years to Local Government Acts across Australia have given councils more discretion as to the services they provide and the way in which they operate: in several States councils have essentially a power of general competence to undertake whatever functions they see necessary to provide good governance for their communities.
- 3.4 Importantly, the expansion of local government's role appears linked to an enhanced profile and capacity both to represent local and regional communities, and to participate in national programs and intergovernment forums.
- 3.5 The evidence indicates, however, that the growth in local government's functions has thus far outstripped its financial capacity to discharge all those functions adequately. This is especially true in rural and remote regions where councils are small and have a very limited revenue base. Paradoxically, it is often these small councils that face the greatest pressures to expand their role - to fill gaps in service delivery as other governments and the private sector rationalise their operations, to promote new economic development, to support community self-help, and to research and advocate the case for outside assistance.

*...generally speaking, the smaller and more remote the council, the greater tendency there is for the council to be expected to provide a wide level of services. This comes about through the lack of other public or private sector providers and the need to fill the void. Councils are not in a position to consider the private sector provider option of specialising in particular activities or dropping off non-profitable services.*

*Quite frankly, local government in our region is the last man standing. The federal government is not represented there at all ... Very few state government departments venture into our territory, so if anything is going to happen it will be through the local government. The community has to help itself.*

Shire of Yalgoo, Transcript, 6 August 2002, Perth, p. 30.

- 3.6 The challenge of finding a better match between local government's responsibilities and its resources is a complex one. As the gap between larger, better resourced councils in densely populated areas and their often struggling counterparts in rural and remote regions continues to grow, questions seem certain to arise about the viability of uniform systems of local government in which all councils have the same legal obligations and are structured in the same way.
- 3.7 Several States have already moved to implement or encourage amalgamations of smaller councils in both rural and metropolitan areas. The onus is on local government to become more efficient and cost effective and, if amalgamations of local government bodies is the most direct way of achieving this, further amalgamations should be considered.
- 3.8 Strengthened and formalised regional cooperation may offer a useful alternative to amalgamations. Some submissions point out that the sheer geographical extent of councils in sparsely settled regions is a barrier to amalgamation and can produce *diseconomies* of scale. It seems probable that there are some cases where mergers would assist, and others where this approach is impractical.
- 3.9 Despite the range of problems, the Committee notes that the evidence does not point to any strong desire on the part of local government to significantly curtail its functions, although there does seem to be widespread caution against assuming a still larger role.

- 1. *Is there a need for significant changes to local government's current package of roles and responsibilities?***
- 2. *Should there be greater differentiation of responsibilities between larger, better resourced councils and those with small populations and limited revenue?***
- 3. *Is there a need in some regions for restructuring to improve the viability of councils?***

## Nature and extent of cost shifting

*A very simple definition of "cost shifting", from a Local Government perspective, is an increase in the cost to Local Government without an offsetting benefit.*

Western Australian Local Government Association, Submission No. 310, p 16.

3.10 The submissions make a strong case that there has been cost shifting from the States and the Commonwealth to local government. This is claimed to have occurred in a variety of ways, with significant differences from one State to another:

- Overall, the level of State grants to local government has failed to keep pace with changing responsibilities and cost increases;
- States (and to a lesser extent the Commonwealth) have legislated for local government to assume additional responsibilities, or changed regulatory frameworks in such a way as to impose additional costs on councils, without providing matching resources. Many councils are given the responsibility of enforcing State regulations without commensurate funding;
- Some States levy considerable charges on local government;
- States (and sometimes the Commonwealth) have reduced or withdrawn financial support for services leaving local government to deal with community expectations that those services will be maintained;
- Rationalisation of public and private services in rural and remote regions has forced local government to fill the gap; and
- Local government across Australia has faced major increases in accountability and compliance requirements without adequate recognition of the cost implications.

3.11 Some submissions also consider limits imposed by some States on the level of local government rates and/or fees and charges to be a form of cost shifting. This is discussed later in this Chapter.

3.12 The Municipal Association of Victoria (MAV) has provided a detailed analysis of cost shifting in the area of human services, particularly Home and Community Care, Maternal and Child Health Services, and public libraries. It argues that these are the major areas of cost shifting experienced by its member councils, and calculates the total cost-shift over recent years at around \$60 million.

3.13 The Local Government Association of Queensland conducted a detailed survey of member councils to determine the extent of cost shifting and reported a net cost to councils of some \$47 million per annum in

undertaking devolved or only partly-funded 'discretionary' activities, and in meeting increased compliance requirements.

*I would like to give ... an indication of the range and subtlety with which these things happen. I would like to categorise them as 'sleepers, creepers and stingers'.*

Coomalie Community Government Council, Transcript, 7 October 2002, Katherine, p 183.

- 3.14 Newcastle City Council's submission documents a long list of additional responsibilities imposed in recent years, particularly as a result of actions by the NSW State government. These include new or more demanding roles in the areas of planning, environmental management and public health, as well as increased levies for waste disposal and fire brigades. Newcastle Council estimates the total ongoing cost of its increased responsibilities at some \$2 million per annum.
- 3.15 Similar evidence was presented to the Committee in submissions from councils or local government associations in all States.
- 3.16 The Committee notes that steps are being taken in at least two States (Tasmania and South Australia) to review financial relationships between State and local government, and that these reviews could facilitate resolution of complaints about cost shifting. Negotiation of partnership agreements between State governments or individual State agencies and local councils can also provide an opportunity to address local government's concerns.
- 3.17 The Committee also notes the view expressed in State government submissions that the States claim to face significant financial problems of their own and would like additional Commonwealth assistance. However, the transfer of GST revenue is expected to ease this problem.

*It is clear from the information provided to your inquiry that State governments have, since the mid 1990s, used their legislative power over local government to require them to deliver a wider range of services to local communities, without a commensurate increase in financial resources. While local governments across Australia have responded by improving their productivity, many now claim that if State governments continue with their trend of devolving service delivery responsibilities to them, without commensurate resources, they will become financially unsustainable.*

Local Government Managers Australia, Submission No. 293, p2.

- 3.18 The evidence is not sufficient for the Committee to make a precise determination at this stage of the extent of cost shifting, or its relative importance amongst the various issues raised by the Inquiry's terms of reference. It does seem reasonable to conclude, however, that cost shifting

is a real and serious concern for local government, especially when added to the apparent mismatch between growing responsibilities and limited resources. Further consideration needs to be given to ways in which actual or potential problems arising from cost shifting might be addressed.

**4. Is cost shifting a growing problem?**

**5. Are there examples of successful State-local government arrangements to deal with cost shifting?**

**6. How might the Commonwealth promote a more comprehensive approach to reducing cost shifting?**

## Local government's revenue base

3.19 A considerable body of evidence to the Inquiry has focussed on deficiencies in local government's revenue base.

*The evidence strongly indicates that the current financial situation is not sustainable in the long run. The situation is one that needs to be urgently addressed by the Federal and State Governments as Local Government's hands are tied. Not to act risks serious failures in service and infrastructure provision.*

Lgov NSW, Submission No. 226, p. 9.

3.20 As noted previously, local councils on average raise about 80% of the revenue they require, principally from property rates and service fees and charges. However, this level of financial self-sufficiency varies greatly between councils: amongst larger councils in metropolitan areas own-source revenues may fund 95% or more of expenditure, whilst small rural and remote councils may depend on grants for over 50% of their revenue.

3.21 Local government's reliance on property rates and service charges is often presented as a significant problem. Submissions to the Inquiry argue that councils find it difficult to generate adequate revenue from rates and charges for a variety of reasons:

- Rates are a highly visible form of taxation compared to income tax, GST etc;
- Being so close to the community, councils are highly sensitive to complaints about the level of rates;

- Rates are a tax on wealth (property values) rather than income, and owners of expensive properties may have only a limited capacity to pay;
- State land taxes tap the same revenue pool as local government rates and increases in land tax further reduce property owners' capacity to pay rates;
- High service charges can be regressive;
- Capacity to pay varies considerably over time, especially in rural areas where farm incomes can fluctuate widely from year to year;
- Many properties, particularly properties owned by State and Federal governments (including extensive areas of Crown land, national parks and forests), churches and charities, are exempt from rates;
- State legislation requires councils to offer reduced rates for pensioners, and the cost is not fully offset by grants;
- Legislation in some States limits councils' ability to 'fine tune' the level of rates in different parts of the local government area;
- Several States impose limits on some fees and charges - and in NSW on increases in rates ('rate pegging'); and
- State and Federal governments promote expectations of low taxes and reduced borrowings.

3.22 Table 3 shows the various sources of local government revenue per capita across Australia. In Queensland, Tasmania and non-metropolitan NSW revenues are increased by councils' responsibilities for water supply and sewerage, reflected in above average income from the sale of goods and services.

Table 3 Local government revenue sources 2000-01 (\$ per capita)

	NSW	Vic	Qld	WA	SA	Tas	NT	Average
<b>Taxation</b>	338.23	325.75	352.91	357.56	364.25	348.38	221.31	<b>340.90</b>
<b>Sale of goods and services</b>	292.22	146.09	586.49	189.74	128.99	405.74	241.90	<b>289.93</b>
<b>Interest</b>	33.73	11.61	23.75	23.52	12.70	21.24	15.44	<b>23.11</b>
<b>Grants and subsidies</b>	85.96	126.25	133.76	151.79	86.89	144.45	211.02	<b>114.57</b>
<b>Other*</b>	148.13	112.31	216.04	86.05	41.44	67.98	133.82	<b>135.01</b>
<b>TOTAL</b>	<b>898.26</b>	<b>721.81</b>	<b>1313.23</b>	<b>808.65</b>	<b>634.27</b>	<b>987.79</b>	<b>828.63</b>	<b>903.47</b>

Source DOTARS, Submission No. 103, p. 20

\* includes revenue from capital grants, assets acquired below fair value, and some fees for services

- 3.23 Submissions highlighted the severe financial problems faced by rural councils with small or declining populations, relatively low incomes in the local community and few opportunities to raise revenue from sources other than rates, fees and charges.
- 3.24 Many submissions argue that local government lacks a 'growth tax' - a revenue source that increases automatically as the economy grows. This argument is used to stake claims for local government to receive substantially increased Commonwealth grants, perhaps linked to growth in federal tax revenues or GDP, or to be given a share of GST revenue.
- 3.25 On the available evidence, the Committee has little doubt that local government faces some real difficulties in generating adequate revenues to meet its expanded responsibilities, and that significant financial problems may be in prospect. Shortfalls in infrastructure spending are of particular concern and are discussed in this Chapter.
- 3.26 However, the Committee would need to be convinced that the best possible use is being made of local government's existing revenue base before it could recommend greatly increased Commonwealth support or major new sources of revenue. It is also concerned that some instances of claimed cost shifting may reflect poor management: if resources have to be diverted from vital activities such as infrastructure maintenance to support previously Commonwealth or State funded programs, then perhaps councils should simply say 'no'. It seems that sometimes local government is trying to be all things to all people at a price it cannot pay.
- 3.27 Clearly, further consideration needs to be given to the impact of cost shifting and State-imposed restrictions on local government revenue, and to the benefits that might flow if these burdens were alleviated. Restrictions on rate increases can be seen as counter-productive when they prevent councils from capturing a share of the benefits of rising land values, especially when State governments derive major revenue streams from land tax and stamp duty.
- 3.28 At the same time, some of the evidence suggests that there may be room for further increases in local government's revenue from existing sources:
- Queensland councils have the freedom to determine their own revenue levels and patterns of rating, and have imposed significant rate increases in recent years;
  - a substantial number of councils in several States have introduced special levies for environmental management or infrastructure provision, in many cases with community support;
  - some NSW councils have been allowed to increase rates well above the rate-pegging limit, often without significant community opposition;



- existing pensioner concession arrangements seem to offer a model for assisting low income residents adversely affected by higher rates; and
  - increasing revenues from land tax in some jurisdictions may indicate that property taxation offers a more robust source of revenue than generally thought.
- 3.29 Some submissions propose a betterment tax - capturing part of the increasing value of land due to permission being given for its higher value use - might provide a useful supplementary source of revenue for councils in areas of rapid growth needing major additions to infrastructure and other services. This may warrant further investigation.
- 3.30 Submissions also draw attention to the non-payment of rates by State business enterprises. This situation exists in most if not all States.
- 3.31 Another issue raised in submissions is the need for greater certainty and predictability in financial arrangements with other spheres of government. This appears to relate in part to concerns that the rules of grant-funded programs or agency agreements may change, leaving local government with increased commitments.

## Scope for Borrowing

- 3.32 The Committee is also conscious of local government's low levels of net debt. Table 4 shows that in several States local government overall is a net lender, whilst in Queensland and Tasmania the level of debt is a function of local government's responsibilities for water supply and sewerage and can be serviced by revenues from those operations.

Table 4 Local Government Debt

	NSW	Vic	Qld	SA	WA	Tas	NT	Total
<b>Net debt June 2000 (\$m)</b>	(1,773)	(326)	1,652	213	(416)	83	(39)	(607)
<b>Population 1999 (millions)</b>	6.41	4.72	3.51	1.86	1.49	0.47	0.19	18.65
<b>Net debt (\$ per capita)</b>	(277)	(69)	471	115	(279)	177	(205)	(33)

Source Local Government Association of Tasmania

- 3.33 The Committee appreciates the need for councils to maintain substantial reserves to cover known liabilities and contingencies. It also recognises the emphasis placed on reducing public sector debt in recent years by both Federal and State governments, and that local government has followed a similar path. However, the figures may suggest that there could be scope for local government to meet some of its financial needs through judicious

borrowing, provided of course recurrent revenues are reliable and sufficient to meet repayments. This relates particularly to the issue of infrastructure funding. However, the Committee would not like to see debt levels becoming a long term impediment to sound local government.

## Summary

- 3.34 At this stage of the Inquiry it seems reasonable to conclude that:
- Unless local government finances are improved it cannot make the contribution to Australia's system of government that might otherwise be desirable - its role may even have to be significantly curtailed, especially in rural and remote areas where the viability of some councils appears doubtful;
  - Apparent deficiencies in local government's revenue base relative to its roles and responsibilities warrant further review by the Commonwealth and States;
  - Cost shifting, in particular by State governments, is a major part of the reason for this problem.

- 7. *What specific steps might be taken to generate significant increases in income from local government's established revenue base?***
- 8. *How might a betterment tax in locations of rapid growth work in practice?***
- 9. *In what ways should the certainty and predictability of financial arrangements with other spheres of government be improved?***

## Financial Assistance Grants

- 3.35 The CGC reported on its review of the *Local Government (Financial Assistance) Act 1995* in June 2001. The Committee is charged with examining the findings of the review.
- 3.36 Submissions to the Inquiry have generally supported the CGC's proposals, although some concerns were expressed about the implications of the move to three pools of funding, and possible abuse of the system of 'declared local government bodies', some being non-elected or statutory authorities of State governments.
- 3.37 There is strong support within local government for retention of the guaranteed minimum grant, even though this means that some councils with access to very considerable own-source revenue are receiving funds that might otherwise be directed to areas of in great need. The CGC

proposes that minimum grants be maintained at their current level by allocating 30% of what would currently be the general-purpose pool for distribution amongst councils within each State on a per capita basis. It argues that removing the minimum grant guarantee entirely would only result in a 9% (\$75m) increase in the amount of funds for distribution on a relative needs basis. Reducing the minimum grant pool to 10% or 20% would increase the relative needs pool by 6% (\$53m) and 4% (\$30m) respectively.

- 3.38 The Committee understands the arguments advanced by the CGC and in submissions. However, in a situation where much of the evidence to the Inquiry highlights the severe financial problems being faced by many councils, it questions whether a reduction in the minimum grant should be dismissed without further examination of options to enable councils with a strong revenue base to generate increased own-source income, and hence reduce their reliance on FAGs. Increasing grants to needy councils by 6-9% could make a significant difference to their financial situation, although it would not seem wise to allocate more and more funds to councils that are unlikely to remain viable for much longer.

*The shire is also concerned at the inequitable per capita basis allocation of Federal Assistance Grants to local councils which results in many wealthy and cashed up councils receiving millions of dollars that would be better allocated to rural and regional councils with small rate bases and limited other revenue sources. The allocation of minimum grants levels should be reviewed and levels of cash reserves held by council also factored into the grant assessment process.*

Shire of Manjimup, Submission No. 219, p 2.

## Quantum and inter-state distribution

- 3.39 The major concerns regarding FAGs expressed in submissions related to the total funding available and the inter-state distribution. These were matters excluded from the CGC review.
- 3.40 There is a widespread view that local government requires a substantial increase in the quantum of FAGs to meet its revenue needs. This is linked to the belief that local government should gain access to a 'growth tax'.
- 3.41 FAGs are currently increased each year in real per capita terms, using the CPI as the inflation index. Local government claims that its costs increase by significantly more than the CPI, and submissions variously argue for

the quantum of FAGs to be tied to a percentage of income tax, total federal taxes, the GST or GDP.

- 3.42 As the CGC points out, successful implementation of full horizontal equalisation of different councils' capacity to deliver services would require a very large increase in Commonwealth funding which is not in prospect. This, coupled with concerns expressed about both the inter-state distribution and the methods of some State Grants Commissions in allocating funds to councils, suggests a need for some discussion of whether FAGs should continue in precisely their present form. If funds are limited, are they best used as an untied 'top-up' of local government revenues - perhaps sustaining councils that might otherwise adjust more rapidly to harsh realities?
- 3.43 Submissions raise two issues with respect to the inter-state distribution. Firstly, that the total amount or perhaps just the general-purpose pool should be distributed on an equalisation basis rather than the current mix of a per capita distribution of general-purpose funds and a fixed share for local roads. This change would significantly advantage the Northern Territory, Tasmania and South Australia, principally at the expense of NSW and Victoria. The State shares of GST revenue have been suggested as a possible 'equalisation' formula.
- 3.44 Other equalisation formulas based on evidence of needs could also be considered, for example, the SES model used by the Department of Education, Science and Training to fund the non-government school sector. The SES formula is based on an assessment of need according to a measure of the socioeconomic status of parents rather than the school's own resource levels. It is, in effect, a measure of the relative capacity of non-government school communities to support their schools financially.
- 3.45 The main argument for retaining the current per capita distribution is that local government roles and responsibilities differ markedly between jurisdictions, and hence a fair equalisation approach is unachievable.
- 3.46 The second issue raised is that the formula for the local roads component lacks any clear rationale and disadvantages South Australia in particular and to a lesser extent NSW and Victoria. For the Roads to Recovery program the Commonwealth applied a different formula that increased funding to South Australia.
- 3.47 Table 5 compares estimated State shares of FAGs for 2002-03 with the distribution of GST revenue. NSW, Victoria and especially Western Australia would be disadvantaged by use of the GST shares - in Western Australia's case largely because it receives relatively favourable treatment in the current distribution of the FAGs roads component.

Table 5 State shares of FAGs and GST

State	Estimated State shares 2002-03				% Roads to Recovery*
	% General purpose FAGs	% Local roads FAGs	% Total FAGs	% GST revenue	
NSW	33.9	29.0	32.4	30.5	28.33
Victoria	24.8	20.6	23.5	21.7	20.83
Queensland	18.7	18.7	18.7	19.1	20.83
WA	9.8	15.3	11.5	9.6	15.00
SA	7.8	5.5	7.1	9.2	8.33
Tasmania	2.4	5.3	3.3	3.7	3.33
NT	1.0	2.3	1.4	4.3	1.67
ACT	1.7	3.2	2.1	1.9	1.67

Source DOTARS, Submission No. 103, p. 62 & 84.

\*does not include additional allocations to State governments for unincorporated areas and Indian Ocean Territories

3.48 FAGs are treated as Special Purpose Payments to the States under section 96 of the Constitution, so the Commonwealth's practice has been to seek the agreement of the States before making changes to the inter-state distribution. In the absence of agreement, the status quo has been retained. The Committee notes, however, that there is no formal intergovernment agreement on the FAGs system, and that the provisions of the Act seems to operate in something of a policy vacuum. In effect, FAGs are currently equivalent to GST payments to the States.

**10. Is there a case for reducing or abolishing the minimum grant?**

**11. Is there scope to adjust the inter-state distribution and rationalise the different arrangements for general purpose and local roads grants, assuming both remain untied in the hands of councils?**

**12. Would the FAGs system benefit from a clearer statement of Commonwealth policy direction and a formal intergovernment agreement on objectives and processes? If so, how should this be done?**

## Infrastructure maintenance and improvement

3.49 Many submissions highlight serious shortfalls in local government expenditure on infrastructure maintenance and improvement, especially roads. Local government is responsible for some 80% (by length) of Australia's roads, and local roads often play a crucial role in supporting economic activity - benefiting both the local area and Australia as a whole.

The need to help local government maintain and improve its roads has been recognised by the Commonwealth in funding the local roads component of FAGs, the *Roads to Recovery* and *Black Spots* programs, and other projects. It is a key component of the Federal government's *AusLink* proposals. Several State governments also provide funding support for local roads.

- 3.50 In addition, the Commonwealth and States provide various forms of financial assistance for other elements of local infrastructure such as water supply and sewerage, stormwater management and flood control, telecommunications etc.
- 3.51 Despite this assistance, the evidence indicates that many local councils continue to struggle to meet infrastructure commitments. This applies in a wide range of circumstances: coping with rapid growth in outer metropolitan and coastal areas; renewing ageing infrastructure in older towns and suburbs; maintaining extensive road networks in sparsely populated rural areas, and so on.
- 3.52 Recent studies in several States suggest a national funding deficiency of at least \$1 billion per annum and perhaps \$2 billion or more - equivalent to about 30% of rate revenues Australia-wide. This seems to reflect the progressive reduction in the share of local government expenditure allocated to roads and infrastructure as councils have moved into the provision of community services and environmental management. It also appears related to the slow overall growth in local government revenues.
- 3.53 The Committee believes that infrastructure funding is indeed a matter of serious concern. Already the Commonwealth has been called upon to inject a major funding increase through the *Roads to Recovery* program - some \$300 million per annum, equivalent to a two-thirds increase in the FAGs roads component. *Roads to Recovery* is making a significant difference and enabling some councils to reduce backlogs in maintenance. Its continuation would be an ongoing benefit.

*It is ... critical that the Roads to Recovery Program be extended or some similar program be established after 2004 and that funding be sufficient to ensure that local governments with reasonable rating effort have the capacity to adequately maintain their vast and crucial local road network. If it can be shown to be absolutely necessary we believe that local governments and their communities would support a small increase in fuel taxes dedicated to this purpose.*

- 3.54 In most States there are systems for levying developers to meet at least part of the cost of infrastructure associated with new development or major urban renewal projects. There may be scope to expand these arrangements with more general infrastructure levies.

**13. What is the scope for specific measures to enhance local government's revenue base to meet infrastructure needs - for example, infrastructure levies and increased borrowing?**

**14. How could supplementary Commonwealth assistance continue to be financed within the constraint of budget neutrality?**

**15. How could the States also provide increased support for local infrastructure?**

## Regional cooperation

*The question of whether local government should become involved in regional activities has long since been answered. It has no choice. Pressures at the individual council level to "do more with less" and the economies of scale and mobilisation of energy and resources that can be achieved through working with others to achieve outcomes makes regionalisation a necessity.*

Western Australian Local Government Association, Submission No. 310, p. 14.

- 3.55 Submissions received have generally indicated strong support across local government for a variety of regional arrangements, but with some provisos:
- That arrangements for cooperation amongst councils should be voluntary;
  - That regional arrangements should not entail large additional bureaucracies and become in effect a fourth tier of government; and
  - That the Commonwealth and States should engage with established local government regional organisations rather than setting up their own regional committees or administrative bodies for planning and program delivery.
- 3.56 A number of local government submissions suggest an expanded role for voluntary Regional Organisations of Councils (ROCs). These organisations often make important contributions in regional planning, resource sharing or joint purchasing schemes, special regional projects, advocacy on behalf of regional communities and liaison with State and Commonwealth agencies. Some receive substantial financial support from member councils.

- 3.57 Several submissions suggest that ROCs or another existing regional body supported by local government should be used to administer new programs, rather than the States or Commonwealth establishing separate arrangements. It is argued that the such actions of Commonwealth and States agencies may undermine the growth of regional cooperation within local government and produce a proliferation of unnecessary organisations and committees.
- 3.58 On the evidence to date, the Committee agrees that ROCs could offer a useful mechanism to promote cooperation both within local government and potentially between governments. It appreciates that selective local government representation on State or Commonwealth committees may not generate the necessary level of commitment to regional initiatives. However, the Committee also notes that ROCs do not cover all regions and that their resources and range of activities are often very limited. Further consideration may need to be given to:
- Ways of encouraging local government to increase participation in and support for ROCs; and
  - Whether ROCs could be used on a selective basis where they demonstrably have the capacity to perform the functions required.

***16. Taking into account inevitable limits on funding, what are the strategic priorities for Commonwealth involvement in regional planning and development?***

***17. On what basis would local government be willing to resource a strong, effective system of ROCs across most of Australia and significantly expand the level of regional cooperation and resource sharing amongst councils as a key element of service delivery?***

## **Scope for rationalisation**

- 3.59 Submissions received to date do not provide a great deal of information on specific examples of the scope to rationalise roles and responsibilities between the levels of government. Several do indicate, however, that more work needs to be done in this area to reduce unnecessary overlaps and duplication in service provision, and suggest the sort of approaches that might be used to enhance cooperation between governments.

*The survey of Councils indicates that there is no widespread perception of a need to transfer roles of other spheres of government to Local Government. The major functions where duplication and*



*overlap of roles and responsibilities is a concern are human services (aged, youth, family, child) and environment protection (including natural resource management) ...*

*Opportunities for rationalisation do exist, including agency arrangements allowing Local Government to be delegated responsibility for specific government services and activities. The underlying issue is the need for certainty of funding ...*

Local Government Association of Queensland, Submission No. 322, p 6.

- 3.60 Concerns about certainty of funding are a recurring theme. Local government is worried that past experiences with cost shifting will be repeated if it offers to accept an even greater role in service provision, acting as an agent for the Commonwealth or States.
- 3.61 More broadly, it appears that significant progress has been made in several States in terms of cooperative strategic planning, negotiating State-local government protocols covering areas of shared responsibility, and more recently through partnership agreements.
- 3.62 Formal partnership agreements in Tasmania negotiated between the State government and individual councils, regional organisations or the local government association, aim to establish a framework for cooperative efforts to address local, regional or state-wide issues, including some rationalisation of roles and responsibilities.
- 3.63 Several States also have standing intergovernment committees or forums to promote cooperative relations.
- 3.64 The Committee notes the valuable experience gained and that a variety of mechanisms can be used to enhance intergovernment cooperation and hence provide a platform for rationalisation of roles and responsibilities - or better coordination of efforts - as and when required. The evidence is unclear, however, on the extent to which this experience is being exchanged and best practice approaches established amongst the States.
- 3.65 A number of submissions also point to the scope for improved tripartite arrangements bringing together the Commonwealth, States and local government. In its submission, DOTARS suggests that local government might be involved in more negotiated agreements at a national level with the Commonwealth and States, or in some cases directly with the Commonwealth (eg for direct-funding programs such as *Roads to Recovery*).
- 3.66 The *AusLink* Green Paper adopts this approach and sets out a framework for a tripartite intergovernment agreement, a national advisory body, cooperative strategic planning and increased local government input to funding decisions. It specifically draws attention to established and

emerging arrangements in Western Australia, South Australia and Queensland for regional planning partnerships between governments and other key stakeholders.

- 3.67 The Committee also notes that local government has been guaranteed membership of the Australian Transport (Ministerial) Council under federal legislation, and is represented on various related intergovernment committees and groups of officials.
- 3.68 The UK White Paper '*Strong Local Leadership – Quality Public Services*' on local government reform provides interesting background reading on some of the issues facing reform of governance (see <http://www.local-regions.odpm.gov.uk/sll/>).

**18. What are the specific areas in which local government sees a need to rationalise roles and responsibilities with the Commonwealth and States?**

**19. Is there sufficient exchange of information between States on 'best practice' intergovernment relations? If not, how could such exchange be improved?**

**20. Should the approach advocated for AusLink be applied more widely? If so, what would be priority areas?**

## Capacity building and accreditation

- 3.69 Submissions make it clear that local government seeks to strengthen its position in the Australian system. Implicit in such a move would be an understanding that it has the necessary skills and resources to play an enhanced role and to engage effectively with other governments.
- 3.70 Over the last two decades the Commonwealth has provided financial support for a number of capacity building initiatives in local government. The States have also supported capacity building programs in their own jurisdictions.
- 3.71 Whilst these initiatives appear worthwhile, and there is good evidence to indicate a steady improvement in local government management, the Committee has received submissions suggesting that a more concerted effort is required. It is argued that the States lack the resources to fund really substantial programs aimed at systemic reform and improvement; that there is a need for a national approach to avoid fragmentation; and that something more than simply a funding program for often unconnected projects is required.

- 3.72 Lgov NSW advocates investigation of a national body along the lines of the UK Improvement and Development Agency (IDeA), a 'joint venture' of local and central government that conducts a variety of forms of capacity building in a coordinated way - training, research, demonstration projects, benchmarking etc. Among other things, it administers a Local Government Improvement Program and provides management advice to councils experiencing difficulties. IDeA is funded by a 'top slice' of the UK equivalent of FAGs.
- 3.73 A related issue is the possibility of a system of accrediting councils or Regional Organisations of Councils to act as agents of the Commonwealth in program delivery. This might facilitate selective delegation of program responsibilities to local government and remove the constraint of the 'lowest common denominator'. Presumably a national agency of some sort would be required to conduct accreditation assessments.

- 21. Should capacity building for local government be approached on a national basis? If so, what are the priorities for a national program?**
- 22. What sort of organisational framework is required to ensure an effective capacity building effort?**
- 23. Would local government support some form of accreditation assessment in return for an increased role in the administration of Commonwealth programs?**

## Some Options

### Overview

- 4.1 This chapter sets out some options for a Commonwealth response to the key issues discussed in Chapter 3. The options are presented as a basis for discussion: they are not in any order of priority, nor should they be read as recommendations. However, they are seen as representative of practical steps that are within the ambit of Commonwealth influence and that might make a real difference.
- 4.2 Inevitably some of the options would be difficult for some stakeholders to accept. The Committee hopes nevertheless for a useful and constructive debate. The questionnaire at the end of this discussion paper seeks specific responses to the options as well as the various questions posed in Chapter 3.

### Finance and cost shifting

#### Option 1a

*Negotiate an umbrella intergovernment agreement on FAGs incorporating some or all of the following elements:*

- *a clear statement of the Commonwealth's policy intent*
- *adjustment of the escalation factor to match increases in GST revenue or GDP*
- *changes to the interstate distribution to redress apparent anomalies*
- *reduction of the minimum grant to direct additional funds to needy councils*
- *making grants conditional on an adequate revenue effort, the continued viability of recipient councils, and effective arrangements to secure efficiencies through regional cooperation and resource sharing (including merging councils where appropriate)*
- *removal of unwarranted State restrictions on local government revenue and substantial reductions in cost shifting*
- *reporting on expenditure*

- 4.3 At present there is no intergovernment agreement on the payment of FAGs. This option seeks to strengthen the system by giving it a clearer set of objectives making the best possible use of the available funds.
- 4.4 There are significant differences of opinion about how FAGs should be administered into the future. The time may be right to open up some of the issues excluded from the CGC review - specifically the escalation factor and interstate distribution. Local government FAGs were linked in the past to increases in grants to the States - now replaced by the GST. The Commonwealth's decision to use a modified distribution formula for *Roads to Recovery* appears to signal dissatisfaction with at least some aspects of the interstate distribution.
- 4.5 Reduction of the minimum grant to free-up extra funds for disadvantaged local government areas could be accompanied by conditions to ensure that recipient councils are viable into the medium-longer term, and make the maximum possible effort to help themselves in terms of revenue-raising, regional cooperation and in some cases mergers. Otherwise there is a risk that scarce funds could be wasted.
- 4.6 Finally, an intergovernment agreement could address the issues of cost shifting and restrictions in some States on local government revenue, and the apparent consequence that the intended beneficial effects of FAGs are being offset by State imposts on councils.

**Option 1b**

*Treat FAGs simply as a tax transfer with a simplified distribution system and formula, administered nationally.*

- 4.7 If it is not possible to reach agreement on resolving perceived problems with the FAGs system, then perhaps consideration should be given to more radical options.
- 4.8 One would be to treat FAGS simply as a tax transfer: an as-of-right payment to all councils based on a simplified formula and distributed directly by the Federal government. This would reduce administration and compliance costs, as well as eliminating the issue of State shares.

**Option 1c**

*Deliver FAGs through a model of broad-banded program grants to facilitate local government's role in key national initiatives such as regional development, transport, environment etc.*

**Option 1d**

***FAGs to be delivered as tied grants.***

- 4.9 Currently FAGs are untied: councils may use the funds as they see fit, including the local roads component.

**Option 1e**

***Consider other horizontal equalisation formulas for local government funding such as the SES formula used by DEST for funding the non-government school sector.***

**Option 1f**

***Deliver FAGs through the Roads to Recovery model.***

- 4.10 The Roads to Recovery program is a very successful program funding directly from the Commonwealth to local governments. This model would not require funding to be channelled through the Local Government Grants Commissions in each State.

**Option 2**

***Include local government in negotiations for the next Commonwealth-State financial agreement and specifically consider:***

- ***the ongoing financial viability of local government in relation to its roles and responsibilities, and the need and scope for increased Federal and State support***
- ***the need to reduce cost shifting and revenue restrictions imposed on local government (unless already addressed under Option 1).***

- 4.11 The evidence indicates that the ongoing financial viability of local government - especially smaller rural councils - is a matter that requires further consideration by the Commonwealth and States. An appropriate context might be the next Commonwealth-State financial agreement. Local government could be included in negotiations and its case for additional assistance - including an increase in the quantum of FAGs or a share of GST revenue - carefully examined. The financial agreement could also address the issue of cost shifting and revenue restrictions on local government if Option 1 is not pursued.

### Option 3

*Through the Local Government and Planning Ministers Council:*

- *investigate the principal factors that impinge on the adequacy and effective utilisation of local government's own revenue base*
- *disseminate best practice in council revenue-raising, and recognise the efforts of those councils demonstrating a responsible and innovative approach to maximising revenue consistent with expenditure needs and community capacity-to-pay*
- *examine the ongoing viability of smaller rural councils and possible need for alternative models of local government in some areas.*

4.12 Prior to the negotiation of the next financial agreement, it would be necessary to undertake some further investigations into local government finances, particularly the adequacy of the revenue base and whether councils are making the best possible use of available rating systems and other revenue options. It may be helpful to search out and disseminate best practice in this field.

4.13 The ongoing viability of smaller councils also needs to be researched. As local government continues to develop, the gap in capacity between large and small councils is likely to become even greater. It may be necessary to consider whether uniform systems of local government across widely differing regions are sustainable. Something along the lines of New Zealand's regional councils and large municipalities with local community boards might be better.

## Infrastructure funding

### Option 4

*Conduct a national study into local infrastructure needs and funding in order to:*

- *fill the gaps in current knowledge and reach a national consensus on the magnitude of the problem*
- *consider a wide range of funding options including local infrastructure levies and increased but cautious use of borrowing.*

4.14 Figures suggest that nationally local government under-spending on maintenance is at least \$1 billion per annum. Shortfalls in maintenance and renewal of local infrastructure is a matter of very real and serious concern, evidenced by the Commonwealth's decision to fund *Roads to Recovery* as well as issues raised in the *AusLink* Green Paper. Follow-up investigations in this area warrant a high priority. Gaps in the data should be filled as soon as possible to build on the studies already completed in several

States, so that a national picture can be assembled. It would then be possible to assess the magnitude of the funding shortfall and consider available options. This would need to be linked to possible action on broader financial issues suggested under Options 1-3. Infrastructure funding shortfalls could be ameliorated, for example, by removal of State restrictions on council revenue raising from established sources.

#### **Option 5**

***Maintain Roads to Recovery into the longer term, either in its current form or as a component of AusLink.***

- 4.15 There is little doubt that local government will press strongly for Roads to Recovery to be continued beyond its current timeframe, and discussions on *AusLink* will provide an opportunity for that issue to be raised.
- 4.16 It is clearly arguable that the deficiencies *Roads to Recovery* was intended to address will not have been completely or even largely overcome in the space of 4-5 years. The difficulty is finding the funds to maintain the program. It remains to be seen whether local government will wish to make a case for any particular source of funding or revenue stream.

## **Regional cooperation**

#### **Option 6**

***As a general rule, ensure that Commonwealth-funded programs involving local government and a regional planning or delivery mechanism make use of established regional organisations of councils (or equivalent) rather than establish parallel bodies, provided the ROCs have demonstrated capacity.***

- 4.17 Increased regional cooperation amongst councils is one way of facilitating rationalisation of roles and responsibilities and enhancing local government's capacity to play a stronger role generally (see also Option 1).
- 4.18 A number of regional organisations of councils have already demonstrated the ability to contribute effectively to program implementation. This option suggests that wherever possible such ROCs should be given a 'first option' to undertake regional components of Commonwealth programs.



## Rationalisation

### Option 7

*Through the Local Government and Planning Ministers Council:*

- *negotiate an intergovernment agreement on principles and procedures for the future transfer of functions and financial obligations from the Commonwealth and/or States to local government, as well as the imposition of new functions*
- *regularly review and disseminate best practice in State-local government relations, particularly in relation to cooperative planning and service delivery.*

4.19 The evidence indicates that rationalisation of roles and responsibilities, including acceptance by local government of any additional functions, requires a policy framework to ensure that councils can minimise the risk of future cost shifting. This would seem to be a matter for Local Government Ministers, led by the Commonwealth (given its interest in maximising the value of FAGs and other funding to local government).

4.20 Greater discussion and dissemination of best practice models for cooperative planning and service delivery, such as partnership agreements, could also promote advances in rationalisation across Australia.

### Option 8

*Ensure that local government is a party to negotiations and a signatory to all SPP agreements covering functional areas in which it has significant responsibilities, using the AusLink approach as a model.*

4.21 Involving local government in all relevant SPP agreements would complement the steps suggested under Option 7 and provide an opportunity to consider new or expanded areas of local government activity such as community safety or management of some health services.

## Capacity building and accreditation

### Option 9

*Use a 'top slice' of FAGs (perhaps 0.5%) to fund a national capacity building agency along the lines of UK Improvement and Development Agency (IDeA).*

- *Give the capacity building agency responsibility for accrediting councils and regional organisations of councils wishing to become agents for the delivery of Commonwealth programs.*

- 
- 4.22 This option picks up the suggestion for a national agency advanced in submissions and adds a possible funding source, drawing on the UK model. Funded through a 'top slice' of FAGs, the agency could be seen as an arm of local government itself. The Commonwealth might be asked to provide a small one-off increase in the FAGs base to launch the agency.
- 4.23 Any moves to allocate local government an increased role in delivering national programs may need to be accompanied by a system of accreditation so that the Commonwealth could be assured of the capacity of the councils and/or regional organisations concerned.