

Response to Cost Shifting Discussion Paper

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Response to Cost Shifting Discussion Paper

The Problem

In our view, the inquiry has established that:

- significant cost shifting is occurring from the States and the Commonwealth to local governments;
- some smaller local governments need structural reform to be viable;
- local governments at times contribute to cost shifting by seeking to meet community needs in inadequately funded areas of Commonwealth or State responsibility;
- local governments have difficulty in meeting critical expenditure needs, e.g. asset renewal;
- No clear case has been made that the FAGS model does not work. The case has been clearly made that the FAGS quantum is insufficient.

Structural solutions are required which go to the heart of roles and responsibilities, and to resources and capacity.

Federal taxation powers arise directly as a result of the constitutional arrangements. These arrangements impose taxation transfer responsibilities on the Commonwealth as a feature of government financial arrangements.

A Solution

It is proposed that:

1. Current FAGS of \$1.35bn be increased to \$2.7.bn and tied to 1.3 % of total Commonwealth taxes in future years, the quantum representing the estimated gap in local authority essential infrastructure funding each year in Australia.
2. FAGS be funded from an allocation from the expected GST windfall payment to the States plus other sources, and be deducted from the States' GST allocation by the Commonwealth.
3. FAGS as untied grants be in the first instance for the purpose of supporting Local Governments' core responsibilities of infrastructure provision and social and community building. To that end FAGS should be paid in two equal parts, the first for infrastructure renewal and the second for other social and community objectives. The total

quantum paid to each State could be allocated on a population basis consistent with VFI principles. The distributions by the States to local governments can be in accordance with HFE principles recognising varying need and capacity underpinned by the principle that everyone in our community is entitled to a basket of services that are common across the nation, as recognised

4. The infrastructure component of FAGS would be distributed between States and in turn local governments initially on the basis of the value of assets under management but adjusted for the size of any "infrastructure gap" and the capacity of a local government to bridge that gap through their own revenue raising capacity
5. The community building portion of FAGS be calculated according to socio economic and capacity disadvantage as currently undertaken by the States Grants Commissions or such other appropriate measures as may be developed in collaboration with local governments in each State.
6. In regard to the infrastructure portion of FAGS, results against agreed asset management standards can be monitored against balance sheet and capital expenditure effort, or standards developed by a national Local Government Best Practice Institute and building on infrastructure studies in Victoria and South Australia.
7. The enhanced financial capacity of local governments through a general increase in FAGS will enable them to fund essential infrastructure important to national economic capacity while also giving them the ability to enhance local social and community well being within a framework of local choice and priorities.
8. Payment of FAGS is conditional on demonstrated local government reform to establish critical mass and viability. Payment of untied FAGS should also be conditional on removal of all rate capping and other revenue collection restrictions imposed by State governments, accepting that local governments should be accountable to their local communities for tax decisions. It is also noted that the States currently receive grants through COAG for community building purposes, which are not fully passed on to local governments.
9. Negotiate a new National Agenda for Local Government between the Commonwealth and ALGA at COAG to describe the desired long-term direction and priorities for government spending as a basis for delivering the core responsibilities of Government i.e. National - nation building; State- capacity building; Local- community building
10. Specific purpose grants can be used by the Commonwealth to fine tune national objectives by further augmenting local capacity in a targeted and strategic manner.

11. Any programs administered by local governments on behalf of State or Commonwealth governments must be funded on a fully costed basis without any cost transfer to the recipient.
12. Local governments will pursue funding arrangements with the States in line with local social and community objectives set by Councils in consultation with their communities.
13. Legislation affecting local governments should not be introduced in the Commonwealth or State Parliaments without preparation of a Local Government Impact Statement.

Essentially what is being proposed is that the three levels of government would apply the principle of subsidiarity, concentrating on what they each do best:

The **Commonwealth Government** would be putting its emphasis on **nation building** by:

- strengthening our infrastructure base and hence
- enhancing our ability to represent and compete internationally and
- achieving social equity through equal access to basic services and infrastructure
- provide or sponsor services needing national standards

State governments would focus on **capacity building** and have responsibility for:

- assessing infrastructure backlogs in conjunction with local government authorities
- State infrastructure
- providing leadership on State-wide social policy and building the capacity of communities
- provide or sponsor services needing State-wide standards

Local Governments would concentrate on **community building** by:

- delivering local infrastructure and
- implementing social and community based programs on a local community priority basis
- provide or sponsor services needing local standards.

The Case

Over the last 30 years local government roles and responsibilities have changed. Some of this is a function of cost shifting and some a function of a desire by local governments to respond to changing local community expectations. Local governments clearly have a local leadership, community planning and discretionary role in addition to their traditional services roles.

The respective responsibilities of different levels of government are unnecessarily complex and lead to some confusion of responsibility. These responsibilities are currently funded through property taxation (rates), local governments' non-rate own revenue raising through fees and charges, and through Commonwealth and State grants (both tied and untied). The nexus between the source of revenue and the site of expenditure has become mired in arguments stressing local differences and excessive dependence on Commonwealth and State funding.

Reform of the purpose and administration of FAGS can assist local governments meet their core responsibilities. The capacity of local governments to perform these roles requires consistent reform across Australia. This in turn may lead to savings, which could be redirected into the FAGS quantum. A resolution, which reflects appropriate responsibilities, is essential for future effective governance at all levels.

The demonstrable failure of the current arrangements to assist the security of the local government sector is well known. The current arrangements tend to avoid public transparency and efficiency considerations. This masks the justifiable need to support rural local governments at a higher level.

Local governments face unreasonable restriction by other levels of government in their rate setting capability. Such restrictions are essentially based on political rather than economic considerations. This needs reform.

The inquiry has established that there is a financial shortfall of at least \$1bn per annum, possibly considerably more, in local governments' funding of asset maintenance and renewal. This equates to almost 15% of municipal rate collections financial year 2000-01. Rating capacity for most local governments is probably inadequate to fund that gap.

Not all Councils face such an infrastructure gap. Performance varies across the sector dependent on the age of the municipality, rate of development, and past revenue and rating strategies. Although the allocation of grants should reflect need and horizontal equity to some extent, those local governments that are performing well ought to be rewarded for their efforts by having maximum discretion over expenditure.

If the infrastructure maintenance and renewal gap is to be bridged, we estimate it would require more than doubling of the current FAGS from \$1.35bn to \$3.bn. The first priority is lifting the standard of infrastructure

renewal across Australia as the necessary base for the future and sustained delivery of national, state and local objectives. We note this figure is considerably more than the ALGA proposal of \$1.75bn, which may be based on more short-term considerations.

Proposals to require preparation of Local Government Impact Statements for all new and amending legislation by Commonwealth or State governments is critical to cooperative federalism and subsidiarity. The cost of such assessments should be fully borne by the initiating department or agency. Recent assessments by the ABS assess national expenditure on environmental management by local governments at \$2.5bn, and resource management at \$1.5bn. Neither of these activities should be funded solely by rates, nor could the Commonwealth or States easily replace these funds or provide the services.

Responsibilities

Distribution of responsibilities ought be driven by generic principles rather than program turf warfare based on short term budgetary considerations.

We propose the following core responsibilities for each level of government.

National	Nation Building , through broad principles and financial support, and services needing national standards.
State	Capacity Building , through leadership and policy management, and services needing state-wide standards
Local	Community Building , through delivery and engagement in places, and services needing local standards

Looking to the future then, local governments in Australia have three fundamental **responsibilities**:

- To provide local leadership
- To provide local services and to build and maintain local physical infrastructure, aligned with local needs and expectations
- To contribute to local social capital

These responsibilities are delivered through three key **roles**:

- Community Governance and Stewardship
- Service delivery
- Innovation

Physical infrastructure is essentially a universal requirement, which should be delivered at least to a minimum standard across the nation. Social infrastructure is a critical need requiring considerable attention by local governments.

The failure to adequately provide, maintain or renew infrastructure at the local level directly impacts on both the States' and the Commonwealth's efforts and ability to build the nation and improve national competitiveness. Australia's three levels of government mean that the principle of subsidiarity is critical to successful governance for the Australian community. For example, a complex system of export incentives or national rail and port improvements will count for nothing if large road vehicles are unable to use local roads and bridges to reach railheads or ports. This is possibly best illustrated in the area of telecommunications where all the plans of a digital revolution through enhanced bandwidth is impossible to achieve without addressing the capacity of the "last kilometre of copper to the home". 'Networking the Nation' recognises that fundamental truth.

State-led capacity building is fundamentally about infrastructure necessary for social and economic activity, which is best delivered and implemented at the local level.

Social infrastructure or capital, and also economic activity, are about building communities in local places which people identify with and as such require a level of direct governance and autonomy. In some instances this requires leadership and political management by State governments to support local solutions specific to local government communities.

Resources and Capacity

How can FAGS be increased without a negative impact on the Commonwealth budget position? This can be achieved in four ways:

- Fund FAGS from the projected excess GST windfall currently going to the states, and from growth in other Commonwealth taxes
- Reform of local government nationally
- Rolling in a portion of specific purpose grants going to local governments and reforming, compliance requirements applying to tied grants
- Streamlining of funding application, and acquittal processes

If cost shifting from the States is as high as is suggested, there is capacity for devolution of funds. It is feasible to redirect a portion of the GST windfall to the States and tie a guaranteed 1.3% of all future Commonwealth tax collections to local governments - refer Attachment 1. (This would equate to 8.6% of GST collections 2003-04). These revenues are exceeding initial forecasts. There is an opportunity to share a growth tax with local government, thus improving the current vertical fiscal imbalance by increasing the base quantum and maintaining its future real value. There is also a case to be made that property taxation such as land tax and stamp duty collected by the States should be hypothecated to its local source.

It is clear that local government in Australia needs structural reform. Reform has been successful in Victoria and suggests there are cost savings to be

achieved. Structural reform appears less advanced in other states. There is a critical mass necessary for optimal service delivery which will vary according to local circumstances e.g. large rural areas. Any financing package needs to directly relate to reforms to improve the structural capability and financial viability of the sector. A policy precedent has been established with the National Competition payments where the Victorian government passes these, albeit partially, to local governments in recognition of the competitive reforms achieved. This connection can be directly linked to tangible progress to reform.

Receipt of FAGS could be conditional on removal of rate capping restrictions and other forms of regulation of local governments' non rate revenue currently imposed by some states. Given the price sensitivity of rates, this is likely to provide an incentive for further reform and financial savings.

Provision of physical infrastructure has an obvious nexus to municipal rates. However, the rate collection capacity *on its own* is insufficient to support the responsibility. Infrastructure is increasingly obsolete, worn out, over utilised and under performing. Expectations are now firmly rooted in the 21st century, whilst rating as the sole method of revenue collection is grounded in the 19th century. Proper location or place-based management requires delivery of all urban and rural infrastructures to be supplemented by Commonwealth taxation revenues, i.e. recognition of the principles of subsidiarity and vertical fiscal equity. The delivery of infrastructure assists the Commonwealth to deliver on its nation building responsibilities at an appropriate level.

Commonwealth taxes can recognise the principles of subsidiarity and vertical fiscal equity by providing in the form of untied FAGS for untied infrastructure spending in the first instance and after that to discretionary community building by local governments.

With this financial support comes a clear responsibility on local governments to manage their expenditure responsibly. Establishment of a National Local Government Best Practice Institute to assist in establishing and monitoring standards and performance can support this. There is scope for further savings by reducing costly assessment and acquittal processes currently required by State and Commonwealth departments.

There may also be a case for a portion of those funds which are already going to local government to be deducted from every national program and allocated direct through FAGS.

Specific purpose funding in the form of Roads to Recovery or Natural Heritage Trusts programs etc to achieve specific national objectives and or State objectives can supplement this effort. Specific purpose grants need to be on a fully costed and fairly costed basis without any direct or implied cost shifts to the recipient. The recent review of the Clean Coasts and Seas programs highlights the successful application of a tripartite program. This model is worthy of further examination.

In the case of social infrastructure programs, e.g. HACC, social policy objectives can be best delivered locally. Grants to deliver programs on behalf of other levels of government must be fully, fairly and transparently costed as genuine joint partners – one party provides the funds and the other delivers the service. This means pay in full at the real cost of doing business.

In the spirit of real partnership it is right and proper that the contributions of the funding source are fully and openly acknowledged. The current system is notable by its absence of trust.

As social infrastructure is about local community building, it is appropriate for local governments to allocate a portion of their own source revenue; both rates and non-rates, to contribute to locally determined priorities. Assuming FAGS are significantly increased, there will be greater capacity for local social infrastructure to be determined and funded locally. Untied funding is an appropriate mechanism to ensure national objectives are met in a manner which is locally responsive and adaptable. National agendas must require delivery of the basic property services in the first instance. Local governments will be disciplined and prudent in the spending of their own revenues if untied FAGS are topping up rate revenue to support the basics.

An important feature of these reforms is to free local governments from unreasonable restrictions placed on their capacity to raise fees and charges. Currently the states are able to engage in cost shifting and restrain local governments' revenue setting. Rate capping in some states is an obvious example, but it also occurs in non-rate revenue. In statutory planning for instance local governments have the responsibility to fund the activity but the fees are determined by State regulation. This inevitably means a lag in review of fees and a lack of accountability for determination of fee levels.

Implementation

A National Agenda for Local Governments, overseen by a whole of government Council, with permanent local government representation is a prerequisite for success. Such an Agenda for the next 10 years might focus on issues such as:

1. Environmental management
2. Infrastructure renewal
3. Emergency management
4. Social capital and community building
5. Primary health care
6. Youth services
7. Integrated Transport
8. Affordable housing
9. Preventative Aged care

10. Regional renewal
11. Heritage
12. Drugs
13. Strategic community planning

A number of these matters can involve responsibility expansion by local government. Provided this can be financed appropriately this is an appropriate response to what the community is increasingly demanding, often involving innovations which raise the benchmark for governments generally. Notable recent examples include the Cities for Climate Protection program and sustainable design initiatives.

One of the disadvantages of the current system is that the three levels of government are inevitably locked in political conflict. This militates against good planning and collaboration. The mistrust between the political levels of government referred to earlier is also evident at the bureaucratic level where a lack of understanding often exists of local accountability to local communities by local governments. The level of inter governmental collaboration on a locality basis amongst bureaucrats is poor. A mechanism needs to be developed to improve this.

Regional collaboration, focussed on planning and desired outcomes at a whole of government and local place level, could be developed. Experience tells us that executive regional authorities, which have decision making authority and funding responsibilities, are unsuccessful and likely to decrease rather than increase democratic responsiveness. Larger local governments rooted in community democracy are more likely to be successful.

The situation in each State varies. In the long term it is desirable, indeed essential, for the Australian federal system to gradually evolve on a truly national basis with less emphasis on state differences. Such a change program needs to recognise State differences as they currently stand. This requires real local government representation at COAG.

Our proposals can be implemented nationally. There is scope for the program to commence in Victoria earlier where the infrastructure data has been established. Victorian governments have made some significant commitments, and changes could likely be implemented more easily in Victoria. Victoria has committed to constitutional recognition of local government and developing a whole of government approach to community links and place management. This is most evident in the recent creation of the Victorian Communities Department under the responsibility of the Deputy Premier. The move to uniform local government elections across the State is illustrative of the commitment and the opportunity.

Conclusion

Our proposal seeks to find a way to clarify the responsibilities of local governments and responsibly structure funding of local governments around

communities' expectations of local governments to be leaders, planners, and service deliverers. Effective democratic governance in Australia requires commitment to the principles of Subsidiarity, Accountability, and Vertical and Horizontal equity.

The above proposals allow for improved vertical and horizontal fiscal balance by:

- Increasing FAGS on the basis of population and needs
- Sharing a growth tax with local governments
- Linking funds to capability and viability;
- Increasing reliance on local revenue raising capacity; and
- Increasing the pool without a negative budget impact to Commonwealth revenues.

Increasingly the community judges the performance of the government sector without discriminating between levels of government or portfolios. Citizens experience government as a whole. More holistic styles of operation, with careful regard to subsidiarity, provide the possibility of fully realising local governments' potential, cutting costs and providing higher levels of service. It will not be achieved without financial viability and structural capability. This requires all three spheres of government to embrace a new maturity and trust in their relations in the interests of real reform of governance in Australia and delivery of a whole of government approach.

This proposal offers a tangible means of all levels of government collaborating on easily understood and communicated roles and responsibilities directed to the overall purpose of providing a physical and social infrastructure conducive to material economic progress and development.

The proposal rests on the assumption that the purpose of government is to ensure that expenditure is directed responsibly to prioritised community needs and expectations. Each community wants a clean, green and safe place, but they also want their differences accepted and recognised. They want national agendas implemented and managed, but supported locally by leadership at the state and local level.

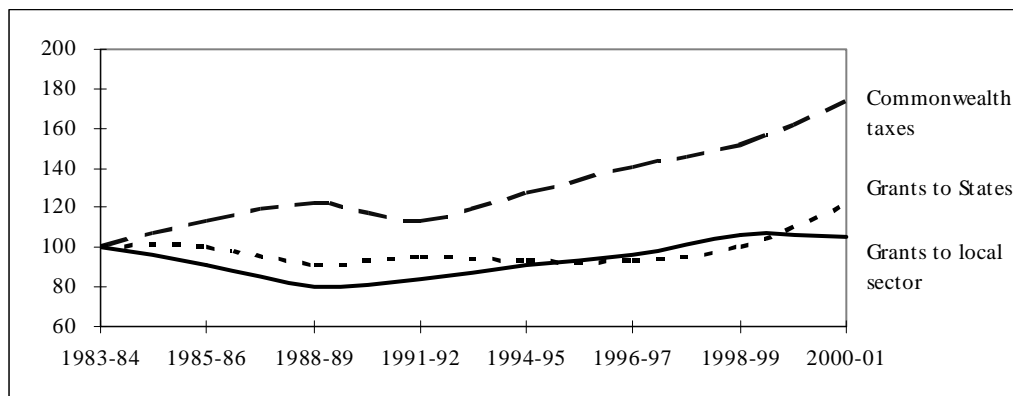
Local governments have much greater value than is currently being realised. Their political capability and leadership is well established. This potential will remain untapped without reform to establish long-term financial viability and organisational capability.

Reform of FAGS can be driven by one principle: - support delivery locally with minimum constraint and maximum accountability.

Extract from unpublished study conducted by Access Economics on behalf of City of Port Phillip, February 2003

Chart 6.4.1 shows the relationship, since 1983-84, between taxes collected centrally by the Commonwealth on the one hand and (current and capital, general purposes and specific purpose) grants paid to the State and local sectors on the other.

**Chart 6.4.1: Per Capita Tax and Grant Revenues, Constant (2000-01) Prices
1983-84 = 100**



From Chart 6.4.1, it is clear that tax sharing grants – at both the State and local sector levels – have failed to keep pace with growth in centrally collected taxes. Between 1983-84 and 2000-01, when expressed in constant price per capita terms, Commonwealth tax collections have increased by 74% over the period while grants to the States by increased by 21% (much of this recently related to the GST arrangements) and by just 5% for the local sector.

Hence, the fact that local government FAGs may have been tracking the increase in population and prices in recent years is not sufficient. Tax sharing grants should grow at the same rate as Commonwealth estimates and projections for Commonwealth taxes (exclusive of GST) and GST revenues (collected by the Commonwealth on behalf of and paid to the States), not less quickly as in the case of FAGs to local government.

Conclusion

The position taken by the Commonwealth clearly overlooks VFI, and the role to be played by untied grants in addressing the symptoms of that imbalance (if not the causes).