

**HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS,  
FINANCE AND PUBLIC ADMINISTRATION – INQUIRY INTO LOCAL GOVERNMENT  
AND COST SHIFTING**

SUBMISSION BY THE DEPARTMENT OF THE TREASURY

**Overview**

Local government is not one of the responsibilities granted to the Commonwealth under section 51 of the Constitution. As a consequence, local government remains the responsibility of State governments. Local governments are established under State legislation and are subject to State government oversight.

Since 1974-75, however, successive Commonwealth governments have provided general purpose funding for local government through Specific Purpose Payments (SPPs) to the States and Territories (the States). SPPs are made under section 96 of the Constitution, which provides that: “the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament sees fit.”

The States are required to pass on to local government in full the SPP the Commonwealth provides for local government assistance, as financial assistance grants. In 2002-03 this funding is expected to total around some \$1,450 million. In addition, the Commonwealth provides a number of SPPs direct to local governments to fund roads, aged care and children’s services. In 2002-03 these payments are expected to total over \$330 million.

The Commonwealth generally makes SPP payments as a contribution to an area which is the Constitutional and traditional responsibility of the States in order to meet Commonwealth policy objectives. The Commonwealth does not seek to take over responsibility for State functions through the grant of SPPs.

Under the 1999 *Intergovernmental Agreement on the Reform of Commonwealth State Financial Relations* the Commonwealth provided the States with access to a growth tax in the GST which, over time, will enable States to better fund State responsibilities according to their own priorities. At the same time, the Commonwealth indicated that it will continue to provide SPPs to the States and has no intention of cutting aggregate SPPs as part of the reform process set out in the Agreement, consistent with the objective of State Governments being financially better off under the new arrangements.

The InterGenerational Report released in May 2002 notes that a steadily ageing population will contribute to pressures on the Commonwealth Budget. These pressures will be best met by maintaining sustainable government finances through, *inter alia*, continuing the current medium term fiscal policy of maintaining budget balance, on average, over the economic cycle.

The need to maintain sustainable government finances while meeting its own responsibilities for ensuring the well being of the Australian people will limit the scope for the Commonwealth to provide additional funding in areas that are the responsibility of other levels of government.

House of representatives Standing Committee on Economics, Finance and Public Administration	
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## Financial assistance grants to local government - current arrangements

Financial assistance grants to local government are intended to assist the budgetary position of local governments and are not required to be spent on any particular function.

The current arrangements for providing financial assistance grants to local governments are embodied in the *Local Government (Financial Assistance) Act 1995* (the Act). The Act provides for funding to be paid to the States as an SPP to be passed to local governments in its entirety.

The Commonwealth provides two types of financial assistance grants to local government, general purpose assistance and untied local road funding. Both forms of funding can be used for any purpose (which means they are 'untied').

General purpose assistance to local government is distributed to the States on an equal per capita basis. The intrastate distribution of these payments is on the basis of horizontal fiscal equalisation (as far as is practicable), subject to a requirement that each local government body must receive a minimum share of funding which is based on 30 per cent of the general purpose funding being distributed on a per capita basis. State Grants Commissions are responsible for determining the distribution of grants.

Untied local road funding is allocated between States on the basis of historical shares, intrastate distribution is then made on the basis of relative road needs assessed by State Grants Commissions.

Section 8(1)(a) of the Act requires the escalation factor, which determines the increase in the previous year's base grant for both forms of assistance, to be calculated as a function of population and CPI increases. The Treasurer is responsible for making both this determination and an estimate of the next year's escalation factor which is used as the basis for payments during the financial year. Section 8(1)(c) of the Act provides that the factor may be increased or decreased if the Treasurer considers there to be special circumstances for doing so.

In 2000-01 and 2001-02, the escalation factor used to determine the increase in local government assistance was based on an estimate of the CPI excluding the impact of the indirect tax reform measures contained in the *New Tax System* (ANTS exclusive CPI). The use of the ANTS exclusive CPI was consistent with the decision that the ANTS exclusive CPI would be used for indexation purposes for most Commonwealth expenses.

- In 2000-01 the ANTS exclusive CPI was lower than the CPI which included the impact of tax reform because of the impact of the introduction of the GST. It was appropriate to use the ANTS exclusive CPI to adjust local government assistance because Government agencies (including local government) are able to claim input tax credits and will therefore effectively not pay GST on their purchases.
- In 2001-02, the ANTS exclusive CPI was slightly higher than the CPI including the impact of tax reform because the latter reflected the impact of the abolition of Financial Institutions Duty (FID) from 1 July 2001. Again, it was appropriate to use the ANTS exclusive CPI to adjust local government assistance because local governments were not subject to FID and therefore did not benefit from reduced costs as a result of its abolition.
- The estimate of the 2002-03 escalation factor was based on the ANTS inclusive CPI (that is CPI that includes the impact of the indirect tax reform measures contained in the *New Tax System*). There is now no difference in the rate of growth of the two indices.

The assistance provided in 2001-02 and 2002-03 is shown below.

**Financial assistance grants to local government, \$m, 2001-02 and 2002-03 (estimated)**

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
<b>2001-02</b>									
General purpose assistance	322.6	238.4	178.8	94.2	74.7	23.4	15.5	9.8	957.3
Untied local road funding	123.2	87.6	79.6	65	23.3	22.5	13.6	10.0	424.8
<b>Total Financial assistance grants(a)</b>	<b>445.8</b>	<b>326</b>	<b>258.4</b>	<b>159.2</b>	<b>98</b>	<b>45.9</b>	<b>29.1</b>	<b>19.7</b>	<b>1,382.1</b>
<b>2002-03</b>									
General purpose assistance	337.6	250.0	188.1	98.8	77.4	24.2	16.2	10.2	1,002.6
Untied local road funding	129.1	91.7	83.4	68.0	24.4	23.6	14.3	10.4	444.9
<b>Total Financial assistance grants(a)</b>	<b>466.7</b>	<b>341.7</b>	<b>271.5</b>	<b>166.8</b>	<b>101.9</b>	<b>47.8</b>	<b>30.5</b>	<b>20.6</b>	<b>1,447.5</b>

(a) Total Financial assistance grants are the cash payments that the State receives on behalf of local government. It is equal to the estimated entitlement for a given year adjusted for an over or under payment from the previous year.

**Background to the development of the current arrangements**

Although the Commonwealth has no constitutional responsibility for local government, in 1973 the Commonwealth Government established a scheme whereby regional organisations of local governments could apply to the Commonwealth Grants Commission (CGC) for Commonwealth funding. The government of the time argued that "local government funding was necessary so as to make local government a genuine partner in the federal system and to promote financial equality within the regions". Consequently, the *Commonwealth Grants Commission Act 1973* was passed which allowed local government to make applications to the CGC for financial assistance. Funding was provided under this arrangement in 1974-75 and 1975-76.

In 1976 an agreement was reached between the Commonwealth and the States and Territories for local government to receive a share of personal income tax collections and for this funding to be 'untied' (that is able to be used for any purpose). This arrangement continued in various forms until 1984-85, with the share of tax collections growing from an initial 1.52 per cent in 1976-77 to 2 per cent by 1980-81.

From 1986-87 the tax sharing arrangements were replaced with a system of indexation of the existing level of grants. (Grants were also indexed as an interim measure in 1985-86.) Grants were initially indexed to the higher of the Consumer Price Index (CPI) and the percentage change in general purpose payments to the States. Funding was distributed between the States and the Northern Territory on a per capita basis. From 1988-89, indexation was generally limited to changes in general purpose payments to the States, but there were one off adjustments in 1988-89 and 1989-90 to prevent assistance from declining when some general purpose funding to the States was transferred to SPPs. General purpose funding for local government functions was extended to the ACT from 1988-89.

Following a decision at the Special Premiers Conference in October 1990 to untie local road funding, this funding was effectively added to the general purpose funding. It continues, however, to be separately identified and is distributed between the States on the basis of historical shares rather than on a per capita basis.

Under the 1998 tax reform proposals announced by the Commonwealth Government in *A New Tax System*, the Commonwealth proposed that responsibility for the provision of these forms of local government funding was to be transferred to the States. As one of the conditions attached to the payment of all GST revenue to the States, States were to be required to maintain financial assistance grants to local government in real per capita terms, while the Commonwealth would repeal the *Local Government (Financial Assistance) Act 1995*. This proposal was adopted in the April 1999 *Intergovernmental Agreement on the Reform of Commonwealth State Financial Relations*. In response to this agreement, the Queensland Government announced that it would provide local governments with a specified share of its GST revenue. A number of local government bodies also indicated at the time they were opposed to the transfer of funding responsibility to the States.

The changes to the tax reform package announced by the Prime Minister in May 1999 resulted in a decline in the amount of GST revenue to be generated and paid to the States. In June 1999 a revised Intergovernmental Agreement was signed by the Heads of the Commonwealth, State and Territory Governments. Under the revised agreement the Commonwealth retained responsibility for local government funding.

As a result of the changes to the system of Commonwealth-State financial relations, it was no longer possible to continue to index local government financial assistance grants to the rate of growth of financial assistance grants to the States as the latter were to be abolished. Consequently, the *Local Government (Financial Assistance) Act 1995* was amended to provide that local government assistance would be indexed to movements in population and CPI.

### **Specific Purpose Payments direct to local government**

In addition to general purpose assistance, the Commonwealth also provides a number of SPPs direct to local government, especially in the areas of roads and aged care services. In 2001-02 it is estimated that the Commonwealth provided \$537.7 million in SPPs to local government. In 2002-03, it is estimated that the Commonwealth will provide \$332.1 million in SPPs to local government. The table below shows the estimated payments of SPPs direct to local government in 2001-02 and 2002-03.

#### **Estimated SPP's Direct to Local Government Authorities (\$'000)**

	2001-02	2002-03
Aged care services	74,631	80,514
Disability services	1,297	1,336
Children's services	41,394	44,154
Local Government Incentive Programme	2,794	0
Roads to Recovery Programme	416,339	200,000
Other	1,200	6,140
Total	537,656	332,144

The largest SPP direct to local government is the *Roads to Recovery* programme. It is estimated that the Commonwealth will provide \$616.3 million to local authorities in 2001-02 and 2002-03. In total \$1.2 billion will be provided under this scheme to local authorities over 4 years, from 1 January 2001, for the improvement and maintenance of local roads. This programme is discussed further below.

### **Road Funding**

There has been a delineation of responsibilities between jurisdictions in recent years, in an attempt to address the issue of cost shifting between tiers of governments. In respect of roads, such a delineation was made at the 1991 Special Premiers' Conference, which agreed upon a hierarchy of

responsibility. The Commonwealth was to have sole funding responsibility for the National Highway System, the States would be responsible for State arterial roads and local government would be responsible for local roads. Notwithstanding this agreement, the Commonwealth continues to provide funding to State and local governments for roads, such as the *Roads to Recovery* programme which is discussed below.

In November 2000, the Commonwealth announced that it would temporarily intervene at local government level to provide substantial tied funding for local roads through the *Roads to Recovery* programme. By means of this intervention, some \$1.2 billion in funding is being provided directly to local government over the period 2000-01 to 2004-05, to repair and upgrade local roads based on each council's own priorities. To ensure an objective distribution of funding, allocations to councils within each State were made in accordance with formulae adopted by State Grants Commissions (allocations between States reflect other criteria such as population and length of roads).

To avoid a situation where a departure from agreed responsibilities could increase the risks of cost shifting, *Roads to Recovery* funds are paid directly to local governments (rather than through State governments). Furthermore, councils must maintain the level of their roads expenditure funded by other means and provide a statement to the Department of Transport and Regional Services that they have done so. The Prime Minister also sought an assurance from all Premiers and Chief Ministers that they will at least maintain their own expenditure on local roads.

Although the 1991 agreement has provided a basis for delineating road funding responsibilities over the past decade, the Commonwealth has recently announced its intention to revisit this agreement as part of a new strategy for transport planning and funding known as AusLink.

### **Commonwealth Funding of States and Territories**

The Commonwealth provides substantial funding to State and Territory Governments, through the provision of GST revenue, general revenue assistance and Specific Purpose Payments. The transfer of all GST revenue to the States and Territories has provided States and Territories with a growth tax which, over time, will enable them to better fund State priorities.

The tables below show estimated GST revenue provision and total Commonwealth Payments to the State/local sector in 2001-02 and 2002-03.

### **Summary**

The main points to note are:

- State governments have legislative control over local governments, and have the primary funding responsibilities for local government.
- The Commonwealth has provided some supplementary funding, mainly of a general purpose nature, since 1974-75.
- In recent times, particular attention has been given to clearly delineating the responsibilities of each jurisdiction, so that cost shifting between levels of governments can be avoided.

**GST Revenue provision and total Commonwealth payments to the State/local sector 2001-02 (estimated)**

2001-02	NSW \$m	VIC \$m	QLD \$m	WA \$m	SA \$m	TAS \$m	ACT \$m	NT \$m	Total \$m
(1) Provision of GST revenue to the States(a)	8,133.9	5,689.0	5,076.7	2,562.1	2,486.7	1,069.5	536.4	1,297.7	26,851.9
(2) General revenue assistance (2.1)+(2.2)+(2.3) (2.1) Budget Balancing Assistance	1,770.2	1,089.7	626.3	390.2	401.2	146.1	86.7	93.9	4,604.3
(2.2) National Competition Policy Payments	1,527.7	910.1	478.4	319.1	345.6	128.6	60.9	86.4	3,856.8
(2.3) Special Revenue Assistance	242.5	179.6	147.9	71.1	55.7	17.4	11.6	7.6	733.3
(3) Total Specific Purpose Payments (3.1)+(3.2)+(3.3)	na	na	na	na	na	na	14.2	na	14.2
(3.1) Specific Purpose Payments 'to' the States	6,847.2	5,054.8	4,005.5	2,504.7	1,712.4	555.9	359.7	517.9	21,558.3
(3.2) Specific Purpose Payments 'through' the States	4,941.7	3,533.4	2,886.3	1,853.6	1,271.7	413.4	239.1	439.7	15,578.9
(3.3) Specific Purpose Payments direct to local government	1,762.1	1,387.8	1,007.9	578.3	400.0	123.8	114.4	67.3	5,441.7
(4) Total Commonwealth payments to the State/local sector (2)+(3)	143.4	133.6	111.3	72.8	40.7	18.7	6.3	10.9	537.7
(5) GST revenue and total Commonwealth payments (1)+(4)	8,617.4	6,144.5	4,631.8	2,894.9	2,113.7	702.0	446.5	611.9	26,162.6
	16,751.3	11,833.5	9,708.6	5,456.9	4,600.4	1,771.4	982.8	1,909.6	53,014.6

**GST Revenue provision and total Commonwealth payments to the State/local sector 2002-03 (estimated)**

2002-03	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
(1) Provision of GST revenue to the States	8,717.8	6,164.0	5,643.6	2,825.7	2,740.7	1,201.2	586.9	1,500.1	29,380.0
(2) General revenue assistance (2.1)+(2.2)+(2.3)	1,112.8	629.0	207.1	172.0	226.2	73.3	49.4	25.8	2,495.7
(2.1) Budget Balancing Assistance	864.2	444.3	67.5	99.0	169.5	55.6	22.8	18.3	1,741.2
(2.2) National Competition Policy Payments	248.6	184.7	139.6	73.0	56.7	17.7	11.9	7.5	739.8
(2.3) Special Revenue Assistance	na	na	na	na	na	na	14.7	na	14.7
(3) Total Specific Purpose Payments (3.1)+(3.2)+(3.3)	7,072.5	5,191.4	3,990.6	2,447.0	1,727.7	511.1	356.6	353.7	21,650.6
(3.1) Specific Purpose Payments 'to' the States	5,174.6	3,700.0	2,932.4	1,835.8	1,296.6	370.1	235.8	281.8	15,827.2
(3.2) Specific Purpose Payments 'through' the States	1,806.9	1,401.2	999.2	565.5	405.0	128.3	117.4	67.8	5,491.3
(3.3) Specific Purpose Payments direct to local government	91.0	90.1	59.0	45.7	26.2	12.8	3.3	4.1	332.1
(4) Total Commonwealth payments to the State/local sector (2)+(3)	8,185.3	5,820.4	4,197.7	2,619.0	1,954.0	584.4	406.0	379.5	24,146.3
(5) GST revenue and total Commonwealth payments (1)+(4)	16,903.1	11,984.4	9,841.3	5,444.7	4,694.7	1,785.6	992.9	1,879.6	53,526.3