

***The Australian Local Government
Association***

***Supplementary Submission to the
House of Representatives Standing Committee on
Economics, Finance and Public Administration
inquiry into***

**COST-SHIFTING BY
STATE GOVERNMENTS
TO LOCAL
GOVERNMENT**

12 February 2003

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Executive Summary

The roles and responsibilities of local government have significantly increased over recent decades. Demands upon local government include: the provision of core local government services; significantly increased liability for the maintenance and renewal of ageing infrastructure; as well as a range of new services. It is important to note that, even without the additional burden of ‘cost-shifting’ to local government, the current quantum of financial assistance grants is insufficient to meet the increased demands on local government. Accordingly, there is an urgent need to increase local government’s resource base, in particular through a significant increase in FAGs.

Some of the new roles, functions and powers have occurred as a result of policy choice and increased community expectations. This is consistent with local government’s legislative responsibilities under state/territory local government acts that are based upon the general principle of local government competencies. Accordingly, it is appropriate that local government own-source revenues and Commonwealth General Purpose Grants under the *Local Government (Financial Assistance) Act 1995* be used for ‘general local government competency’ related purposes – services that local government itself appropriately chooses to deliver to local communities.

However, the evidence before the House of Representatives Standing Committee Economic, Finance and Public Administration Inquiry into Cost Shifting (the Committee) clearly indicates that many new roles and responsibilities are a consequence of the practice of cost-shifting. That is, the burden of the cost of provision of a Commonwealth and or State/Territory service (including services provided via a Commonwealth-State Specific Purpose Payment Agreement) that has been arbitrarily transferred to local government without a supporting revenue stream.¹ This must be addressed.

There is now sufficient evidence documenting the widespread practice of cost-shifting by the Commonwealth and state governments and the Government of the Northern Territory to local government to warrant swift action by the Commonwealth to address the problem.

There is a need for a full and detailed assessment of the extent of cost-shifting. ALGA believes the Productivity Commission should carry out this assessment. The Commission should work closely with state local government grants commissions, which have comprehensive, relevant data.

Cost-shifting causes serious inefficiencies and distortions in public administration. It also runs counter to the principle that the tax revenue of the nation should be distributed between all three spheres of government in a manner commensurate with their respective roles, responsibilities and general competency, and therefore expenditure. As the major

¹ Consistent with the broad definition of cost-shifting provided in the Australian Local Government (ALGA) Preliminary Submission July 2002

tax revenue earner, the Commonwealth must accept responsibility to correct the current revenue sharing inequities that leave local government seriously disadvantaged.

In addition, a formal intergovernmental agreement (IGA) on government service provision should be developed to address cost-shifting. To achieve this, the three spheres of government should collectively agree on the assignment of responsibilities for specific purposes. Clear compliance measures must be developed by the Commonwealth to ensure all spheres of government meet the terms of the IGA on cost shifting.

The terms of reference for the Committee require recommendations to be budget neutral. This is unrealistic. Budget neutrality should be viewed holistically and take into account total public sector spending. ALGA believes the economic and social benefits of reducing cost-shifting should provide total public sector budget neutrality in the medium to long term, though there may be some cost to the Commonwealth in the short term.

Supplementary Submission

Introduction

- 1) This supplementary submission to the House of Representatives Standing Committee on Economics, Finance and Public Administration Inquiry into Local Government and Cost Shifting (the Committee) has been prepared by ALGA to complement the current work of the Committee. The preliminary ALGA submission was substantial and provided information on the:
 - roles, responsibilities and recognition of local government;
 - nature of cost-shifting and decline of state government specific purpose payments (SPPs);
 - finances of local government; and
 - measures to improve the revenue base of local government.
- 2) This supplementary submission builds on submissions made to the inquiry and evidence presented to the Committee over the past few months. It provides the Committee with a suggested way forward to address cost-shifting and improving revenue sharing arrangements between the three spheres of government.
- 3) The submissions to the Committee to date reflect the diversity of interest and concerns of local government. It also reflects the complexity of the Committee's task.
- 4) This supplementary submission calls for a five-point plan to address cost-shifting. The Commonwealth should:
 - acknowledge cost shifting occurs and that it is a substantial problem;
 - quantify the extent of cost-shifting;
 - take measures to ensure public sector revenue is fairly shared across all three spheres of government;
 - develop an inter-government agreement (IGA) to address cost-shifting on specific service provision; and
 - enforce the terms of the IGA through appropriate compliance provisions.

Acknowledging the Problem

- 5) The Committee has received more than 330 submissions and has conducted a number of public hearings. It now has a very substantial body of evidence confirming the fact local government is on the receiving end of substantial and sustained cost-shifting activity by the Commonwealth, states and the Government of the Northern Territory.
- 6) Transferring responsibility for the delivery of public services from one sphere of government to another can encourage innovation and efficiency in the delivery of services to the community. However, the majority of such transfers have simply been

a means for the Commonwealth, states and the Government of the Northern Territory to devolve responsibility and activity in order to improve their own fiscal positions.

- 7) It is important that, given the body of evidence provided to the Committee, a firm statement is made as to the existence and likely extent of the cost-shifting problem.

Identifying the Extent of Cost-shifting

- 8) The national interest is best served when the three spheres of government work together to ensure taxpayers' funds are spent efficiently and effectively to achieve specified outcomes.²

- 9) The public interest is not served when services are devolved without appropriate funding as this:

- leads to a distortion in the allocation of local government resources, causing inefficiencies within local government;
- reduces fiscal transparency within the overall public sector;
- leaves local government fiscally vulnerable, leading to financial instability;
- makes difficult the clear attribution of the costs of service delivery, leading to uninformed decision making within government;
- reduces the ability to assess performance, leading to a lack of accountability in the public sector;
- generates greater levels of regional inequality;
- reduces accountability of governments to their electors; and
- reduces the effectiveness of local democracy.

- 10) Current evidence on cost-shifting is not comprehensive. The lack of detailed and comprehensive data allows cost-shifting governments to avoid public scrutiny.

- 11) An appropriate policy response will require objective evidence to be made publicly available. A full study and assessment of cost-shifting to local government should be undertaken by the Productivity Commission in conjunction with state local government grants commissions, which hold comprehensive and relevant data.

The lack of comprehensive, objective data quantifying the problem of cost-shifting leads to ambiguity. The Productivity Commission must be employed to provide credible data to guide policy development on the issue of cost-shifting.

² In 2000-01, all spheres of government raised \$257 billion in revenue and spent \$249 billion on the provision of goods and services.²

Sharing Public Revenue

- 12) Demand for government services provided by all spheres of government increase as the economy grows. To meet increasing demand, each sphere of government must have access to secure growing revenue sources. While the Commonwealth and state/territory governments enjoy the benefits of revenue growth from GST and tax reform, local government revenue sources are severely constrained. Local government faces increasing costs to meet the growing provision of core local government services, significantly increased liability for the maintenance and renewal of ageing infrastructure as well as a range of new services. It is important to note that, even without the additional burden of cost-shifting to local government, the current quantum of financial assistance grants is insufficient to meet the increased demands on local government. Accordingly, there is an urgent need to increase local government's resource base, in particular through a significant increase in FAGs.
- 13) Local government is not receiving a fair share of public sector revenue. The lack of an appropriate methodology to share the nation's public sector revenues in an equitable manner is the most significant problem faced by local government in Australia. The widening vertical fiscal imbalance (VFI) between the Commonwealth and local government is exacerbating this problem.
- 14) Successive Commonwealth governments have failed to adequately address this issue. The last major review was undertaken by the Commonwealth Grants Commission (CGC) when it reviewed the *Local Government (Financial Assistance) Act 1995*. But the terms of reference expressly precluded the CGC from reviewing the amount of funding provided by the Commonwealth to local government.
- 15) ALGA believes a more equitable arrangement would be to link FAGs and Commonwealth taxation using a methodology which sets total FAGs to local government to an equivalent of 5% of the GST revenue that flows to the states and territories.
- 16) Suggestions that state governments and the Government of the Northern Territory could share their GST proceeds with local government overlook some critical problems with the flow of GST funds. Solving the VFI problems experienced by local government should not be left with state governments and the Government of the Northern Territory. This issue must be resolved by the Commonwealth.
- 17) ALGA therefore believes the Commonwealth must take responsibility for addressing the revenue sharing problems that leave local government seriously disadvantaged.

As the major tax revenue earner, the Commonwealth must address the current revenue sharing problems that leave local government seriously disadvantaged.

Intergovernmental Agreement on Government Service Provision

- 18) Cost-shifting causes serious inefficiencies and distortions in public administration. It also runs counter to the principle that the tax revenue of the nation should be distributed between all three spheres of government in a manner commensurate with their respective roles, responsibilities and general competency, and therefore expenditure. As the major tax revenue earner, the Commonwealth must accept responsibility to correct the current revenue sharing inequities that leave local government seriously disadvantaged.
- 19) To achieve this, the three spheres of government need to agree on who provides what. There also needs to be a resourcing agreement to ensure that specific functions are adequately funded.
- 20) Paradoxically, ALGAs preliminary submission anticipated the difficulty in comprehensively defining the roles and responsibilities of all spheres of government. Particularly, in the light of contemporary state local government legislation based on the general principle of local government competencies.
- 21) However, the Inquiry has brought to light significant evidence that local government's functions and thus roles and responsibilities have increased, particularly over the past few decades. Some of these roles, functions and powers have occurred as a result of policy choice and increased community expectations. Others are clearly a consequence of cost-shifting from other spheres of government on to local government.
- 22) ALGA submits that the increase in the provision of local government services that has occurred as a result of policy choice and increased community expectations is consistent with the local government's legislative responsibilities under state/territory local government acts that are based upon the general principle of local government competencies. Accordingly, it is totally appropriate that local government own-source revenues and Commonwealth General Purpose Grants under the *Local Government (Financial Assistance) Act 1995* be used for these 'general local government competency' purposes.
- 23) However, all new roles and responsibilities in particular, state and or Commonwealth specific services that are a consequence of the practice of cost-shifting must be addressed. In this context cost-shifting is to be defined as where '....the burden of the

cost of provision of a Commonwealth and or State/Territory service are transferred to local government without a supporting revenue stream.³

- 24) To address the specific issue of cost-shift the Committee should recommend the establishment of a formalised intergovernmental agreement (IGA) on government service provision. The IGA should clearly define the roles and responsibilities of the three spheres of government for the provision of specific services.
- 25) Such an IGA should cover not only a rationalisation of roles and responsibilities of the three spheres of government, but should also address the issue of appropriate funding.
- 26) This would lead to a better use of resources, reduction of waste and duplication and an improvement in the quality of services provided to local communities.
- 27) The IGA would require a set of guiding principles that would outline clear roles and responsibilities for each sphere of government in specific areas of service provision and focus on the performance of each sphere through agreed benchmarks.
- 28) The IGA would provide substantial benefits, including:
 - more certain policy outcomes as a result of predictable levels of funding;
 - an ability to specify expected performance;
 - a greater level of transparency; and
 - a meaningful framework for reprioritising and reallocating resources within and across the spheres of government.

A formal intergovernmental agreement on government service provision, addressing key issues such as revenue sharing and a rationalisation of roles and responsibilities between the levels of government is required.

Compliance Issues

- 29) The proposed intergovernmental agreement requires a clear set of compliance measures. The compliance measures should include a system of incentives and penalties. An independent arbiter should be appointed to administer the compliance measures and resolve disputes between jurisdictions.
- 30) Incentives in the form of financial bonus payments could be made to spheres of government that perform well and avoid breaches of the IGA. Such payments could be funded from improved economic performance resulting from measures

³ Consistent with the broad definition of cost-shifting provided in the Australian Local Government (ALGA) Preliminary Submission July 2002

implemented by incentives within the IGA. These would be provided on a similar basis to the current system of National Competition Policy payments and should be made available to all spheres of government.

Clear compliance measures must exist to ensure all spheres of government meet the terms of an IGA. The Commonwealth must act decisively to prevent cost-shifting.

Other Options

31) In the absence of a new IGA, the Commonwealth should fully explore avenues to influence and encourage states to cease the practice of cost-shifting. These could include:

- making payments directly to local government;
- applying penalties to states and territories where cost-shifting occurs; and/or
- employing the use of other 'sanctions' through Specific Purpose Payments (SPPs) agreements.

Budgetary Impact

32) The terms of reference for the Committee require recommendations to be budget neutral for the Commonwealth. ALGA believes this to be unrealistic and impractical. Budget neutrality should be viewed holistically and take into account total public sector spending. While there may be some cost to the Commonwealth in the short term, the economic and social benefits of an end to cost-shifting should provide total public sector budget neutrality in the medium to long term.

The current terms of reference are unrealistic. Resolving the problem of cost-shifting will have no more than a short-term budgetary impact.

Australian Local Government Association
8 Geils Court
DEAKIN ACT 2600
Ph: (02) 6122 9400
Fx: (02) 6122 9401
E-mail: alga@alga.asn.au
www.alga.asn.au