

30 April 2003

Ms Susan Cardell  
Committee Secretary  
Standing Committee on Economics, Finance and Public Administration  
House of Representatives  
Parliament House  
CANBERRA ACT 2600

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

Submission No: ..... 384 .....

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Secretary: .....

Dear Ms Cardell

**Re: Cost shifting inquiry discussion paper**

In response to the cost shifting inquiry's discussion paper, "At the Crossroads," and questionnaire, the MAV has prepared a written reply. A copy of the reply is attached. The MAV is happy for the reply to be made public if the committee considers it appropriate.

The contact person for any queries you may have is Mr Troy Edwards, senior adviser. He can be contacted on 03 9667 5539 or [tedwards@mav.asn.au](mailto:tedwards@mav.asn.au)

Yours sincerely

  
ROB SPENCE  
Chief Executive Officer



**MAV response to the local  
government and cost shifting  
questionnaire**

**April 2003**

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## 1. GENERAL RESPONSE TO THE DISCUSSION PAPER

### Key Points:

- The cost shifting inquiry has identified both deficiencies in local government's revenue base relative to its roles and responsibilities and that cost shifting plays a major role in this deficiency.
- At the heart of the cost shifting problem is the straightforward issue of ensuring a more equitable distribution of taxation amongst all levels of government.
- Local government must have access to a tax transfer from the Commonwealth in order to provide adequate services and develop local and regional resources.
- The current process of revenue sharing, the FAGs system, provides an appropriate method of facilitating a tax transfer from the Commonwealth to local government that is sensitive to the state variations in local government roles, responsibilities and asset profiles.
- The single biggest factor limiting the effectiveness of the FAGs process is the inadequate quantum of funds available. The most obvious way of redressing this is to link the national quantum of FAGs to proportion of GST revenues.

### 1.1 Local government financial relations and cost shifting

To date, the cost shifting inquiry has identified both deficiencies in local government's revenue base relative to its roles and responsibilities and that cost shifting plays a major role in this deficiency. The inquiry has also come to the clear realisation that unless local government finances are improved, its contribution to the federation will be significantly curtailed<sup>1</sup>.

Within the current Australian structures of government, local government is subject to a range of structural and policy impediments to developing a stable and growing revenue base. The most critical structural limitation is local government's limited capacity to raise funds.

A large recurrent funding gap has been identified in Victoria's local government sector. This gap comprises a significant under-spend on asset renewal. It is questionable whether this gap could, or should, be met from council rates. The gap comprises annual shortfalls recorded over a number of years. Although the annual deficiency has been reduced by substantial increases in rates, it still amounted to \$316.3m in 2001-02.

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<sup>1</sup> Speech by Mr David Hawker, MP and Chair of the cost shifting inquiry to LGPro conference in Victoria on 20 February 2003

Exacerbating local government's recurrent funding gap is the high degree of vertical fiscal imbalance (VFI) between the Commonwealth, State and local government. State and local governments are heavily reliant on tax transfers from the Commonwealth in the form of general purpose and specific purposes payments. The issue of VFI is most pronounced for local governments with outlays at 2.4 times the level of own source revenues.

## 1.2 Responding to the Financial Challenge

At the heart of the cost shifting inquiry is the straightforward issue of ensuring a more equitable distribution of taxation amongst all levels of government. In this context, the Commonwealth has an obligation to provide a share of tax revenues to State and local governments that reflects their expenditure responsibilities.

Local government must have access to a tax transfer from the Commonwealth in order to provide adequate services and develop local and regional resources. The current process of revenue sharing, the FAGs system, provides an appropriate method of facilitating a tax transfer from the Commonwealth to local government that is sensitive to the state variations in local government roles, responsibilities and asset profiles.

The single biggest factor limiting the effectiveness of the FAGs process is the inadequate quantum of funds available. This is exacerbated by the lack of an appropriate growth mechanism to ensure the funding pool grows in line with local government's increasing costs for service provision and asset renewal. The Commonwealth must address both the quantum of funds available and provide for a realistic growth factor in the FAGs process. The most obvious way of doing this is to link the national quantum of FAGs to proportion of GST revenues.

There is a clear necessity to develop a new intergovernmental agreement between Commonwealth, State and local governments that addresses the issues of tax transfer from the Commonwealth to other levels of government and provides for a growing, sustainable revenue stream for local government. This is not just an issue for local government but one that underpins the long-term effectiveness of our federal system.

## 2. RESPONSE TO THE QUESTIONNAIRE

**Option 1a** *Negotiate an umbrella intergovernmental agreement (IGA) 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*

### MAV Response

The MAV believes that adjusting the escalation factor to provide realistic and sustainable growth of the FAGs quantum is a critical recommendation that the Committee must make.

No clear case has been made that the FAGs model does not work and needs to be replaced. The fundamental issue is that the pool of funds available under the FAGs model is inadequate to meet local government's needs and does not provide realistic growth in that pool of funds. Evidence gathered by the inquiry committee bears out this position.

The MAV is of the view that creating a system where Commonwealth government policy is a major determinant on FAGs is a direct form of intervention in the general competence of local government. FAGs is a tax transfer method and should not be subject to political manipulation.

The Commonwealth must include the national local government sector's efficiency as a consideration in any reform of FAGs. Any change that does not consider this factor could negatively impact on Victorian councils and be, in effect, a penalty for substantial efficiency gains since the mid 1990s.

The challenge is to address the growing incompatibility between a property based tax system and population driven demand for service provision. At the same time, there must be a realisation that council rates have a number of structural limitations as a revenue stream.

**Option 1b** *Treat FAGs simply as a tax transfer with a simplified distribution system and formula, administered nationally.*

MAV Response

The MAV does not support this option on the detail presented. We believe this model has limited capacity to take account of the differing local government systems in each state. There is a risk that "simplified distribution system and formula" would exclude efficiency considerations.

**Option 1c** *Deliver FAGs through a model of broad based program grants to facilitate local government's role in key national initiatives such as regional development, transport, environment etc*

MAV Response

The MAV strongly opposes this model. It ignores the clear importance of local government being funded on general competence basis and presents a substantial threat to local level flexibility.

There is a clear risk to local government that the Commonwealth would use such a reform to reflect federal political priorities rather than local government needs.

**Option 1d** *FAGs to be delivered as tied grants.*

MAV Response

The MAV strongly opposes this model. It ignores the clear importance of local government being funded on general competence basis and would presents a substantial threat to local level flexibility.

There is a clear risk to local government that the Commonwealth would use such a reform to reflect federal political priorities rather than local government needs. There is the potential for local government to incur substantial administrative costs to handle and acquit such tied grants.

**Option 1e Consider other horizontal equalisation formulas for local government funding such as the SES formula used by DEST for funding the non-governmental school system.**

MAV Response

It is difficult to assess the merits of this option on the detail presented. The MAV would approach any move to use the SES formula for local government funding with a great deal of caution.

Some of the risks of such an approach might include:

- rate base issues – such as business and residential rate profiles;
- ability to adjust for regional population issues – ie low population with large road maintenance obligation;
- lack of consideration of council's financial position; and
- likely reduction in importance of efficiency in local government funding.

**Option 1f Deliver FAGs through the R2R model.**

MAV Response

The MAV does not support delivering FAGS through the Roads to Recovery model. The methodology of the Roads to Recovery model is open to a range of criticisms, including lack of transparency and the limited understanding of the origins of the model.

The MAV cannot see any justification for funding local government's general functions on a model developed for road building and repair. This is clearly unacceptable.



**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*

MAV Response

The MAV supports the inclusion of local government in negotiations for the next intergovernmental agreement on finance. The MAV believes that the IGA should discuss full Commonwealth – State – local financial issues. The Commonwealth should not require the states to forgo a portion of their share of the GST to local government.

It is difficult to see what an IGA could do about the limitations of the property based tax system, especially given the state-by-state variations.

There is a substantial issue of who would sign on behalf of local government. Victorian local government should sign any IGA through the MAV president rather than the ALGA president.

**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*

MAV Response

The MAV would support this option with the inclusion of Premiers or Treasurers in addition to Local Government Ministers. The inclusion of either Premiers or Treasurers ensures that state representatives with overall financial responsibilities participate in the process.

Victorian local government would strongly support any moves nationally to expedite structural reform of local government in other states. This option could drive restructure in other states where conditions are right. The corollary is that other (Victorian) councils would be penalised financially for already having undergone restructure and financial reform.

**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 borrowings.*

MAV Response

The MAV supports this option. Extensive research and analysis has been undertaken in Victoria into the size of the infrastructure funding challenge and the need for access to appropriate funding to deal with the issue.

The MAV would welcome a realistic and positive contribution from the Commonwealth addressing national infrastructure needs, including funding programs to address the infrastructure gap.

**Option 5** *Maintain R2R into the longer term, either in its current form or as a component of Auslink.*

MAV Response

Victorian local government strongly supports the long-term retention of the Roads to Recovery program as the primary funding program for local roads.

**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.*

MAV Response

The MAV does not support this option. Victorian local government believes that Commonwealth programs must use councils as the most appropriate regional organisations. The structural reforms of the mid 1990s have provided Victoria with a network of local government authorities of a size and capacity to handle Commonwealth program funds directly.

The MAV believes there is a clear need to preserve flexibility around regional groupings for specific tasks and/or issues. Government must avoid undercutting the many regional groupings of councils that have been established to pursue specific issues – ie Interface councils and TimberTowns.

- Option 7**     ***Through the Local Government and Planning Ministers Council:***
- ***negotiate an IGA 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***

MAV Response

The MAV would support this option with the inclusion of Premiers or Treasurers in addition to Local Government Ministers. The inclusion of either Premiers or Treasurers ensures that state representatives with overall financial responsibilities participate in the process.

Increased vertical fiscal imbalance as functions devolved to local government have not been accompanied by sufficient funding support. There must be commitment from all levels of government to address current funding for functions and existing viability issues before considering an expansion of responsibilities.

To some degree this option ignores the inherent general competence of local government to provide for their local communities and has the potential to create further cost shifting opportunities.

- 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.***

MAV Response

The MAV supports this option. However, there is a need to ensure it does not impose substantially increased administrative costs to programs. The inclusion of local government in SPP negotiations should also not be at the expense of existing relationships between states and local government.

At this stage it is difficult to use Auslink as a model because there is no clear understanding of just how Auslink will function.

**Option 9      Use a top slice of FAGs (perhaps 0.5%) to fund a national capacity building agency along the lines of UK's 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**

MAV Response

The MAV supports the notion of a greater commitment to capacity building but not at the expense of the quantum of FAGs available to councils. Funding for capacity building programs is a separate issue to a Commonwealth – local government tax transfer.

In essence, even this proposal could be seen as cost shifting as the Commonwealth seeks to force local government to use its own FAGs for developmental purposes. Up until 1996-97 the Commonwealth had provided funds for this type of work through programs such as the Local Government Development Program and the Local Government Incentive Program.