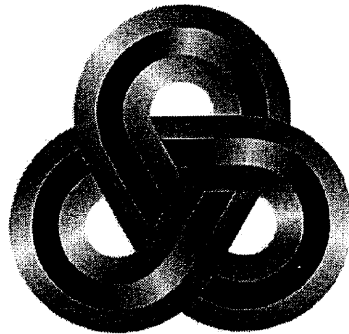


**ALGA SUBMISSION**

To the

**Senate Standing Committee on Economics**

**Inquiry into the Structure and Distributive Effects of the Australian  
Taxation System**



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## **BACKGROUND AND INTRODUCTION**

### **About ALGA**

1. The Australian Local Government Association (ALGA) represents the views of local government on national issues. It is constituted as a federation of the local government associations (LGA's) in the six states and the Northern Territory, together with the Government of the ACT. Each year, the National General Assembly of Local Government provides Australia's 717 local government authorities with the opportunity to consider national policy directions and convey their views to the ALGA national executive.

### **Purpose of the Submission**

2. ALGA wishes to alert the Committee to serious inequities in the current tax sharing arrangements between the Commonwealth and local government. Local government authorities and the communities they serve are being seriously disadvantaged by these arrangements.
3. There is an urgent need to reform the current tax sharing arrangements between the Commonwealth and local government. The introduction of the "*New Tax System*" (and the resulting Intergovernmental Agreement) in July 2000 restructured and improved the financial relationship between the Commonwealth and the states and territories. Future intergovernmental financial reform must address the unfair financial relationship between the Commonwealth and local government as a matter of urgency.

## THE ISSUES

### **Local Government - An Equal Partner in Australia's Federation**

4. Local government authorities are democratically elected bodies responsible for the interests and well-being of citizens within their localities.
5. Australia has three spheres of government – federal, state/territory and local government. Each works together as equal partners in the Australian federation.
6. Local government is an active and vital member of Australia's federation. Local government (through ALGA) is a full member of the Council of Australian Governments (COAG) and participates in ten other ministerial councils. These arrangements provide an effective way for the three spheres of government to collectively address issues of national concern.
7. As the world moves towards a more globalised future, there is an equally strong trend towards 'localisation'. For local government, it means growing demand not only on the quality, but also the range of services provided to Australian communities.
8. Today, local government offers a far broader spectrum of services than was the case a decade ago. For example, local government operates ports and airports, repairs and protects the environment, provides welfare and aged care services, maintains the bulk (84% by length) of Australia's road system and plays a critically important role in the nation's health care through environmental health measures, regulatory functions and waste management.
9. There are 717 local government authorities across Australia employing some 152,000 people. In much of rural Australia local government is a major employer.
10. The need for effective local government has never been greater. Many local and regional communities face an uncertain future. Major challenges facing local government include:
  - maintaining the quality of community life and community cohesion while managing economic, social and institutional change;
  - ensuring adequate services and safeguarding environmental quality (especially in areas of rapid growth or economic decline);
  - promoting local and regional economies, and ecologically sustainable development; and
  - making more efficient and effective use of resources against a background of financial constraint.

## **The Commonwealth - The Dominant Tax Collector**

11. In 2002-03, some \$272 billion in revenue<sup>1</sup> will flow to all spheres of government. Most of this - 81% - is raised by the Commonwealth. The Commonwealth levies tax across the major tax bases, including:
  - taxes on income profits and capital gains;
  - fringe benefits tax;
  - goods and services tax; and
  - excise.
12. While the Commonwealth dominates tax collection, responsibilities for expenditure lie mainly with state/territory and local governments. Because of this imbalance in revenue raising capacities and service provision obligations, it is critical that tax sharing agreements are both fair and transparent.
13. Local government supports an integrated, robust and centrally administered taxation system that returns a fair share of tax to all spheres of government.
14. In the case of local government and the Commonwealth, a tax sharing agreement is needed that has a direct link to tax growth. This would enable local government to strengthen itself as an institution and improve service delivery to communities.
15. Local government would prefer to be fiscally independent of other spheres of government. In practice however, this is neither realistic or efficient for the operation of the Australian federation.
16. Local government has access to a tax on property (property rates). While property rates are a relatively stable tax base for local government, they have not kept pace with the increased demands on local government and have been in declining in real terms. Between 1966 and 2002, total rate collections by local government fell by 27% in real terms. This further disadvantages local government and impedes its ability to meet its service obligations.

## **A Fair Distribution of the Nation's Taxation Revenue**

17. Inter-governmental financial relations in Australia continue to be characterised by significant differences between the relative revenue-raising and expenditure responsibilities of the three spheres of government. The mismatch of spending and taxing powers between spheres of government is known as vertical fiscal imbalance (VFI).
18. The problem of VFI continues to get worse as the Commonwealth's tax raising power grows while tax sharing with local government continues to be unfairly restricted.
19. Despite clear evidence that VFI occurs between the Commonwealth and local government, the Commonwealth has failed to recognise the full extent of the problem. To date, little has been done to address the problem.

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<sup>1</sup> Including non tax items but excluding inter-government transfers

20. The pressure on local government to increase the provision of human services has been increasing in recent years. A growing economy and increasing community expectation are driving this trend. In addition, the Commonwealth and state governments are increasingly shifting responsibility for service provision to local government without adequate financial compensation (cost-shifting).
21. A recent review of local government by the Commonwealth Grants Commission (CGC) found that expenditure by local government on human services has increased at a rapid rate over the past 20 years at the expense of traditional property services.
22. The lack of adequate revenue has seriously impaired the ability of local government to meet its service obligations. The problem needs to be addressed by providing local government with a fair share of tax from the Commonwealth.

### **The Current Situation for Tax Sharing**

23. Australia's federal system of government will work best when each sphere of government has access to sufficient resources to meet their service obligations. This can be achieved through access to a tax base exhibiting real levels of growth. The Commonwealth and state/territory governments (through access to the GST) already have access to such tax bases. Taxes collected by the Commonwealth and states and territories are expected to grow at a far greater rate than GDP. This provides these two spheres of government with a strong base to meet their service obligations. It is an entirely different story for local government.
24. In 2000-01, the Commonwealth raised over \$185 billion in revenue. This figure exceeds Commonwealth own purpose expenditure by around 40%. In the same period, through its own efforts, local government raised revenue equivalent to 90% of its expenditure needs. The remaining 10% was financed through funds provided by the other spheres of government. The situation is worse for many rural and regional local government authorities where the ability to raise revenue is severely restricted.
25. For over 25 years, the Commonwealth has provided financial assistance grants (FAGS) to local government.
26. Commonwealth funds are essential sources of revenue for local government authorities, and for many are critical to their survival. In recent years, the value of FAGS has declined in real terms placing further strain on local government finances.
27. There has been a continual failure to assess and address the revenue requirements of local government. An opportunity to address the serious inequity of local government financing was ignored during the recent reform of the tax system.
28. Under the original "*New Tax System*" proposal, responsibility for the payment of FAGs was to be transferred from the Commonwealth to the states and the

Government of the Northern Territory on the condition that they were to be no less (in quantum) than they had been under the Commonwealth.

29. In the final version of the “*New Tax System*” saw responsibility remain with the Commonwealth but with no change in the level of payments provided to local government.
30. Local government remains excluded from sharing a fair and appropriate amount of the nation’s taxation revenue.

### **Moving to a Fairer Deal**

31. A tax sharing agreement between local government and the Commonwealth would be the most practical policy response to address VFI and solving the financial difficulties faced by local government. A tax sharing agreement linked to a growth tax would help local government improve service delivery and meet community demand.
32. A new tax sharing methodology must ensure local government has a fair share of the nation’s growing tax base. This would go a long way to:
  - improving equalisation among local government authorities;
  - improving the delivery of services by local government authorities;
  - maintaining and improving local government infrastructure;
  - repairing the environment;
  - improving pricing policies of local services;
  - building local government staff capabilities; and
  - improving community cohesion.
33. Any new funding methodology must be based around the notion of an entitlement to a tax share rather than Commonwealth grant provision. Any proposed methodology must be:
  - linked to a taxation base that grows in a robust and consistent manner;
  - simple to administer and explain; and
  - independent of payments to other spheres of government or programmes.

34. ALGA believes that a tax sharing agreement between local government and the Commonwealth must:
- be assigned to an appropriate 'head' of taxation;
  - specify a fixed percentage of that tax; and
  - be legislated.

## **CONCLUSION AND RECOMMENDATIONS**

35. Local government authorities are democratically elected bodies that play a critical role within the Australian federation.
36. Local government supports a coordinated, robust and integrated taxation system that would overcome the problems of a disjointed system prone to avoidance and revenue leakage.
37. Because of the imbalance in revenue raising capacities and service provision obligations in the Australian federation, tax sharing agreements must be secured for local government that are both fair and transparent.
38. There is an urgent need to reform the current tax sharing arrangements between the Commonwealth and local government. The next stage of intergovernmental financial reform must address the relationship between the Commonwealth and local government as a matter of urgency.
39. A stable, robust tax sharing agreement linked to a growth tax would enable local government to strengthen itself as an institution, and improve service delivery to communities.
40. Any new funding methodology must be based around the notion of an entitlement to tax sharing rather than Commonwealth grant provision. This would see untied funding linked to the growth in taxation that is enjoyed by the other two spheres of government. Any proposed methodology must be:
- linked to a taxation base that grows in a robust and consistent manner;
  - simple to administer and explain; and
  - independent of payments to other spheres of government or programmes.
41. ALGA believes that a tax sharing agreement between local government and the Commonwealth must:
- be assigned to an appropriate head of taxation;
  - specify a fixed percentage of tax; and
  - be legislated.