



30 April 2008

Committee Secretary  
Select Committee on State Government  
Financial Management  
Department of the Senate  
PO Box 1600  
Parliament House  
CANBERRA ACT 2600

Dear Committee Secretary

The Australian Local Government Association (ALGA) notes with interest the recent establishment of the Senate Select Committee on State Government Financial Management (the Committee) and its focus upon Commonwealth and state and territory fiscal relations and state and territory financial management, and appreciates the opportunity to provide a submission to its inquiry.

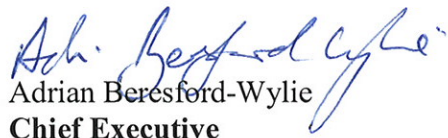
By way of background, ALGA is the national voice of local government, representing more than 600 councils across the country. In structure, ALGA is a federation of state and territory local government associations. Since 2001, membership has included the Government of the Australian Capital Territory (uniquely in Australia, the ACT Government combines both state and local government functions).

ALGA wishes to comment upon four issues that it believes should be included in the examination of Commonwealth, state and territory fiscal relations. They are:

- Intergovernmental financial transfers from other spheres of government to local government as an aspect of reforms needed to intergovernmental relations;
- The potential for cost shifting from other spheres of government to local government and the need to prevent this occurring;
- Infrastructure and infrastructure renewals; and
- Transparency in the reporting of financial transfers to local government.

ALGA's comments on each of these issues is included in the Attachment to this letter.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Adrian Beresford-Wylie', is written over the printed name.

Adrian Beresford-Wylie

**Chief Executive**

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## **Intergovernmental financial transfers and relations**

Any examination of improvements to the way our system of Commonwealth-State financial relations works must include local government. Local government represents almost every Australian and plays an integral role in the development and continued sustainability of Australia's local communities.

Over recent decades, Australians have increasingly called upon the local government sector to deliver a wider range of services and infrastructure than traditionally was the role of local government.<sup>1</sup> Commonwealth general-purpose revenue transfers to local government remain an essential funding source to enable local governments to meet the legitimate expectations of their local communities.

Importantly, local government generates a large proportion of own-source revenue, but according to the Productivity Commission<sup>2</sup>, local government has little scope to increase such revenue. Unfortunately, local government has experienced a relative decline in general-purpose funding support from the Commonwealth in each of the years since 1996-97.

In its pre-Budget 2008-09 submission, ALGA noted that the main general-purpose funding mechanism from the Commonwealth to local government – Financial Assistance Grants, or FAGs – is flawed. In short, ALGA believes that FAGs do not provide a sufficient level of general-purpose funding to allow local government to meet the needs of the local communities they serve.

In particular, the current FAGs system does not recognise or address the financial sustainability challenges facing up to 30 per cent of Australia's local councils. The finding of PriceWaterhouseCoopers (PwC)<sup>3</sup> that the aggregate national infrastructure renewals backlog in local government is approximately \$14.5 billion, highlights the real effects of continued under-funding in the sector, which hurts local communities. (To clear the backlog and correct the underspend, PwC estimates a funding gap of around \$2.16 billion per year would need to be filled).

For this reason, ALGA has been calling upon the Commonwealth to review the current FAGs methodology, emphasising that a fairer funding system is consistent with the broad needs of the community.

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<sup>1</sup> The causes of this increased demand are varied and diverse. They include cost-shifting from other spheres of government, as well as demographic change (in rural and coastal communities in particular).

<sup>2</sup> See especially the Productivity Commission (PC) study, *Local Government Revenue Raising Capacity*, April 2008, which found that on average, local councils are raising 88 per cent of their theoretical maximum own-source revenue benchmark.

<sup>3</sup> National Financial Sustainability Study of Local Government (commissioned by the Australian Local Government Association), November 2006.

As is detailed in the already published submission of the Western Australian Local Government Association to the Committee, ALGA considers a fairer long-term funding system would see the Commonwealth allocate a minimum 1 per cent of total taxation revenue (excluding GST) to local government.

ALGA notes that in the Productivity Commission's final report on Assessing Local Government Revenue Raising Capacity (April 2008), it finds that '...there is a case to review the provision of Australian Government general purpose grants to local government' (finding 5.6).

A copy of ALGA's pre-Budget 2008-09 submission is at <http://www.alga.asn.au/policy/finance/PreBudgetSubmission2008and09/ALGA2008-09BudgetSubmissionFINAL.pdf>.

### **Cost shifting**

Previous studies and reports, including that of the House of Representatives Standing Committee on Economics, Finance and Public Administration on Rates and Taxes: A Fair Share for Local Government<sup>4</sup>, have noted that the effects of past cost-shifting from other spheres of government onto the local government sector have been negative.

The types of cost-shifting behaviour that have had an adverse effect on local government in previous years are defined in the PC report cited earlier in this paper.<sup>5</sup> They are:

"The first is where local government agrees to provide a service on behalf of another sphere of government but funding is subsequently reduced or stopped, and local government is unable to withdraw because of community demand for the service.

The second is where another sphere of government ceases to provide a service and local governments voluntarily decide to provide the service."

In April 2006, an Intergovernmental Agreement to stop cost-shifting was entered into by the Local Government and Planning Ministers Council.<sup>6</sup>

In essence, the Intergovernmental Agreement seeks to address cost shifting through in principle agreement from governments that when a responsibility is devolved to local government, local government is consulted, and the financial and other impacts on local government are taken into account.

ALGA is confident that adherence to this Intergovernmental Agreement by all spheres of government will help avoid many of the capacity and funding issues that have prevented

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<sup>4</sup> Published October 2003 (the 'Hawker' report).

<sup>5</sup> See footnote 2, above.

<sup>6</sup> The full title is *The Intergovernmental Agreement Establishing Principles Guiding Intergovernmental Relations of Local Government Matters*. The establishment of the Agreement followed a recommendation of the Hawker Report referred to at footnote 4, above.

local government in the past from receiving fair compensation for new and/or additional mandated functions placed upon them.

Consistent with the Intergovernmental Agreement, ALGA would urge the Committee to consider the effect on local government of any of its proposed findings and/or recommendations.

### **Infrastructure and Infrastructure Renewals**

As indicated previously under the heading '*Intergovernmental financial transfers and relations*', a growing body of evidence shows that local government is being forced to defer maintenance and renewal of assets (in particular, local road assets and community infrastructure) to fund increases in operational activities.

ALGA notes that the Roads to Recovery program has been very successful in addressing some of the backlog and renewals issues affecting our local roads. Local government owns and manages over 80 per cent of Australia's total road network.

ALGA also notes the vital contribution the Federal Government funding is making, through the current AusLink program, to our national transport corridors. ALGA was pleased to note the recent announcement by the Australian Government of the new Infrastructure Australia (IA), a body which is to audit and identify gaps and deficiencies in nationally significant infrastructure. Although individual councils rarely have responsibility for nationally significant pieces of infrastructure, the infrastructure that councils own and manage in aggregate terms is vital to the efficient operation of the Australian economy and to meeting the social and other needs of our local communities. The Government has announced its intention that one of the twelve members of IA will have a background in local government.

As a general observation, ALGA supports enhanced collaboration between all spheres of government to ensure that Australia's infrastructure needs are fully met.

### **Transparency and accounting in the reporting of financial transfers**

ALGA notes that there is a lack of transparency in the reporting by most States of financial transfers to local government.

Currently, the Commonwealth provides general-purpose funding to local government via the States, which then administer the funding following recommendations made to the Commonwealth Minister by Local Government Grants Commissions established in each State. As noted earlier in this submission, Commonwealth general-purpose funding to local government, known as Financial Assistance Grants (FAGs), takes the form of a Specific Purpose Payment (SPP).

Because FAGs are paid initially to the States to distribute to councils, some States have treated these grants as payments to local government from the State government. This is

misleading and in the absence of better accounting treatment rules and/or more transparent financial reporting by the States of Commonwealth general-purpose funding to local government, there is a real risk of double-counting funding grants. In such circumstances, aggregate fiscal data for local government provide a misleading picture which overestimates the States' financial contribution to local government and undermines efforts to establish a true picture of local governments' financial circumstances.

The House of Representatives Standing Committee on Economics, Finance and Public Administration acknowledged this problem in its October 2003 report *Rates and Taxes: A Fair Share for Responsible Local Government* (the Hawker report):

'Often there are limited tracking or auditing requirements placed on SPPs....however [the] SA and Queensland governments have started to publish in their budget papers a summary of the grants going to local government.' (p.53)

ALGA notes the efforts of both South Australia and Queensland and urges other jurisdictions to follow suit.