

With the completion of a parliamentary investigation into cost shifting onto local government, Graham Sansom reviews the report and outlines why adequately funded and properly administered local government is essential.

A fair slice of the cake

A close-up photograph of a single slice of chocolate cake resting on a silver fork. The cake has a dark chocolate top layer, a lighter-colored filling, and a base layer. It is garnished with chocolate shavings. The background is a soft, out-of-focus light color.

Setting a national framework for local government is difficult—very difficult. There are significant differences between the seven state and territory systems. Local councils vary enormously in size, characteristics, resources and what they choose to do. Local government's national representative, the Australian Local Government Association (ALGA), is dominated by the state associations that fund it. And no association can bind its members, whilst state governments direct councils pretty much as they wish.

Federal agencies and politicians often find all this just too hard, and apparently try to avoid thinking about local government too often. It's much easier to fall back on the Constitution and deal with local government as an addendum to agreements with the states. This perhaps explains why for three decades the federal government has provided most financial assistance to councils, currently around \$2 billion annually, but has done little to ensure that states administer local government fairly, wisely and in the national interest.

That situation may be coming to an end. The trigger for a review was cost shifting: states (and less so the Commonwealth) increasing local government's responsibilities without either providing necessary funds or enabling councils to generate additional revenue of their own. This became the focus for a wide-ranging inquiry into local government's roles, relationships and funding by the House of Representatives Economics, Finance and Public Administration Committee.

The committee's report, *Rates and Taxes: A Fair Share for Responsible Local Government*, proposes sweeping changes to the way federal funding is allocated to councils and the associated framework of intergovernment relations. Even partial implementation of the committee's recommendations would transform current arrangements. Significantly, the report is bipartisan.

The committee concluded that cost shifting “is, ultimately, a symptom of what has become dysfunctional governance and funding arrangements. It is time to combine the best efforts of governments and choose a better way”.

Some key findings:

- Local government's responsibilities have increased dramatically over recent decades, but revenues have lagged. (The committee's earlier discussion paper suggested that had local government revenues increased as fast as those of the Commonwealth—but still slower than the states—councils across Australia would have \$3 billion extra to spend each year.)
- Cost shifting is widespread and exacerbated by councils accepting even more functions to satisfy community expectations. Information is sketchy, but seems to support ALGA's estimate that cost shifting to local government totals between \$500 million and \$1.1 billion annually.

Photo: Getty Images

- Overall, local government is in good shape financially, with historically low levels of debt. But many councils in rural and remote regions have very limited resources and are highly dependent on grants. Also, most councils are under-funding infrastructure maintenance and renewal. The infrastructure funding shortfall is at least \$1 billion each year, perhaps \$2 billion.
- States have imposed unwarranted revenue limitations on councils through rate-capping or controls on fees and charges. Some also levy councils to help fund state services, such as fire brigades.
- Local government does not always receive its fair share of Commonwealth special purpose payments made to and through the states—or states offset federal grants by reducing their assistance to councils.
- Some state and federal government agencies and business enterprises do not pay council rates.
- Some councils are guilty of poor financial management: not increasing rates when they could and should; investment in non-essential infrastructure and assets that are very costly to maintain; not saying ‘no’ when functions could be left to the states or Commonwealth.
- Intergovernment relations are poor. Roles and responsibilities are often unclear and the costs of duplication and coordination are excessive. On the other hand, there are good examples of state-local cooperation in states such as Tasmania, South Australia and Queensland.

The House Economics Committee makes a wide range of recommendations to address these issues. These include:

- New intergovernment agreements on roles, responsibilities and associated funding measures; to tackle cost shifting; and to address arbitrary state restrictions on local government revenue.
- Greater local government participation in formulating federal-state agreements, and provision of a share of funding for local government wherever it plays a significant role in delivering the programs concerned.
- Local government impact statements to identify additional financial pressures that may flow from Commonwealth and state legislation.
- Ensuring that federal funds intended to pass through the states to local government reach their target, and are not offset by states cost shifting or reducing their own expenditure—

including monitoring by the Auditor-General.

- Payment of council rates by state and federal government agencies and businesses.
- All councils to audit their infrastructure, with data to be used as an input to calculation of future Financial Assistance Grants (see below).
- A national capacity building agency for local government along the lines of the UK’s IDEA (Improvement and Development Agency), with a strong focus on financial management.
- Investigation by the Commonwealth Grants Commission of the potential benefits of greater regional cooperation between councils and amalgamation of councils where appropriate.
- A new Local Government Liaison Unit to support improved intergovernment relations, enhance direct federal-local government links, and monitor program implementation and cost shifting. This would presumably replace the National Office of Local Government.
- A Council of Australian Governments (COAG) Summit on Inter-governmental Relations in 2005 to review progress and promote further steps, including best practice in establishing working partnerships between the three spheres of government.

Significantly, the committee introduces the possibility that states might in future be penalised for cost shifting, failing to pass on local government’s intended share of federal program funds, reducing their own assistance to councils, or imposing arbitrary limits on councils’ revenues. Evidently it became convinced that the Commonwealth has not been getting full value for the billions of dollars provided to local government over the years through Financial Assistance Grants (FAGs) and other programs. This realisation seems long overdue.

The federal government provides around \$1.5 billion to local government annually in untied FAGs that councils may use as they see fit. FAGs are indexed for ‘real terms per capita’ growth. They include three components: a minimum per capita grant for all councils; a needs-based (‘horizontal fiscal equalisation’) grant; and the ‘identified road component’ based on a separate formula, and now also untied. FAGs are allocated to individual councils by state Local Government Grants Commissions (LGGCs).

The committee tackled various longstanding concerns about FAGs:

- Their value has declined over the years relative to federal taxation and GDP, and the total amount falls well short of what’s required to equalise the service delivery capacity of all councils across Australia.
- The real terms per capita guarantee will produce slower growth in FAGs than the corresponding GST revenue provided to the states.
- FAGs are divided amongst the states on a per capita basis rather than using the fiscal equalisation approach applied to states grants. This disadvantages some states (for example Tasmania, which has a declining population but a number of needy rural councils, and the Northern Territory, which struggles with the special needs of Indigenous communities).
- The roads component is divided amongst states by means of an old, little understood formula that is also seen as unfair, notably to South Australia.
- Some LGGCs apply questionable methodologies in determining grants for individual councils that seem inconsistent with national guidelines.
- Providing a minimum grant to all councils, however strong financially, reduces the funds available to assist disadvantaged areas by about \$80 million per annum.

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The committee also noted, however, that there has been a steady shift of the balance of assistance towards rural councils and areas of socio-economic disadvantage, which suggests that the system is generally having the desired effect, albeit imperfectly.

Again, the committee has put forward some bold recommendations to improve the FAGs system:

- Abolish the minimum grant to free-up more funds for needy councils.
- Combine the needs-based and roads components, and abandon the old roads formula.
- Distribute grants directly to councils nationally, applying uniform equalisation principles across all states: the Commonwealth Grants

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Commission would determine how much each council should receive, with the state LGGCs playing an advisory role (assuming they were retained, which seems to add unnecessary costs).

- Establish a Federal and Local Government Finance Advisory Group to develop a new equalisation formula.
- Include an additional weighting for Indigenous community councils.
- Transfer responsibility for the system to the Treasurer, so it can be integrated with the broader framework of intergovernment financial relations.

The committee gave a strong hint that the total amount of FAGs should be increased, although its terms of reference precluded a firm recommendation on this. It also indicated support for greater monitoring of council performance, implying a possible link to grants.

These recommendations will be highly contentious. Local government has repeatedly defended a minimum grant to all councils on the grounds that all

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communities are entitled to a share of federal support. It has fought off previous proposals to abolish the separate roads component and to link grants to performance. Councils in NSW, Victoria and Western Australia strongly resist moves to direct national distribution because—depending on the formula finally adopted—their states will see tens or hundreds of millions of dollars transferred to others. And in general, larger and more affluent councils are likely to find an accelerated shift in the balanced of funding to small, rural and remote councils that simply cannot survive without increased assistance.

But the committee's approach may well be what's needed to make sense of a system that has become unrealistic. Federal funding will always be limited and must be directed to areas of greatest need. Why subsidise rates in Toorak and Point Piper? Why run a system that in effect makes it easier for state governments to impose arbitrary rate-capping or limits on fees and charges, and to levy councils to fund state

services? Why retain costly LGGCs that fail to do the job properly?

Remember the critical statistics quoted earlier: local government would have \$3 billion more to spend each year if its revenue had increased as fast as the Commonwealth's; cost shifting could be \$1 billion per annum and the shortfall in infrastructure spending \$2 billion. So to paraphrase former President Clinton: It's the revenue base, stupid! The expansion of local government functions has outstripped revenue growth and infrastructure spending has had to be cut.

This situation can be turned around. The committee's proposals would make a significant difference over time, particularly for rural councils that genuinely struggle to raise rates. We also need a concerted effort to restore rate revenues across local government as a whole to the levels of 30 years ago.

Indeed, the committee's recommended changes to the FAGs system can only work if council rates are increased substantially in those states and local government areas that would see their grants reduced or eliminated.

In 1974-75 rates provided 54% of total revenues; by 1997/98 that had fallen to 47%. Local taxes in Australia represent a very small percentage of total taxation—about 3%. Most of us, including business and industry, pay very modest rates and could afford more. The NSW government caps rates at around CPI, but has reaped vast increases in land tax and stamp duty from precisely the same group of taxpayers. In Victoria the state government has accepted that rates must increase faster than CPI to pay for infrastructure.

Local government often says it lacks a 'growth tax'. But across much of Australia land values rise steadily and so could rates. Some people have difficulty paying what is effectively a tax on wealth rather than income, but there are ways to handle that: rebates, deferred payment etc. In most cases we are talking only a few dollars per week—less than the next federal tax cut?

In Australia, the Commonwealth collects most taxes, whilst states and local councils deliver most services. This is why local government constantly seeks additional federal grants, such as the recent extension of *Roads to Recovery*. But is this wise in the long term? Grants come and go, often leaving councils with unmet community expectations—a form of cost shifting. Should local government instead argue for lower

federal taxes and political support for increased rates?

A related issue is the level of borrowing. Councils have mimicked federal and state policies by reducing debt: many are debt-free and local government nationally is a net lender. This makes little sense when councils provide infrastructure that will last 50 years or more, and should be funded in part by future generations. The committee correctly supports increased borrowing provided recurrent revenues (ie rates) can cover repayments.

The report's title sums it up nicely. Local government has not been getting a fair deal, particularly from some state governments. The committee provides abundant evidence of this.

Successive federal governments have failed to keep a close watch on proceedings—even though there are billions at stake—and to ensure that funding arrangements and intergovernment frameworks work effectively.

But local government must act responsibly and accept necessary reforms. Too many councils are highly dependent on grants; some have accepted additional functions when they could have said 'no'; rate increases have often been too low; and the shortfall in infrastructure funding is unsustainable.

Adequately funded, properly administered local government is essential to meet the needs of local and regional communities. FAGs were introduced to provide extra money to enable councils to play a wider role—not to reduce rates or state assistance. In future local government will almost certainly expand its role still further to address emerging issues and to accept some state or Commonwealth functions that are better handled locally. This can be done responsibly provided the right policies are in place. The House Economics Committee has pointed the way. ■

Graham Sansom is Associate Professor and Director of the UTS Centre for Local Government. He is a former CEO of the Australian Local Government Association and advised the committee in the early stages of its inquiry.

The Rates and Taxes report by the House of Representatives Economics Committee is available at www.aph.gov.au/house/committee/efpa or email efpa.reps@aph.gov.au or phone (02) 6277 4587 for more information.