

“RATES AND TAXES: A FAIR SHARE FOR RESPONSIBLE LOCAL GOVERNMENT”

GOVERNMENT RESPONSE TO THE REPORT OF THE HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION

The Australian Government acknowledges the vital role local government plays in providing essential local services and responding to the needs and priorities of local communities. The Government also supports the need for local government to have access to adequate resources to meet its obligations. Although local government is an instrument of State and Territory legislation, the Australian Government has for more than thirty years provided financial support to local government through the financial assistance grants to improve the financial capacity of local government and its efficiency and effectiveness.

The Australian Government also provides direct funding to local government under its Roads to Recovery programme and provides funding to and through the States under a variety of Specific Purpose Payment programmes. The total funding provided to local government in the 2005–06 Budget is in excess of \$2 billion. Under the financial assistance grants programmes alone local government will receive more than \$1,617 million in 2005–06.

While this is a very significant amount of funding, it represents only around 10 per cent of local government’s revenue with the vast majority of local government’s revenue coming from its own sources. It is important that local government has the capacity to make the best use of its own revenue sources.

The adequacy of resources available to local government is significantly and negatively impacted by cost shifting on to local government by State and Territory Governments. Cost shifting may be difficult to comprehensively define and the Commonwealth Grants Commission has identified several different actions which have been described as cost shifting¹. Nevertheless, there can be no doubt that cost shifting occurs. The need to address cost shifting by State Government onto local government was one of the Government’s key motives in asking the House of Representatives Standing Committee on Economics, Finance and Public Administration to undertake this inquiry.

Over 400 submissions were made to the Inquiry and the Committee visited every State and Territory during the course of the Inquiry. As part of the Inquiry, the Committee issued a discussion paper and received over 100 responses to it.

The recommendations in this report are wide ranging and complex and in developing its response the Government consulted with State and Territory Governments, the Australian Local Government Association, State and Territory Local Government

¹ Commonwealth Grants Commission 2001, *Review of the Operation of the Local Government (Financial Assistance) Act 1995*, p52–3.

Associations and local government individually. The Government also consulted key stakeholders through the Local Government and Planning Ministers' Council.

Roles and Responsibilities

Recommendation 1

The Committee recommends that the Prime Minister and the Treasurer meet with State and Territory Premiers/Chief Ministers and Treasurers and local government to develop a Federal-State inter-governmental agreement which identifies:

- *the roles and responsibilities of local government in delivering Federal and State programs;*
- *policy priorities and strategies at the local level;*
- *the allocation of funds and resources from the Federal and the State governments to local government in order to fulfil its responsibilities; and*
- *the expected performance and funding responsibilities on the part of all levels of government.*

The development of a tripartite inter-governmental agreement on local government relations is supported in principle and the Government has announced that it will pursue the development of such an inter-governmental agreement.

A special roundtable meeting convened by the Local Government and Planning Ministers' Council on 10 June 2004 agreed to further explore the development of an inter-governmental agreement on local government aimed at improving outcomes for local communities. The roundtable agreed that officials, representing the Australian Government, the State and Territory Governments and Local Government Associations, would take this work forward and would provide a progress report to the next meeting of the Ministerial Council.

The text of an inter-governmental agreement will need to be agreed by all spheres of government and will need to be referred for consideration to the Council of Australian Governments.

Recommendation 2

The Committee recommends that local government nominate one representative from each State and the Northern Territory to represent local government at Federal-State inter-governmental agreement negotiations.

The Australian Government supports this recommendation in principle but will only be one of the parties in these negotiations. It would be up to all the parties involved in developing each inter-governmental agreement to determine whether local government should be represented during negotiations and this would not be appropriate in all circumstances.

Recommendation 3

The Committee recommends that the Minister representing the Minister for Local Government, Territories and Roads propose, as a precursor to the Summit on inter-governmental relations, a resolution that the House of Representatives recognises local government as an integral level of governance of Australia.

The Australian Government supports a Parliamentary resolution that recognises local government as an integral level of governance in Australia and the Government will propose such a resolution in both Chambers of Parliament.

Cost Shifting

Recommendation 4

The Committee recommends that, when developing Federal-State inter-governmental agreements, the Federal government consider:

- *including representation from local government during negotiations; and*
- *requiring a commitment from State governments to identify and provide a share of payments to local government when it is seen as having a significant role in delivery of programs under the agreement.*

The Government supports this recommendation in principle, noting that the participation of local government during the negotiation of Australian Government-State Government inter-governmental agreements would depend on the agreement of all parties and would not be appropriate in all circumstances. Where local government has a direct role in delivering a programme and participates in negotiations, the Australian Government will require the identification of the share of payments that are to be provided to local government.

Recommendation 5

The Committee recommends that, in line with the Tasmanian Partnership Agreement, Federal and State governments pay rates to local government.

The Australian Government does not support this recommendation.

The Tasmanian Partnership Agreement includes reciprocal obligations so that local government pays land and payroll taxes to the State Government. It also contains significant exemptions for the State government from paying rates. In some states, local government associations have estimated that such an agreement would leave local government worse off financially and consequently some local government associations do not support this proposal.

Under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* signed by Heads of Governments in June 1999, reciprocal taxation was to be progressed on a revenue neutral basis through negotiating a Reciprocal Tax Agreement. However, the inclusion of local government in reciprocal taxation would be administratively and legally complex. It would involve local government rates being applied to both Australian Government and State Government landholdings, and State taxes being applied to local government activities. This would involve a complex three-way revenue neutrality mechanism between the Australian Government, State and Territory Governments and local government. In March 2002, the Ministerial Council for Commonwealth-State Financial Relations agreed that no further action be taken on reciprocal taxation.

One effect of local government financial assistance grants is to compensate local government for its lack of rate revenue from Australian Government land. In some

States the Local Government Grants Commission takes into account the impact of non-rateable land on each council directly in determining the council's share of the financial assistance grants.

Recommendation 6

The Committee recommends that the Prime Minister and the Treasurer meet with State and Territory Premiers and Treasurers and local government representatives to develop a Federal-State inter-governmental agreement which:

- *recognises cost shifting as a problem which has occurred over a number of years;*
- *allocates revenue to local government from the relevant level of government if responsibilities are devolved;*
- *addresses State restrictions on local government revenue raising such as rate capping, levies and charges and non-rateable land; and*
- *develops local government impact statements to identify the financial impact on local government of legislation by State and Commonwealth governments.*

Under the proposed inter-governmental agreement, the Australian Government will seek to have cost shifting recognised as a problem, to have revenue allocated to local government from the relevant level of government if responsibilities are devolved and to have State restrictions on local government revenue raising addressed.

The development by the Australian Government of local government impact statements is not supported.

Recommendation 7

The Committee recommends that the Federal government consider extending ANAO's powers to examine the expenditure of Federal SPPs² to and through the States to local government.

The Australian Government has reviewed the possible extension of the Australian National Audit Office's powers to examine the expenditure of Australian Government Specific Purpose Payments to and through the States to local government but has decided against extending those powers.

Recommendation 8

The Committee recommends that the Minister for Finance issue a direction to all Federal agencies to ensure that all renegotiated and future Federal-State SPP agreements:

- *describe clear Federal government objectives and measurable outcomes;*
- *specify performance indicators that are directly linked to the objectives to ensure financial accountability;*
- *define the roles and responsibilities of each party to the agreement;*
- *require State governments to report on the volume of funds to be distributed to local government to perform functions; and*

² Special Purpose Payments.

- *disclose the funding adjustments to be applied to State governments in the case of cost shifting to local government.*

The Australian Government already requires that new and renegotiated Special Purpose Payment agreements provide clear Australian Government objectives and measurable outcomes, specify performance indicators that are directly linked to the objectives and define the roles and responsibilities of each party to the agreement.

The Government supports State Governments reporting on the volume of funds to be distributed to local government to perform particular functions.

Disclosure of cost shifting issues will be considered in the context of the negotiation of the proposed inter-governmental agreement.

Infrastructure

Recommendation 9

The Committee recommends that local government bodies be required to audit the state of their infrastructure (using a nationally accepted methodology) and provide status reports to the Commonwealth Grants Commission as one of the inputs into the needs based formula for Federal FAGs³ to local government.

- *The infrastructure data collected should be used to adjust FAGs where councils are found to be negligent in managing infrastructure.*

The Australian Government supports efforts to improve the management of local government infrastructure.

The financial assistance grants provide recurrent funding for local governments and allocations to individual authorities do not take into account capital requirements. The Government does not support the proposal that financial assistance grants for councils should be reduced where councils are found to be negligent in managing infrastructure. In rejecting this proposal the Government acknowledges the difficulty of determining when a council may be considered negligent.

The Government recognises that local government authorities may wish to make prudent use of borrowing to finance infrastructure investment and the Minister for Local Government, Territories and Roads will facilitate consultation between key stakeholders, including the State and Territory Governments and local government, on impediments to such prudent borrowing.

Recommendation 10

The Committee recommends that SPPs directed to local government, such as roads, should be conditional on States not reducing their effort.

The Australian Government supports this recommendation.

³ Financial assistance grants.

The Government programmes of tied road funding to local government, the *Roads to Recovery* and *National Blackspot* programmes and the AusLink programme, contain this condition.

Capacity building in our regions

Recommendation 11

The Committee recommends that the Local Government and Planning Ministers' Council establish a body along the lines of the UK IDeA to address capacity building. This body should also oversee the Federal and State governments' best practice awards.

This recommendation needs to be considered by the Local Government and Planning Ministers' Council.

The Minister for Local Government, Territories and Roads will pursue local government capacity building by seeking to enhance the National Awards for Local Government through the Local Government and Planning Ministers' Council.

Recommendation 12

The Committee recommends that the Federal government establish a Local Government Liaison Unit to:

- *liaise with State departments of Local Government and local government peak bodies to strengthen Federal/State/local relations;*
- *provide the contact point and conduit for local government at the Federal level and provide information on new Federal initiatives, policies and programs;*
- *receive feedback on the performance of Federal programs and any cost shifting occurrences; and*
- *coordinate periodic strategic meetings and policy briefings for a Federal and local government officers' forum and other interested parties as required.*

The Australian Government does not support the need to establish a new Local Government Liaison Unit. The functions identified for such a unit are largely provided by the Local Government Branch within the Department of Transport and Regional Services. Agencies also use the Australian Local Government Association for disseminating information on Australian Government initiatives, policies and programmes. The Government liaises with State and Territory Departments of Local Government and local government peak bodies through periodic meetings of the Local Government and Planning Ministers' Council and the Local Government Roundtable⁴.

Recommendation 13

The Committee recommends that the Commonwealth Grants Commission, in consultation with the LGGCs⁵ in each State, assess the efficiencies of amalgamations

⁴ This is an annual meeting between the Minister for Local Government, Territories and Roads and the Presidents of the Local Government Associations to discuss issues raised by the Associations.

⁵ Local Government Grants Commissions.

or regional cooperation of local government, and use available mechanisms to adjust FAGs grants for the benefit of the sector at large.

- *To facilitate amalgamations, where appropriate, councils should not be financially penalised through a net loss of FAGs payments for four years.*

The Australian Government does not support the use of the Commonwealth Grants Commission to assess the efficiencies of amalgamations or regional cooperation.

The Government does, however, agree that the financial assistance grants should not be seen to financially penalise councils which amalgamate. The Minister for Local Government, Territories and Roads will propose a new National Principle under the *Local Government (Financial Assistance) Act 1995* specifying that financial assistance grants for amalgamated councils be maintained for four years after an amalgamation so that the grants do not act as a disincentive to voluntary amalgamation. It is intended that funding for the amalgamated council for the four years would be determined as if the councils had not amalgamated. The Minister will consult with State and Territory Ministers for Local Government and with local government on the variation to the National Principles as required under the Act.

Recommendation 14

The Committee recommends that the Federal government:

- *continue to develop partnership arrangements with local government on the delivery of Federal programs and service delivery; and*
- *as appropriate, engage established regional organisations of councils, or similar regional bodies, which have demonstrated capacity, in regional planning and service delivery.*

The Australian Government supports this recommendation.

Commonwealth funding of local government

Recommendation 15

The Committee recommends that the Commonwealth, States and local governments consider what tax design improvements would be necessary to eliminate tax on tax effects arising out of the GST.

Division 81 of the GST Act has the effect of allowing a determination by the Australian Government Treasurer to list certain taxes, fees and charges that are not subject to GST. However, the determination can only make the payment of a compulsory tax, fee or charge to Government not subject to GST. Stamp duties are usually included in the Division 81 list. This means that the GST does not apply to stamp duty when paid to the State revenue collection authority.

Stamp duties are State taxes and the calculation of those duties is determined by the States. Individual States can decide whether their stamp duties are levied on a GST inclusive or exclusive price and whether to adjust the rate of stamp duty accordingly.

However, the States have recently indicated that they are not willing to remove these tax effects. For example, the abolition of stamp duty on general insurance products was recommended by the Royal Commission into the failure of the HIH Insurance

Group. The Royal Commission also recommended that the states exclude the cost of the GST for the purposes of calculating stamp duties or other levies that are imposed on insurance premiums. The Treasurer wrote to the States on 11 September 2003 encouraging them to carefully consider the recommendations and to take appropriate action. However, the States have strongly resisted the implementation of these recommendations to date.

Recommendation 16

The Committee recommends that a new methodology for the distribution of FAGs to local government be designed which incorporates the following elements:

- *a national model which is consistent across each Local Governing Body;*
- *distribution of funds on equalisation principles ie on the basis of need;*
- *funds to be paid direct to local government;*
- *funds to remain untied and be allocated from one pool;*
- *data on local conditions/factors to be provided by LGGCs;*
- *a weighted factor be applied to indigenous community councils to ensure their level of disadvantage is taken into account;*
- *appropriate acquittal arrangements; and*
- *a new model, as presented by Professor Farish, to be designed by a Federal and Local Government Finance Advisory Group of experts and phased in over three years, with the process to be facilitated by the Commonwealth Grants Commission.*

The Australian Government does not support this recommendation.

The current system of distribution of financial assistance grants aims to achieve a balance between national consistency in the different methodologies to allocate grants within States and Territories and the need for flexibility in accommodating local variations in services provided by local government and in available data. The Government will continue to promote greater consistency between the differing methodologies through regular exchange of view between the State Local Government Grants Commissions.

The Government supports the continuation of the minimum grant whereby all councils receive a proportion of financial assistance grants funding based on population.

The Government acknowledges the apparent disadvantage to South Australia in the current interstate distribution of the identified roads component of the financial assistance grants. This disadvantage was addressed in the interim by the Prime Minister's announcement on 15 March 2004 of additional local roads funding for South Australia of \$26.25 million over the three years to 2006–07.

The Government will ask the Commonwealth Grants Commission to review the current interstate distribution of the identified roads component of the financial assistance grants and to report back to Government by 30 June 2006. The Government will provide a long term solution to South Australia's disadvantage after the Commonwealth Grants Commission reports.

The way forward

Recommendation 17

The Committee recommends that COAG⁶ host a Summit in 2005 on Inter-governmental Relations:

- *to report on the implementation of the Committee's recommendations;*
- *to review:*
 - *SPPs paid to States and Territories with a view to isolating funds for direct payment to local government;*
 - *the relevant anomalies of A New Tax System;*
 - *the revenue raising capacity of councils with consideration of financial penalties for States and Territories which fail to adequately support or deliberately suppress that capacity; and*
 - *successful State/local government partnerships and the opportunities for Federal government participation in those partnerships;*
- *to determine processes to develop:*
 - *methods to resolve duplication and overlap of service provision;*
 - *a fully responsible financial role for local government free from policies that arbitrarily limit revenue raising capacity from their normal sources;*
 - *a direct financial relationship between the Commonwealth and local government;*
 - *a national methodology for local government bodies to evaluate their infrastructure needs and requirements; and*
 - *a set of principles to reduce cost shifting and unfunded mandates and to ensure that Commonwealth and State and Territory responsibilities administered by local government are adequately funded.*

The Australian Government does not support the recommendation for a Summit on inter-governmental relations at this time and believes that many of the issues identified in this recommendation will be considered by the Local Government and Planning Ministers' Council in the development of an inter-governmental agreement.

The Government does agree with the Committee on the importance of local government authorities having the capacity to raise revenue from their own sources and will ask the Productivity Commission to examine this issue.

Recommendation 18

The Committee recommends that the Federal Treasurer assume responsibility for the financial relationship with local government.

The Australian Government does not support this recommendation. Responsibility for the financial relationships with local government is to remain with portfolio Ministers.

⁶ Council of Australian Governments.

