

## **Intergovernmental Relations Conference**

**QT Canberra**

**17 September, 2014**

**9.15am - 10am**

### **Current challenges in intergovernmental relations**

#### **A Local Government perspective**

Thank you for the invitation to speak here today on what is becoming an increasingly important area – intergovernmental relations.

This area has always been of interest in Australia for a number of obvious reasons

- We are a Federation with several clearly established levels of government
- We have three capable and representative levels of government which have tax bases and track records in delivering services and infrastructure
- We are a wealthy country in which Governments have the resources and legal authority to deliver services and infrastructure and of course to implement and administer legislation and regulation and
- As Australians, we accept that governments have a legitimate, albeit evolving role in regulation, funding and delivering services.

At the present the topic of intergovernmental relations has taken on a renewed focus because of the Federal Government's announcement of a process to look at reform of the Federation through the development of a White Paper on Federation and a complementary White Paper on the Reform of Australia's Tax System.

The White Paper process recognises that the operations of the Federation can be and should be improved and it paints a picture about why that reform is becoming increasingly necessary. Mostly, that relates to the fiscal stress the different levels of government currently find themselves under but there are

other underlying issues such as an ageing population and an increasingly competitive global environment.

Today I want to touch on this White Paper process but I also want to give you an understanding of the local government perspective about our inter-governmental relations and what role local government plays in our Federation and in the lives of everyday Australians.

First, let me tell you a little bit about the Australian Local Government Association – ALGA- and local government itself.

In doing this I am mindful of the fact that I am likely to be talking to a number of people in this room who are disadvantaged. Disadvantaged because they live in Canberra and so do not really experience local government as every other Australian experiences it. If you are a resident of Canberra you don't have a local council who you vote for, whose members you see on your main street and in your shops, and who you can collar and raise your day to day problems with. You do get local services but they come from a Territory Government which is not really the same.

Now, back to ALGA and who we are and what we do.

ALGA is the national body which represents the interests of local government at the national level. There are about 560 councils across Australia and they are established by the States and Territories. Within each state and the Northern Territory the councils are members of state and territory local government associations and those associations are the members of ALGA.

ALGA has a Board, headed by the President, and comprising two representatives from each state and territory associations – usually the state association presidents and vice presidents. Working to the Board is a Chief Executive and a Secretariat.

I am the current President of ALGA having held the role for nearly two years but I am also the Mayor of Marion City Council, a metropolitan council in the southern suburbs of Adelaide.

ALGA's key activities include representation of local government on national bodies and ministerial councils, providing submissions to Federal Government and Parliamentary inquiries, raising the profile and concerns of local government at the national level and providing forums to guide the development of national local government policies.

As President of ALGA, I am a full member of the Council of Australian Governments, COAG. The President or his or her delegate is also a member of three of the eight COAG ministerial councils including the Council on Transport and Infrastructure, the Law Crime and Community Safety Council and the Disability Reform Council. ALGA is also a member of the Food Regulation Ministerial Council.

Local government in Australia is not a small undertaking. Its national significance is underlined by the fact that it employs around 195,000 Australians (just over 10 per cent of the total public sector), owns and manages non-financial assets which in 2011- 12 were estimated to be worth \$316 billion, raises around 3 per cent of Australia's total taxation revenue per annum and in 2011-12 had an annual expenditure in excess of \$30 billion, or just under 6 per cent of total public sector spending.

Local government's expenditure is directed towards the provision of a wide range of local services, which include: housing and community amenities; transport and communications; recreation and culture; and social services and welfare. Independent research commissioned by ALGA in 2012 shows that the majority of Australians agree that local councils play an important role in their lives.

Local government undertakes its work while being more than 80% self-funded. The largest source of revenue is local government's tax base – property rates - which account for just over 40% of revenue and then fees and charges which account for a further 30% plus. This figure is higher than might be expected because in several jurisdictions – Queensland, Tasmania, western New South Wales – local government provides water and sewerage. Elsewhere, state government or private entities provide those services.

Local government does receive funding from the other two levels of government in the form of tied or untied grants which account for perhaps up to 15% of our funding as an aggregate national figure but of course the importance of government funding, particularly Commonwealth funding varies for each council. While Commonwealth funding is about 10% of local government's revenue it can account for as little as 2% of revenue for large metropolitan councils and as much as 90% of revenue for small remote councils which have very small populations and no capacity to raise rate revenue.

I mentioned earlier local government's extensive role in delivering a wide range of services and infrastructure. What local government delivers has been changing over the past 40 years as councils have moved away from just delivering property based services such as roads, stormwater infrastructure and rubbish collection to also delivering a range of human services in the areas of health, housing, child care aged care, youth services as well cultural, recreational and economic development services. In fact councils generally deliver more than 150 services to their local communities.

Why have things changed? Well, part of it is because during the 1990s State Governments moved to free up what local governments could do by changing their local government legislation and giving councils powers of general competence. That allowed councils to provide the services which the community wants rather than just the services which the state government defined as their limited role. It turns out that communities wanted a lot more services delivered at their local level and it also turns out that when state governments withdraw services from towns communities want those services to continue and expect their councils to pick up the slack.

In addition, as the capacity of councils has grown, the state governments and the Commonwealth have seen councils as partners in delivering services, infrastructure and regulation to meet state and national objectives. Some of these tasks have come with appropriate resources but unfortunately others have not. Increasing regulatory functions for councils have not always been accompanied by the resources or the necessary training as the Productivity Commission's Report into Local Government as a Regulator found in 2012.

In fact, the problem of loading up councils with roles but without the necessary resources – cost shifting – became such a problem in the 1990s that a 2003 House of Representatives Committee Report on the matter – Rates and Taxes: A Fair Share for Local Government (also known as the Hawker Report after the inquiry’s chairman David Hawker) accepted that the annual imposition on local government from cost shifting could be more than \$1 billion,

In response to the Report, the Howard Government sought to address the issue with the state governments and in April 2006, all Australian governments signed the Intergovernmental Agreement Establishing Principles Guiding Intergovernmental Relations on Local Government Matters (the IGA). The IGA outlines a set of principles designed to establish an ongoing framework to address future cost shifting, and prevent the cost shifts that have occurred in the past.

Despite the Agreement, the effects of cost shifting to local government from other levels of government (mainly state governments) for which the sector remains uncompensated, have continued to grow over recent years, and present a genuine threat to the ongoing financial sustainability of the sector. This is because other levels of government continue, whether indirectly or directly, to assign additional responsibilities to councils. These include increased emergency and disaster management, environmental programs, community education, business development, management of certain land and the transfer of roads.

Putting cost shifting to one side, let me return to the matter of intergovernmental transfers between local government and the other levels of government. Councils receive grants from the other levels of government to deliver services and infrastructure vital to local communities. There are programs in most if not all states which provide some support to councils in delivering recreational facilities like ovals, parks and swimming pools, although the majority of costs usually falls to the council. In some cases councils are also contracted by state to maintain state government infrastructure such as state government roads. There are lots of other small programs which help councils to deliver services which State Governments recognise as local priorities.

At the national level, the Australian Government has recognised for more than 40 years that citizens, regardless of where they live, should be entitled to receive some basic standard of local services and infrastructure. The mechanism for providing support to councils to deliver these services is called the Financial Assistance Grants program or FAGs for short.

The FAGs, which total \$2.3 billion this year, are a vital part of the revenue base of all councils. They are indexed each year by a combination of CPI and population growth and each council receives an allocation from the grants. For many smaller rural and remote councils, FAGs form the majority of their revenue.

The FAGs are absolutely essential to allow local communities across Australia to provide a reasonable level of service and infrastructure to local residents. These grant are used to maintain a great range of infrastructure including local roads, bridges, parks, swimming pools, libraries and community halls as well as services to the young, the elderly and community groups of all kinds.

In 1996 the FAGs were at a level equivalent to 1% of Commonwealth tax revenue. In recent years they have slipped to 0.7% but will decline to just 0.53% by 2017-18.

The other major Federal funding program which councils receive is Roads to Recovery which has been in place since 2001. The program is worth \$350m per year and has provided councils around Australia with more than \$4.75 billion in funding. The funds are spent only on roads and bridges and one of the primary outcomes of the program has been improved access and productivity on local roads which adds to national productivity.

I have given you an idea of the scale and roles of local government and also a some inkling about the challenges in terms of growing demands for services and the problem of cost shifting but let me now turn to the new challenges which face local government which stem primarily from the 2014 Budget, the report of the Commission of Audit and the Federation White Paper.

In the May Budget the Government decided to freeze the indexation of the Financial Assistance Grants for three years. The decision will cost councils an estimated \$925 million by 30 June 2018. In fact, the decision will mean that the total value of the grants will be reduced by about 13% over the three years. The

reduction will be permanent meaning that the annual level of the grants will be hundreds of millions of dollars less than they would otherwise be from now on. Within six years, the size of this reduction will be greater than the value of the entire Roads to Recovery program.

This is a bitter pill for every local community, especially regional communities since up to two thirds of the money will come from regional councils and ALGA will campaign to have the FAGs indexation and the lost grants restored.

It's not just the indexation of the grants which is a problem however. The long term future of these grants – and the direct relationship between local government and the Federal Government which goes back to 1974 – is at risk.

The National Commission of Audit released its report just before the Budget and it recommends that the Commonwealth should play no role in local government funding. Not just direct funding but also no Financial Assistance Grants. The grants would end but the Commonwealth would pass some taxing power to the states to raise the money which they could then pass to local government. The same goes for health, education, infrastructure and lots of other things the Commonwealth does.

The primary purpose of the Commission of Audit, in broad terms, was to examine the details of what the Commonwealth does and whether it could be done more cost effectively.

The report looked at activities undertaken by the Commonwealth and whether there was a compelling reason to continue them; and importantly for local government, whether there was a strong case for continued direct involvement of government, or whether the activity could be undertaken more efficiently by the private sector, the not-for-profit sector, the States or local government.

The Commission of Audit included recommendations that the Commonwealth end its funding for local government, including the Financial Assistance Grants program and the Roads to Recovery program.

Recommendation 22 (in the Phase 2 report) said that "states would have access to the personal income tax system so that they are in a better position to fund

their own priorities. This will include support for local government." The recommendations further concludes that "tied grants to local government would cease, and to the extent that programs are identified as priorities, local or State governments could provide them to the communities they service."

Recommendation 5 (also in the Phase 2 report) pursues the same model for infrastructure funding. That is the states are responsible for infrastructure and should determine their own priorities. The Commission recommended that a range of infrastructure funding including the identified roads component of the Financial Assistance Grants and Nation Building Funds, that is Roads to Recovery grants, be consolidated into a single pool.

The Audit Commission proposed that the revenue associated with the Financial Assistance Grants would go to state governments rather than councils, with the states then to determine whether any funds are passed on to councils. Given the financial pressures which state governments are under it is likely that little if any of the funds will make it to local communities.

The end of the Roads to Recovery program would strip billions in road funding from local communities with devastating consequences for productivity, road safety and general access, particularly in regional communities.

These recommendations would bring about a quantum change in the Commonwealth-local government relationship and one which ALGA does not support.

It would be a severing of the relationship between the Commonwealth and Local Government.

There would be no Financial Assistance Grants, and no special purpose payments aimed at addressing specific local government needs such as Roads to Recovery or the new Bridges Renewal program. There would be no ad hoc funding investments in local infrastructure projects.

In all cases funding would flow to the States as part of general income tax funding and the States would be responsible for resourcing local government as they saw fit, or perhaps more realistically, as they could afford.

It would create a situation where there would be no linkage between local Federal MPs and Senators and local councils in terms of election promises, as it would be the states which would have the power to distribute those funds.

I wonder how that division of responsibilities would survive political reality?

Interestingly, the 1996 National Commission of Audit established by Prime Minister John Howard recommended that Financial Assistance Grants be integrated into revised State payments.

The 1996 Commission of Audit highlighted a particular view of how the Federation and the Commonwealth should work. It took the view that the Commonwealth should only deal with national matters and the states and local government should deal with everything else. It also took the view that local government is a state responsibility and while accepting the legitimacy of providing FAGs, implied they should be integrated into revised state payments.

This recommendation was rejected.

So where to for the 2014 National Commission of Audit Report? Well the Government referred the recommendations concerning local government to the Federation White Paper process and it is in that context that we will see the concerns of local government addressed.

The Terms of Reference for the White Paper on the Reform of the Federation were released at the end of June. Mr Abbott said at the time that it was important to reduce, and if possible, end duplication and make interacting with governments simpler.

He said it was important to clarify the roles and responsibilities for States and Territories, so they are, as far as possible, sovereign in their own sphere.

It is important for local government, as the third sphere of government to ensure that the White Paper process does not become a conversation simply between, and about, the Commonwealth and the States. Local government must be involved in the process in a bid to forge a consensus between all major political

parties and indeed state governments that local government is an equal partner in the Federation and that we should be funded appropriately to undertake the roles and responsibilities that are assigned to us, and that the community expect.

The White Paper will now be a standing item on the COAG meeting agenda while the White Paper process will be overseen by a steering committee comprising the Secretaries and Chief Executives of the Commonwealth Department of Prime Minister and Cabinet, State and Territory First Ministers' departments and the Australian Local Government Association.

A number of Issues papers will be released during the remainder of this year, the Green Paper is expected to be released in the first half of 2015 and the White Paper by the end of 2015.

At the same time, the White Paper on the Reform of Australia's Tax System will also be underway.

The challenge for local government is to be engaged in this process and to influence its outcomes so that local government plays an appropriate part in any new Federal model.

ALGA has argued that the Federation White Paper process should not be a search for a perfect Federal model, with the Constitution being the only source material. We need a review which looks at how the Federation actually works in the real world - how the different levels of government – including local government – work together now and can work together better in the future.

All three levels of government serve the Australian people – and our citizens don't really seem to care too much about which level of government does what. They just want to see services and infrastructure provided in the most efficient and equitable way possible. And they want a fair share of those services to be delivered at the local level in their local communities.

So what could come out of the White Paper process? Well, one thing that seems reasonably certain is that the White Paper won't recommend Constitutional change.

A possible change to the Constitution to include local government is something which occupied ALGA for the last few years and most of you would be aware that the push for constitutional recognition of local government fell at the last hurdle in 2013.

The Constitutional change ALGA sought was a narrow one – a change to Section 96 to confirm the capacity of the Commonwealth to directly fund local government. In fact, it was just 17 words.

The referendum could only take place on or after 14 September last year because of the legislative timetable adopted by the previous Government. When the election was brought forward by a week it could not go ahead. We will never know whether it would have been successful. We at ALGA were confident it would have got up but that's immaterial. The fact is the Constitution was not changed and the current Government is not going to put the referendum forward.

Constitutional recognition of local government may no longer be on the agenda but the threat to the direct funding we receive from the Federal Government through program such as Roads to Recovery has not gone away. The doubts raised in the High Court cases of Pape and Williams remain.

The High Court handed down its Williams 2 decision on 19 June this year. From our initial assessment, one reading of the decision is that it potentially has significant implications for all programs under the Financial Framework Legislation Amendment Act 2012, some of which provide funds to councils. Another reading is that it still only directly impacts the Commonwealth provision of school chaplains. Either way legal uncertainty will remain.

The Federation White Paper is not an avenue to seek Constitutional recognition but it is an opportunity to get acknowledgement of the fact that local government does play a role in the Federation and should continue to play a role. That is our challenge.

It is also an opportunity to try and address the challenge that local government as a whole faces in the area of financial sustainability. As councils we can and should seek to be as efficient as possible in delivering services and

infrastructure but that is not going to be enough to overcome the gap between our income and expenditure. A report in 2006, commissioned by ALGA from PricewaterhouseCoopers, put local government annual infrastructure backlog at \$14.6 billion nationally and stated that the backlog was a product of councils with limited revenue bases concentrating on meeting the growing demands for recurrent services rather than setting aside funds to deal with infrastructure renewal.

Well, the demands for services are going to keep growing but our revenue is going to remain under pressure. Many smaller councils do not have the option to increase rates – their rates bases are just too low. Other councils in major metropolitan areas have more capacity to look at rates increases but even they recognise that there are growing questions about ability to pay in ageing communities as asset rich homeowners retire and become income poor.

We need to look at the match between taxation and service provision. At the aggregate level, local governments raise a little over 40% of their revenue from rates. Many councils of course raise much more from rates, others much less. We will have to argue strongly to protect our rate base.

The Henry Report into Tax reform identified rates (and all types of land tax) as a very efficient tax which should be exploited to the full. Unfortunately the states collect two thirds of land tax. We get the rest. And yet there are increasing demands from the other levels of government that local government rates be used to collect levies such as emergency services levies or environmental levies, or suggestions they be used to fund national programs such as the new National Injury Insurance Scheme, expected to begin in 2017. Local government cannot afford to lose its rates revenue.

Our local ratepayers expect to see local services and infrastructure delivered by councils in return for the rates they pay. This is a point we must push strongly in the forthcoming Taxation White Paper, foreshadowed over the next two years.

Let me finish on answering the question Why does local government matter in the Federation?

Local government is the closest level of government to the people. The vast majority of local government work is focused on direct provision of local services, planning and the provision of local and regional infrastructure.

Local government services and infrastructure are used every day by every Australian. Whether it's using a footpath, playing in a park, driving to work on a local road, a visit to the local library, or having the rubbish collected, Australian lives are touched by local government in many different ways.

Local government exists to deliver the services and infrastructure we need at the local level and, in our democracy, local communities expect to have a say in how those services are delivered. They expect to be able to vote for elected representatives who will oversee the operations of a local government and they expect to hold those elected representatives accountable.

Our communities also expect that their local representatives will work in partnership with their state representatives and their Federal representatives to deliver the services and infrastructure they need. As I said earlier, people pay their taxes to all three levels of government and they expect services and infrastructure and services to be delivered efficiently, effectively and equitably in return. And that includes local services.

Our challenge in intergovernmental relations is to meet those expectations.

Thank you