



ALGA SUBMISSION TO THE TAXATION ISSUES PAPER

Introduction

The Australian Local Government Association (ALGA) welcomes the Taxation Issues Paper as the first step in the Government's White Paper on Taxation.

While this submission from ALGA responds to calls for submissions on the Issues Paper it draws heavily on ALGA's comprehensive submission to the Tax Review undertaken by Dr Ken Henry in 2008-09. Many of the fundamental issues highlighted at that time remain unchanged and the Productivity Commission's Report on Local Government Revenue Raising Capacity continues to be the most authoritative work on revenue issues. The key issues highlighted in this submission include:

- the importance of taxation revenue for the provision of essential local government services and infrastructure at the local and regional level;
- the role local government plays in raising (some of that) taxation revenue within a federalised taxation system;
- the nature of local government's tax base (rates), having regard to the requirement that a well-designed tax should be fair, efficient, simple, transparent and adequate/sustainable;
- the constraints and restrictions that impinge upon local government's ability to fully exploit its taxation base (ability to pay, capping, concessions, exemptions and the potential for state crowding out);
- the critical role of intergovernmental grants from the Commonwealth and the states to the sector (both in the form of general purpose funding and specific purpose payments) in order to promote horizontal fiscal equity for all Australians; and
- the inadequacy of current intergovernmental transfers, especially Commonwealth general purpose funding, in achieving horizontal fiscal equalization.

Comments in this submission about the adequacy of funding transfers from the Federal Government relate primarily to the Financial Assistance Grants provided to local government (which ALGA considers to be analogous to the general purpose funding provided to the state and territories¹ in the form of the GST).

ALGA notes that submissions received in response to the Treasury Issues Paper are intended to assist the Treasury in the development of a Green Paper as part of the White Paper process, with that Green Paper expected to be released for formal consultation with the community later in 2015. This submission is designed to flag critical issues, from a local government perspective, that should be taken into consideration as the White Paper progresses. ALGA anticipates making a further submission responding to the Green Paper.

About the Australian Local Government Association (ALGA)

ALGA is the national voice of local government in Australia, representing around 560 councils across the country. In structure, ALGA is a federation of state and territory local government associations.

ALGA was established in 1947 and throughout its history has been closely involved in issues of national significance affecting the local government sector as a whole. ALGA has enjoyed a close, productive working relationship with the Commonwealth Government, illustrated by its current membership (through its President) of the Council of Australian Governments, and a number of other Commonwealth-State Ministerial Councils, both formally and informally, which consider different sets of complex policy issues across many sectors of the economy.

In addition to its representative role on Commonwealth-State Ministerial forums, ALGA's key functions include participating in policy reviews, providing submissions to and appearing before Federal Parliamentary inquiries, and enhancing opportunities for local government to inform the development of national local government policies.

Governments and the importance of taxation revenue

While there are a number of theories about the role of government, it is relatively uncontroversial to observe that when government performs its role effectively and efficiently, the economic and social wellbeing of individuals is seen to be, or seen to be being, enhanced. As noted by Dr Peter Abelson,

A good government supplies essential public services including law and order, economic infrastructure, and basic health and education services. It assists the poor and protects the vulnerable in society. It provides the institutions and rules that allow markets to flourish, effort to be rewarded, and people to lead prosperous and healthy lives.²

¹ References in this paper to 'states' are to be read as references to the 'states and territories' unless otherwise indicated.

² Abelson, P, 2008, *Foundations of Public Economics*, McGraw-Hill Sydney, Chapter 1, 'Principles and Practice,' p.8.

In Australia, governments perform numerous functions, both economic and non-economic. Their powers are generally granted to them in constitutional legislation, which in turn establishes the scope of their role and limits on their powers.

In general, it can be said that government has three main economic functions: allocation; distribution; and stabilisation.³ Aspects of each of these functions are referenced in the Issues Paper (although not identified in these same terms). For the purposes of clarity, they are described briefly below.

The 'allocation' function refers to the allocation of resources by government in the presence of market failures, and particularly to the supply of public goods. This function also requires government to regulate externalities, prevent or regulate market power, facilitate competitive markets, and protect the public from information failures.

The 'distribution' function refers to the distribution of income and services in the presence of poverty and income inequality. This function, which includes the power to levy taxes on personal income and the capacity to disburse welfare payments, is designed to protect the vulnerable whilst also aimed at enhancing the aggregate economic and social wellbeing of citizens. An example of distribution that affects local government is the concessions and rebates offered to elderly or financially constrained land owners from paying rates.

The 'stabilisation' function refers to macroeconomic management, notably policy making aimed at achieving full employment and price stability. This function is designed to provide robustness in the economy and resilience from external shock. It is controlled primarily through monetary and fiscal policy.

The theory of fiscal federalism⁴ suggests that these three main economic functions of government should be allocated to different spheres of government, according to the capacity of each to achieve the required objective. It is also accepted generally that central government should perform the macroeconomic management function. In Australia, it is the federal government that has prime responsibility for both the distribution and macroeconomic functions.

The Australian Government controls the key instrument of income redistribution: the taxation of personal income. This is consistent with the philosophy that only central government can create horizontal equity (the like treatment of like citizens across the country), and comes as a result of the high degree of vertical fiscal imbalance that exists in Australia between the Australian Government and the other two spheres of government.

Implicit in the acceptance that government should have a place in the life of its citizens is the acknowledgement that the allocation, distribution and stabilisation functions are made possible only if government has appropriate and adequate financial resources to do so.

³ Abelson, P, 2008, op cit; Rosen, H and Gayer, T, 2008, *Public Economics*, 8th edition, McGraw-Hill, New York.

⁴ For example, see Musso, J, 1998, 'Fiscal federalism as a framework for government reform' in Thompson and M.T Green, *Handbook of Public Finance*, Marcel Dekkar, New York.

The revenue available to a sphere of government should reflect the extent to which it must perform any or all of the three functions of government detailed above. Accordingly, if the role of government is to deliver services, and necessary infrastructure, then revenue (including taxation) is required to support the administration of those functions.⁵

It is ALGA's view that an analysis of local government's taxation revenue power and other revenue mechanisms cannot be undertaken in isolation from the role of, and allocation of public functions to, local government.

Consistent with the principle of subsidiarity, local government is responsible for governance at the local community level and delivery of essential local services and infrastructure at the local level. The fact that local government is a common governance feature around the world underlines the significance, in practice, of the subsidiarity principle.

Facilitating local choices and making decisions on local services through a system of local government has a number of key advantages. Local government has the ability to use local knowledge and most appropriately identify and manage local variations in needs, preferences and costs of services. Being the sphere of government closest to Australian local and regional communities, local government is best placed to actively engage the public in the decision-making process. Furthermore, democratically elected local government has the political mandate to make local choices for which an administrative system could not be made accountable.

Local governments are well-placed to provide local 'public goods'. These 'public goods' are defined as goods and services that primarily serve and benefit the local population but which private firms cannot charge for and will not supply. Examples include urban planning services, climate adaptation and mitigation, public health programs, the provision of local roads, parks and ovals, storm water and drainage systems, and various local and regional community facilities.

In practice, local councils around Australia provide public goods in the form of physical infrastructure and services.

Physical infrastructure can include:

- construction and maintenance of roads, streets, pavements, traffic lights, bridges and car parks
- stormwater, sewerage and drainage systems (in some states)⁶
- parks and sporting facilities (swimming pools, golf clubs, sports courts)
- libraries and other community facilities (galleries, performing arts centres, museums)

⁵ It is important to distinguish between the roles of government as a funder of services and as a supplier of services. In some circumstances, it may be appropriate for a sphere of government to both fund and supply a service; in others, it may be more appropriate that one sphere of government fund a service whilst another supply it.

- child care and aged care facilities
- caravan parks and camping resorts.

Services provided by councils can include:

- engineering (public works design)
- strategic planning and development assessment
- public health and sanitary services (food inspection and animal control, immunisation, public toilets)
- recycling, trade and household waste services
- recreational and cultural services
- tourism promotion
- local and regional economic development facilitation
- community education programs
- water supply and sewerage services
- social or welfare services (child care, elderly care and accommodation, meals on wheels, counselling)
- the regulation of building standards (inspection, licensing, certification, enforcement)
- general local administration (such as regulations relating to registration and management of dogs and slaughtering).

A key feature of the provision of these public goods is that the local council is the sole supplier. For many of these services, there are no effective substitutes.

Accordingly, the revenue framework for local government needs to be commensurate with its role as the third sphere of government responsible for local matters. Local government can only function effectively if a mechanism is in place to appropriately share public functions and correspondingly allocate funding or revenue raising powers between local government and the other two spheres of government.

The changing nature and role of local government in Australia

In Australia, local government has existed since 1840 (that is, prior to the establishment of some colonial governments in Australia).⁷ Key milestones achieved by the local government sector in its early years included: building and establishing roads for newly formed colonies including rural roads (sometimes through the establishment of Roads Boards); establishing wharves and jetties and the means to cross rivers; provision of community public buildings, parks and gardens; the delivery of gas, electricity and in some areas, water and water sewerage services (which still remains the case today in Queensland, Tasmania and parts of rural New South Wales and South Australia).

When local governments were first established, the broadly held assumption was that they would predominantly deliver what were once typically regarded as “property-based services”: maintenance and building of local roads, provision of public amenities and collection and disposal of rubbish. Perhaps reflecting this assumption, local authorities were granted a

⁷ The first Australian local council to be established was the Adelaide City Council.

power to levy taxation on property, in the form of rates – the further assumption being that services would be provided only to the rated properties within a specific municipality.

While its role has never been amenable to precise definition, there can be no doubt that if the role of local government was once assumed to be as provider of property-based services, it has changed significantly. Changes have occurred over a considerable period of time, with some human services such as immunisation, being provided by councils since the 1930s. The pace and level of change, however, has become more rapid. This was noted by the Commonwealth Grants Commission in its 2001 review of the *Local Government (Financial Assistance) Act 1995*, which concluded that the composition of services being provided by local government over the period 1961-62 and 1997-98 had ‘changed markedly,’ there having been ‘a move away from property-based services to human services; a decline in the relative importance of road expenditure; an increase in the relative importance of recreation and culture, and housing and community amenities; and an expansion of education, health, welfare and public safety services.’⁸ A similar point was made by the Productivity Commission in its 2008 study into local government own-source revenue raising.⁹ It found that the majority of local government spending was no longer exclusively in the areas of ‘property-related services and roads’ but also in the areas of ‘recreation, health and welfare services.’¹⁰

There are many reasons why local government’s roles and responsibilities, as well as the range of services and infrastructure provided by it, have been evolving and expanding over recent decades to include more services to people (in addition to services to property). One of the hallmarks of local government in Australia has always been its willingness to take on new functions or increase levels of service, provided they are underpinned by appropriate funding and agreements. Changing community demands and expectations prompted by demographic change (such as ageing populations), changing settlement patterns (‘sea’ and ‘tree’ changers, as well as the growth of mining communities) and different economic conditions, have caused local government to choose to expand its service types and levels. At other times, functions have been devolved to local government. Sometimes this has been done in a transparent manner with appropriate funding support. In other cases, another sphere of government has raised the requirements associated with the services being provided by local government, or has changed the operating environment in which local government services are delivered. On many occasions in the past, devolution of responsibilities to local government has simply been caused by another sphere of government engaging in responsibility and/or cost shifting.

In 2003, the Standing Committee on Economic, Finance and Public Administration (the Hawker Committee) issued its report into local government funding and observed that ‘there is no doubt that local government has, over a number of years, been on the wrong end of cost shifting, largely by state governments.’¹¹ The Hawker Committee accepted ALGA’s estimate that previous cost shifting to the sector was costing the sector between \$500 million

⁸ Commonwealth Grants Commission, 2001, *Review of the Operation of the Local Government (Financial Assistance) Act 1995*, Canberra, p.53.

⁹ Productivity Commission, 2008, *Assessing Local Government Revenue Raising Capacity*, Research Report, Canberra, p.17.

¹⁰ Productivity Commission 2008 (op cit), p.7.

¹¹ Standing Committee on Economic, Finance and Public Administration, 2003, *Rates and Taxes: A Fair Share for Responsible Local Government*, Canberra, Foreword.

and \$1 billion per annum at that time. ALGA believes the result of previous cost shifting has been to place upward pressure on local government own-source revenue, which has had to absorb the ongoing cost.

Importantly, the issue of local government facing increased costs for service delivery as a result of devolution (cost shifting), raising the bar, and councils' own decision-making in response to community demands has been recently addressed by all jurisdictions through the establishment of an Intergovernmental Agreement (IGA) 'Establishing Principles Guiding Inter-Governmental Relations on Local Government Matters,' signed in April 2006.¹² The IGA sets out a framework within which services and functions delivered to the community at the local level on behalf of another sphere of government are to be funded. These principles remain relevant but ALGA is disappointed that there have been instances of state and territory governments failing to observe the terms of the IGA. ALGA strongly believes that there is a need to revise and strengthen the IGA to ensure it meets its objectives.

ALGA believes that the sphere of government which is closest to the people it serves should be responsible for making decisions on their behalf, provided it is generally competent to do so. 'Competence' relates not only to legal competence but also to fiscal capacity. Accordingly, as local government increasingly broadens its service provision role into more human service areas, and from economic and social development through to environmental management, the cost implications for local government where it is delivering services on behalf of other spheres must be closely assessed.

Local government's role in the collection of taxation revenue in Australia

In Australia, local government is empowered to raise its own revenue through:

- council rates and charges on property
- user fees and charges
- interest
- fines and other penalties
- developer contributions and charges.¹³

Council rates levied on property are the only source of tax revenue available to local government. In other words, of an upper estimated 260 taxes nationally that may be imposed under the current taxation system, local government has just one.

On average, rates revenue constitutes around 3 per cent of Australia's total taxation revenue per annum,¹⁴ which compares with the share of total taxation raised by the states (15 per cent) and the Commonwealth (82 per cent). Rates are, however, a critical source of revenue for local government.

¹² A copy of the IGA is available at www.lgpmcouncil.gov.au/publications/charter.aspx.

¹³ These powers are granted to local government under legislation in some (but not all) states.

¹⁴ Productivity Commission, 2008, op cit, p.28, see Table 2.5. The Table shows that local government's taxation revenue has been a relatively stable proportion of total Australian taxation revenue since 1990-91, whilst Commonwealth total taxation revenue has been increasing.

In the period since 1998-99, revenue raised by local government from property taxes accounted for around 38 per cent of total local government revenue on average per annum, and constituted local government's main single source of revenue.¹⁵ This average figure, however, masks very wide differences between councils, especially between metropolitan and remote rural councils.

It is therefore important to assess whether rates satisfy the requirements for a well designed tax. Standard principles of taxation suggest that a well-designed tax should be fair, efficient, simple, transparent, and adequate/sustainable.

Design principles for 'good' taxation

Fairness

'Fairness' in taxation has traditionally been assessed in two different ways: one is the benefit principle and the other is the ability to pay principle. According to the benefit principle, households which benefit from services should pay for them. For example, in so far as services are provided to properties, a property tax reflects the benefit principle. Independent analysis commissioned by ALGA to assist in the preparation of this submission states:

Moreover, in so far as the value of the land is a result of community actions, in provision of economic or social infrastructure, the case for taxing land is even stronger.

If services are provided rather to individuals, user charges may be more equitable according to the benefit principle, though not necessarily according to the ability to pay principle.¹⁶

The ability to pay principle in turn reflects the principle of vertical equity (or what may be described as 'progressive' taxation). This means that households with more disposable income (or less need) should pay more tax than households with less disposable income (or more need). The principle of horizontal equity holds that like households should pay like amounts of tax. Of most relevance in the local government context is that the local tax bill should be divided as fairly as possible, according to the ability to pay within any given area.

Rate revenue is typically a combination of a fixed minimum rate per property and an ad valorem rate levied on the land and based on either unimproved (site) value or improved (capital) value. While either measure of value might not be a good measure of relative household income at the national or state level, it is usually a reasonable measure of relative household income (when considered over the property owner's lifetime) within a local council area.

Where the application of rates to low income households might risk bearing the characteristics of a regressive tax, relief is usually available in the form of concessions and/or rebates (these are discussed in more detail below).

¹⁵ See ABS 5512.0 *Government Finance Statistics*; also Productivity Commission, 2008, op cit, p. xxii Figure 2.

¹⁶ Applied Economics, 2008, *Local Government in Australia: role, finance and taxation, Report One*, p.16.

Efficiency

Rates on land are generally considered to be an efficient form of taxation in that they do not significantly distort economic activity and resource allocation.¹⁷ Unlike taxes on capital, rates generally do not tax or deter structural improvements.¹⁸ Of particular significance in this context is a 2008 study by the OECD, cited by the Treasury, that indicates that property taxes have the least detrimental impact on economic growth, followed by taxes on consumption, labour income and capital income.¹⁹ Taxes on capital (comprising conveyance stamp duties and land taxes) are state taxes that can be relatively inefficient taxes in the sense that they may either discourage turnover or become embedded in the cost of production.

Simplicity

ALGA agrees with the Productivity Commission that accounting for the actual ability of individuals to pay rates (that is, through measuring income) may provide some better overall consistency with the fairness principle of ‘ability to pay.’ However, introducing such a system at the local government level would involve myriad complexities, suggesting that the benefits may be outweighed by the costs.

Rates are a ‘simple to use’ tax. Land is immobile and easy to identify for taxation purposes. Taxes on land are also hard to avoid, meaning that tax expenditures by local government should be low.²⁰ This makes local property tax a relatively simple tax that is within the administrative competence of individual local governments, and is low cost to administer.

Whilst the main administration cost for rates is in the valuation process, the stability of both property and property ownership makes rates administration relatively easy and cost efficient.

Transparency

A good tax must be transparent and certain. Apart from some issues ratepayers may experience in understanding the different types of valuation methods that can be applied to land, local property tax is transparent, highly visible and generally predictable.

Adequacy/sustainability

¹⁷ Productivity Commission (2008), op cit, p.177. See also the State of the Regions 2006-07 report, commissioned by ALGA and prepared by National Economics, which states that ‘rates are preferable to most other taxes on efficiency grounds, at least to the extent that they are imposed on values arising from scarcity of land. These scarcity-values or location rents are approximated by site and unimproved values. Scarcity values are not affected by the decisions of individual land owners to build or otherwise improve their properties, so a site value rate has no incentive effects other than the incentive to earn as much income as possible from the site. By contrast, most other taxes have unwanted incentive effects. For example, the income tax reduces the incentive to paid work’ (p.58).

¹⁸ In some jurisdictions, councils may levy rates on the capital improved value of land. However, the Productivity Commission (2008) noted the general consensus that ‘the distortions and efficiency costs are small’ (p.177).

¹⁹ Johansson A, et al, 2008, ‘Tax and Economic Growth’, OECD, Paris.

²⁰ It is noted that concessions and rebates are tax expenditure but as they bear characteristics that are in the nature of welfare funding, should be borne by central government as it has appropriate revenue heads of taxation (income) to fund these expenditures. This point will be discussed later in this submission.

There is a widely held misconception that local government income from land rates increases proportionally with increases in land values. In practice, local councils in Australia determine an annual budget and then strike a rate (this is usually a requirement mandated in state legislation). The Productivity Commission noted that local governments have capacity to set different rates in the dollar for different land uses and specific activities, depending on what is permitted under state legislation, in order to raise the requisite revenue.

Levying a tax on the basis of property values therefore enables councils to determine autonomously the level of public services to be provided, so long as rates are not limited by the state government (as they are in New South Wales [NSW] and the Northern Territory [NT]) and local households and businesses have sufficient disposable income to fund that level of local services.²¹

As noted in the State of the Regions 2006-07 report, commissioned by ALGA and prepared by National Economics, 'local government has a history of rating in line with rate paying capacity' and 'take(s) their taxpayers' incomes into account when setting the rate...'.²² For those councils where there are low levels of local business and household income, and/or low or declining population, real issues arise about the financial sustainability of the council. For Australian taxpayers, general rates revenue accounts for about 1 per cent of gross state product (GSP) on average across Australia and between 1.3 and 1.9 per cent of household disposable income. For most councils, the rates incidence is between 1.5 and 1.8 per cent of after tax income.²³

The taxation revenue of local councils is neither constrained by the nature of the tax nor the tax base (or its value). Rather, the key constraints on the level of revenue that local jurisdictions can raise are the level of local household incomes and also the diversity of rate base in terms of access to commercial and industrial income. The rate base does not constrain tax revenue in areas with adequate household incomes or with an appropriate mixture of household, commercial and industrial income.

Whilst ALGA is confident that local councils in general are making the best efforts to raise appropriate levels of taxation revenue, as broadly confirmed in reports such as those of the Productivity Commission (which concluded that local government on average is raising close to 90 per cent of its theoretical maximum revenue²⁴), taxes raised from property cannot fully support the provision of the many services and infrastructure functions of local government noted above. This is particularly the case in councils areas where population is low, relative to the area of the council. In mining communities undergoing rapid growth, high levels of disposable income are not necessarily able to be converted into additional revenue because of factors such as small resident populations, and so cannot be used to address increased demands being placed upon roads and other community infrastructure, which raise the costs for council of maintenance and renewals.

²¹ This compares with systems in Europe under which the revenue is centrally collected and distributed back to the local government sector.

²² See p.78 and p.73 respectively.

²³ Productivity Commission, 2008, op cit, p.135.

²⁴ Productivity Commission, 2008, op cit, Finding 5.4.

In addition, local government rates are insufficient to redress the significant community infrastructure investment backlog being carried by the sector (estimated at \$14.5 billion in 2006), which is discussed later in this submission.²⁵

Summary: Local Government and Taxation

Consistent with the principle of subsidiarity, access to a stable local taxation base is critical for local government to continue to deliver the level of services it currently undertakes, whilst providing and maintaining local community infrastructure in a way that responds to community needs and expectations. As the Productivity Commission noted, ‘the capacity of local governments to raise revenue is important to their financial stability and their ability to promote the well-being of their local communities.’²⁶

Rates are an efficient head of taxation and non-distortionary. There is a strong case for rates as a major source of finance for local services provided by the local government sector.²⁷

Constraints on local government’s ability to fully exploit its taxation base

ALGA contends that there are a number of limitations imposed on local government that impede it from raising rates revenue to a greater extent. One of them is the ability of communities to pay (as described above). Another is the increasing reliance of the states on property taxation revenue. Finally, state-imposed regulatory restrictions also affect local government’s ability to fully exploit its taxation base.

States’ increased reliance on property taxes is affecting local government taxation revenue

Beside local government rates, there are a number of other forms of taxation in Australia that are property-based and whose use by other spheres of government potentially diminishes the fiscal capacity of local government rates.

Property tax is a revenue source that state governments rely on increasingly to supplement other own-source revenue, despite rapidly growing GST revenue which is returned fully to the states by the Commonwealth.

In 2012-13, taxes on property comprised the main single source of total state taxation revenue, at 38 per cent. Over recent years, of all property taxation raised in Australia, around two-thirds is raised by the states.²⁸ This may help explain why total property taxes contribute some 3 percentage points more than the OECD average to total national taxation revenue in Australia (just under 9 per cent compared with an OECD average of 6 per cent).²⁹

²⁵ It is noted that in calculating the maximum hypothetical cost recovery that may be made by local government for public goods and services delivered by local government, the Productivity Commission (2008) did not take into account any reference to local government’s future liabilities, such as local community infrastructure renewals where adequate provision has not been made to cover these liabilities (see p.93). The Productivity Commission acknowledged that if future costs turn out to be higher than currently reported costs, the aggregate cost recovery ratios would be correspondingly lower (see p.xxix).

²⁶ Productivity Commission, 2008, op cit, p.xix.

²⁷ See further Productivity Commission, 2008, op cit, p.139.

²⁸ In 2012-13, they constituted 64 per cent of total property taxation – see ABS 5506.0.

²⁹ See the Treasury paper p.206 citing OECD 2005 data in an OECD 2007 report.

The increased reliance of the states on property taxes not only risks diminishing the capacity of ratepayers to pay local government rates, but suggests that there are serious issues that need to be considered in the Taxation White Paper about the role of the states and how best to address their vertical fiscal imbalance. ALGA is of the view that states' reliance on property-based taxes is undesirable and needs to be considered in the context of intergovernmental transfers to the states.

Regulatory constraints

The states exercise a range of legislative controls over the manner in which local governments may levy rates. These can include the valuation methods that may be applied, the ability of councils to charge different rates for different types of rate payer, the provision of exemptions and concessions, and restrictions on the annual percentage increase in rates revenue (known as 'rate pegging' or 'rate capping'). It is noted that some exemptions from rates and concessions are also imposed by the Commonwealth.

Local government considers that regulatory rules imposed upon it in relation to own source revenue raising have the potential to diminish revenue collection efforts and may also cause distortions and inequities as local government attempts to seek revenue from alternate sources in order to meet expenditures.

Rate pegging (or capping)

In Australia, councils in NSW have been affected by rate pegging since 1977. From 1 July 2008, shires in the NT were also subject to rate pegging and the recently elected Victorian Government has committed to introducing rate capping. ALGA submits that rate pegging undermines the principle of subsidiarity, and is both unnecessary and undesirable.

Rate pegging is unnecessary from an accountability perspective in that councils are directly elected by their local communities, and are therefore already highly accountable to them for the decisions they make that affect the community. Councils' own democratic, governance and managerial processes determine their revenue and expenditure decisions.³⁰ Accordingly, unless councils raise rates in a manner that fairly accords with the demands and expectations of their communities, and its overall capacity to pay, they risk voter backlash at local government elections, as do both State and Federal Governments.

Further, to the extent that rate pegging may have been motivated by fears that councils would otherwise exploit 'land booms,' it is instructive to note that during the land boom of 1996 to 2005, despite land values rising faster than disposable income, councils at a national level maintained their rating effort constant in relation to earned income.³¹

³⁰ Productivity Commission, 2008, op cit, p.61.

³¹ State of the Regions 2006-07, p.78. This was also observed by the Productivity Commission, 2008, op cit, at p.53 which stated 'In times of rapidly rising property values, councils often decrease the rate in the dollar, so as to reduce the revenue raised to match the revenue required to fund the budget.'

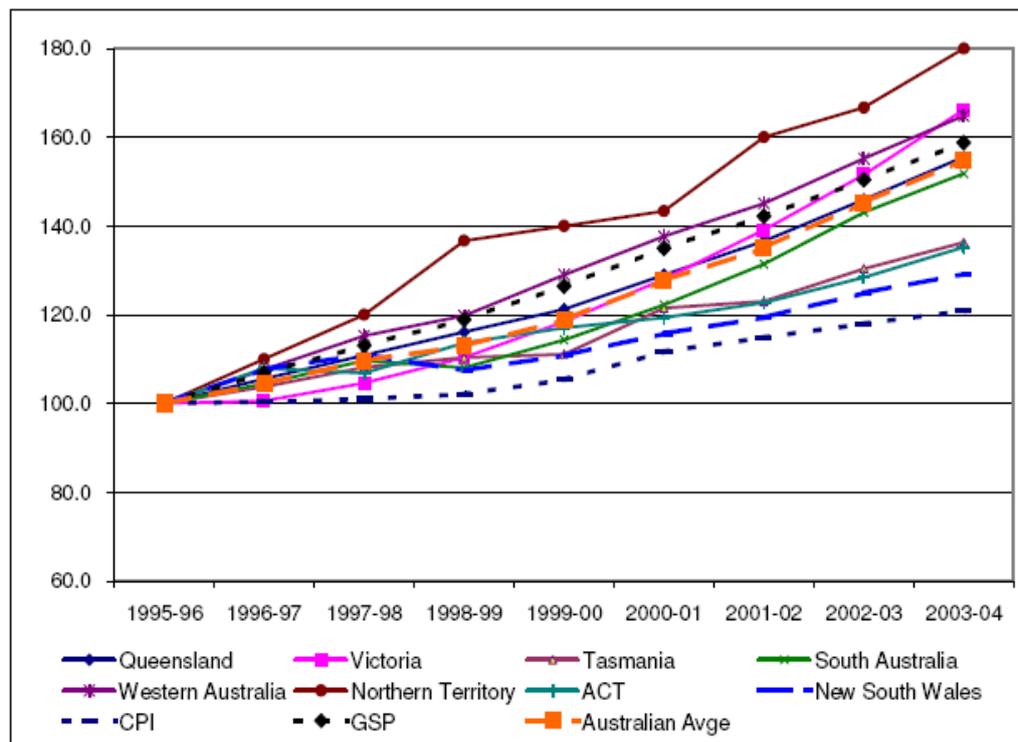
Rates pegging undesirably adds pressure to raise revenue from other sources. The Allan Inquiry³² commissioned by the Local Government and Shires Associations of NSW showed that between 1995-96 and 2003-04, rate revenues increased by significantly less in NSW than in all other states, and by less than half the increase in GDP, as noted in Table 1 below.

TABLE 1: Rate revenues between 1995-96 and 2003-04

STATE	Per cent increase
NSW	29.2
ACT	35.2
Tasmania	36.3
South Australia	55.1
Queensland	55.6
Western Australia	64.8
Victoria	66.1
GDP	61.8

The Productivity Commission confirmed that in NSW, rate pegging had a dampening effect on the revenue raised by councils (Finding 6.4), and that NSW councils have experienced the lowest growth in real own-source revenue per person of all jurisdictions in the period 1998-99 to 2005-06 (0.3 per cent a year, compared with the national average of 2.2 per cent).³³ This is consistent with the Allan Inquiry, as seen in Figure 1 below.

FIGURE 1: Growth in NSW council rates compared to those of other states 1995-96 to 2003-04



Source: Brooks, J. (2006).

of local

³³ Productivity Commission, 2008, op cit, p.115.

In addition to dampening revenue growth, rate pegging has other negative consequences. For example, the rate pegging limit provides an easy default option from both a political and managerial perspective. Possible reasons for this include:

- Rate pegging alleviates the need for councils to undertake community consultation to justify rate increases within the rate pegging limit;
- Increasing rates within the rate pegging limit avoids the need to enter into the complex process of applying for special rate variations;
- Councils can blame the State Government for their financial deficiencies; and
- Rate pegging reduces the need for long-term strategic and financial planning.

In relation to the latter point, ALGA considers that rate pegging may operate as an incentive to under-invest in less visible, less politically sensitive, responsibilities such as infrastructure maintenance and renewal, where a council is faced with ever increasing community expectations in other areas, and does not have the option to increase revenue to match these expectations. It is notable that of the \$14.5 billion estimated infrastructure renewals backlog identified in 2006 by PriceWaterhouseCoopers for the local government sector, which is often driven by the difference in growth rates between operating expenditure and operating income, the highest was found to be in NSW.³⁴

In addition, rates pegging creates pressure to increase non-rates revenue as an alternative source of revenue.³⁵

Finally, rate pegging might add considerable compliance and administrative costs to local government's taxation system.³⁶

Mandatory concessions and rebates relating to rates

The Commonwealth Treasury has previously noted that in 2005-06, around 17 per cent of households relied on government pensions and allowances for at least 90 per cent of their income (these were more likely to be comprised of people living alone or aged 65 years and above than households with higher private income). Local government accepts that these households may not be able to pay, or would struggle to be able to pay, a range of costs, including their local government rates.

Local government fully supports the principle that those who require genuine assistance in order to pay rates should be supported. However, it is inconsistent with the economic functions of government detailed earlier in this submission to impose the obligation on local

³⁴ PriceWaterhouseCoopers, *National Financial Sustainability Study of Local Government*, 2006, Sydney, p.113. The renewals backlog is discussed later in this submission under the heading 'Local government financial sustainability.'

³⁵ However, the Productivity Commission (2008) did conclude that in NSW, this option has largely been exhausted (see p.116 and Finding 6.4, p.117).

³⁶ This was an observation made to the Productivity Commission, 2008, op cit, p.112.

government (and local ratepayers) to support what is essentially an income assistance measure most appropriately funded from income tax revenue and income re-distribution.

As revealed in Commonwealth Intergenerational Reports, Australia faces numerous emerging macroeconomic challenges and opportunities into the 21st century. Principal among these is the ageing of Australia's population, which is occurring at an unprecedented rate and represents one of the most significant demographic changes in Australia's modern history. As a result, it can be expected that into the future, an increasing percentage of local community populations will become entitled to rate concessions which, if not adequately funded, will add to the financial pressures affecting local government. In this regard, ALGA is concerned by the recent decision of the Federal Government in the 2014-15 Budget to withdraw Commonwealth support for pensioner concession, including rate concessions and the potential flow on impact to local government.

Other restrictions on local government taxation

Other forms of regulation also have an impact on local government's ability to fully exploit its capacity to raise own-source taxation revenue.

In particular, exemptions of land from rating (such as for crown-owned land including state and national parks, indigenous land, mining leases, and religious organisations) are a key issue. For some councils, a relatively large percentage of land is non-rateable. As noted by Applied Economics,

Rates exemptions can limit the revenue that some councils can raise, notably those with low rates bases, such as some rural and many remote and Indigenous councils, or those that have large exemptions relative to their rates base.

They also have some efficiency and distributional implications. For example, exemptions might reduce the cost of producing various goods and services and so may distort economic activity by lowering the price and encouraging increased consumption of these goods and services.³⁷

As a general principle, agencies receiving similar services should pay similar taxes or user charges. This encourages the most efficient use of land. Economic efficiency and transparency principles further suggest that religious and charitable organisations should receive income subsidies rather than subsidised inputs.³⁸

The Productivity Commission concluded in its study that 'there is a paucity of data available to assess the net effect of rates exemptions plus the gains from Commonwealth and State provided tax benefits (that is, reciprocal tax arrangements).'³⁹ ⁴⁰ Nonetheless, it concluded that such exemptions have efficiency and distributional implications that may result in the burden of rates being higher than otherwise on rateable properties.

³⁷ Applied Economics, 2008, op cit, p.20.

³⁸ Applied Economics, 2008, op cit, p.21.

³⁹ Productivity Commission, 2008, op cit, p.108

⁴⁰ It is noted that there is at least one exception: in Tasmania, state government properties pay rates to councils.

A particular case in point is the unwillingness of some federally-leased airports to pay appropriate rate equivalent payments which have been determined on the same basis as property rates calculated on commercial property within the same municipal areas.

ALGA would further observe that where rate equivalent payments are made directly to the Australian or state governments by entities that receive local government rates exemptions, they are not always subsequently re-distributed to local government.⁴¹ This is likely to exacerbate efficiency and distributional effects and, as with concessions and rebates that are not fully reimbursed, place pressure on local government finances.

The issue of reciprocal tax arrangements between the three spheres of government was considered by the Hawker Committee⁴² and subsequently in intergovernmental forums. Governments agreed in general not to pursue this issue and ALGA does not propose that the Review revisit this complex area.

Summary: Restrictions on Local Government Taxation

Local government notes the Australian Government's commitment to reducing unnecessary red tape and promoting more uniform or at least more consistent legislation across the states in areas such as consumer product safety and consumer credit, licensing of trades, and personal property securities. In a similar vein, ALGA submits that state laws and/or regulations that directly affect the ability of the sector to levy appropriately adjusted rates revenue, should be reviewed.

As a minimum, ALGA supports the Productivity Commission's suggestion that periodic reviews of state laws and regulations that affect local governments' ability to raise own source revenue should be conducted as a matter of course.⁴³ ALGA notes that reform efforts could be encouraged by the Commonwealth within the context of its fiscal relations reform.

Local government non-taxation own-source revenue

Whilst rates are the only form of taxation that can be raised by local government, local government also raises other forms of own-source revenue. Municipal rates (that is, taxation, which accounted for around 38 per cent of revenue in 2013-14) and charges for goods and services (28 per cent of 2013-14 revenue). Other non-taxation own-source revenue includes interest earned on deposits, fines and other penalties, and in some states developer contributions and charges.

Non-taxation own-source revenue such as fees and charges are important for local governments. Together with own-source taxation revenue, local government has been raising more than 80 per cent of its total revenue (aggregated at the national level) in the period since 1998-99.⁴⁴ This is very high by international standards.⁴⁵

⁴¹ This was also noted by the Productivity Commission, 2008, op cit, p.202.

⁴² Op cit at footnote 17.

⁴³ Productivity Commission, 2008, op cit, Finding 6.8.

⁴⁴ Productivity Commission, 2008, op cit, p.xxi and Table 2.6, p.29.

⁴⁵ Applied Economics, 2008, op cit, p.13.

Further, as previously noted, the Productivity Commission found that local councils are, on average, raising almost 90 per cent of their hypothetical benchmarks in own-source revenue, and that for 50 per cent of councils, own source revenue constitutes at least 72 per cent of their total revenue.

Current grants and subsidies from other levels of governments to local government were around 11 percent.⁴⁶ These grants, including the Financial Assistance Grants (FAGs) are extremely important to local government particularly in, high growth areas and rural and remote areas. The decision in the 2014 Federal Budget to freeze Fags without any indexation for three years most significantly affects these high growth and rural and remote councils for whom the FAGs represents a large proportion of revenue.

Summary: Non Tax Revenue

Local government raises a very high level of own-source revenue, including own-source taxation, notwithstanding various limitations that act as constraints upon its ability to raise the fullest amount of its hypothetical own-source revenue benchmark. Many, but not all of these limitations, are imposed upon local government by state governments and merit review. Intergovernmental transfers to local government are extremely important.

Local government financial sustainability

The financial sustainability of the local government sector is a major challenge that will impact on the future economic and social wellbeing of many local and regional communities. ALGA agrees with the Productivity Commission that the ability of a council to cost recover is not the same as being financially sustainable.⁴⁷

In the past decade there have been several in-depth studies of local government finances, such as the Hawker Committee (2003), the Financial Sustainability Review Board (FSRB, South Australia, 2005), the Allan Inquiry (NSW 2006) and Access Economics (SA, NSW, Tasmania, Western Australia). In addition, ALGA commissioned PriceWaterhouseCoopers (PwC) in 2006 to provide independent analysis into the extent of the local community infrastructure backlog in 2006, titled National financial sustainability study of local government.

These studies have focused on two related issues: (i) the sustainability of local government in the face of increasing demands for locally provided services and limited income sources and (ii) infrastructure backlogs. In aggregate, they found that a significant number of councils, typically between 10 and 30 per cent, are financially vulnerable or, in extreme cases, not sustainable and that many councils have substantial infrastructure renewal backlogs.

For example, PwC concluded that:

- 36 per cent of councils have an interest coverage ratio (Earnings Before Income Tax after depreciation allowances divided by interest payments) of less than 3;

⁴⁶ See Productivity Commission, 2008, op cit, p.xxii, Figure 2, for breakdown in percentage terms.

⁴⁷ Productivity Commission, 2008, op cit, p.93.

- the estimated infrastructure backlog across Australia was \$14.5 billion (in the mid-case) on a non-financial asset base of \$200 billion (note: while the Regional and Local Community Infrastructure Program which provided around \$1 billion will have helped to address the backlog, that asset base is now estimated at \$354 billion and if the backlog has remained stable as a proportion of the asset base it could be closer to \$25 billion); and
- there was an estimated annual funding gap to cover the backlog and underspending, of \$2 billion per annum, although it is likely that the value of this gap has probably increased in proportion to the increase in local government's asset base and the annual gap could now be in the order of \$3.5 billion.

One of the most significant concerns of local government is the size of its asset management task. Councils have far more assets (in value relative to income) than any other sphere of government in Australia. ABS data show, for example, that in 2012-13 depreciation made up around 20 per cent of local government expenses, which is significantly higher than for the state government sphere (less than 6 per cent) and the Australian Government (less than 2 per cent).⁴⁸ Councils are responsible for an estimated \$354 billion of non-financial assets. ALGA notes that this estimate indicates the written-down value of council assets, and that the replacement costs are likely to be far higher.

In working toward more sustainable funding for the sector, local government is fully committed to the 'twin track' approach recommended by PwC. The first part of this approach is that individual councils pursue internal reforms to improve efficiency and effectiveness, through for example, improved internal asset and financial management, and business practices; the second is to pursue changes to intergovernmental funding.

However, as the Productivity Commission study found, some council areas have too low an income base to generate adequate services by current national standards and no matter how great their internal reform and own-source revenue raising efforts, are simply not able to be financially independent. In particular, the Productivity Commission found that 20 per cent of local councils relied on Commonwealth and state grants for half or more of their revenue. More tellingly, finding 5.5 of the Productivity Commission report found that even with additional own-source revenue raising efforts:

A significant number of councils, particularly in rural (87 per cent) and remote (95 per cent) *would remain dependent on grants from other spheres* of government to meet their current expenditure. *Some councils would remain highly dependent on grants.*⁴⁹ (ALGA emphasis)

Other sources of funding to local government including intergovernmental transfers

Historically in Australia, both the state and local government sectors have needed to be supported by distribution mechanisms that provide a national equalisation of public services. ALGA considers that it is economically most efficient for the national government to

⁴⁸ See PwC report, 2006, op cit, in reference to ABS Government Finance Statistics 2004-05.

⁴⁹ Productivity Commission, 2008, op cit, Finding 5.5 and p.xxxviii.

continue to collect relatively more revenue than the other spheres, given administrative efficiencies, incentive effects and the nature of our constitution.

Grants from other spheres of government are an important component of total local government revenue. Whilst it is difficult to gauge the precise level of grants, particularly from the state sphere, local government derives around 11 per cent of its total revenue from intergovernmental grants.⁵⁰

The majority of state 'grants' represent reimbursements for concessions mandated by them on the sector or contract payments for maintenance of state government-owned roads.⁵¹ In comparison, the majority of Commonwealth funding to local government is for general purposes. There are also Specific Purpose Payments made to local government by the Commonwealth in areas such as childcare and disabilities services. Specific Purpose Payments also include roads, with the major component being the Roads to Recovery program.⁵²

ALGA acknowledges that the Commonwealth has long understood the need to distribute its taxation revenue to the local government sector, in order to support local councils' key functions (building and strengthening local communities). Since 1974-75, the Australian Government has provided untied financial assistance grants (FAGs) to local government. (FAGs were also provided to the states until the introduction of the GST saw their abolition. Accordingly the states now have access to a growth tax which reflects the real economy).

Between 1976 and 1985, the FAGs were set as a proportion of net personal income tax collections. From 1986 to 1995, they generally increased at a rate equal to the increase in general purpose payments to the states. Since 1995, the rate of increase has generally been equal to growth in population and the consumer price index (CPI), with the exception of 1997-98 when they were escalated only for the CPI and the 3 year period commencing 2014-15 for which the indexation of the grants has been scrapped, with the value of the FAGs frozen for 3 years. The result of this decision will be to permanently reduce the base amount of the FAGs by an estimated 13%, with significant implications for all councils, but particularly rural and regional councils which are more grant dependent.

Commonwealth general purpose grants represented around 6 per cent of total local government revenue in 2006-07.

The Australian Government provides FAGs under the *Local Government (Financial Assistance) Act 1995* (the Act) and they have two components: general purpose grants (\$1.6

⁵⁰ See Productivity Commission, 2008, op cit, p.xxii, Figure 2, for breakdown in percentage terms. ALGA would note it has significant concerns with data regarding grants, and from state governments in particular. This is due to a range of factors including that some states do not identify grant funding separately in state budget documentation, the lack of uniformity in how or whether all local councils report grants received, and definitional differences in ABS data. Some of these issues were expanded upon in ALGA's 2008 submission to Senate Select Committee on State Government Financial Management, which recommended that 'the Australian Government impose more stringent requirements on state governments having regard to the identification of Commonwealth funds flowing through states to local government'. See further, Senate Select Committee on State Government Financial Management report, September 2008, Recommendation 11.

⁵¹ There is some evidence that grants from the states to the local government sector are falling.

⁵² This funding has greatly assisted local government in being able to provide for much needed renewals and upgrades of Australia's local roads.

billion in 2014-15), which are divided among the states on a population basis; and identified but untied roads grants (\$0.7 billion in 2014-15), which for historical reasons are allocated to the states on the basis of fixed shares. It is then for the states to distribute the funds to local councils in accordance with recommendations made by local grants commissions, which each have their own methodology but must adhere to the seven national principles for distribution as set out in the Act. These are replicated in the Box on the following page.

Clearly, general purpose grants are supposed to supplement the ability of local government to support functions. However, FAGs have been reducing over time as a proportion of overall Commonwealth taxation revenue. In 1996-97, FAGs represented just over 1 per cent of Commonwealth taxation revenue. In 2013-14 this was less than 0.7 per cent and the figure will have fallen to well below 0.6 per cent by 2017-18.

ALGA notes that the current level of FAGs is insufficient to achieve horizontal fiscal equalization, a point also observed by the Productivity Commission.⁵³ Grants Commissions have reported that general purpose funding at current/recent levels is not achieving horizontal fiscal equity. The State of the Regions 2006-07 report concluded that:

‘...the quantum of grant availability only compensates approximately 30 per cent of the amount required to equalize resources available to councils because of inequalities in revenue available for standard effort.’⁵⁴

The Productivity Commission concluded in its 2008 report that ‘there is a case to review the provision of Australian Government general purpose grants to local government’ (finding 5.6). This confirms ALGA’s long-held view that FAGs must be reconsidered, and gives its examination in the context of the current taxation review added weight.

In the past, ALGA has identified that its preferred option to overcome the insufficiency of Financial Assistance Grants in achieving horizontal fiscal equalization is to establish commonwealth grants as a fixed minimum percentage of total Commonwealth taxation revenue. This would return local government to a ‘fixed share’ mechanism such as it had in the late 1970s and early 1980s, thereby creating more certainty for councils and the communities that depend upon them for the delivery of critical services and infrastructure.

The overall financial sustainability challenge for local government is illustrated by the difference between the current level of tax revenue councils collected through rates, \$14.7 billion⁵⁵, the intergovernmental transfers currently provided by the Commonwealth in terms of grants – in the order of \$3 billion, the transfers from the states – estimated to be in the order of \$1.2 billion (the difference between local government grant revenue in 2013-14 of \$3.767 billion and FAGs and R2R revenue of \$2.55 billion) and the likely size of the annual infrastructure gap which is being borne by local government, which could well be in the order of \$3.5 billion.

⁵³ Productivity Commission, 2008, op cit, p.23.

⁵⁴ State of the Regions 2006-07, op cit, p.82.

⁵⁵ ABS Cat 5512. 2013-14

If taxation was to align with spending requirements and intergovernmental transfers were to be eliminated local government's rates revenue would need to increase to an annual figure in the order of \$22.5 billion – an increase of \$8 billion. However, there are constraints on the rates base - the Productivity Commission's conclusion was that local government is already raising 90% of its theoretical rates capacity (suggesting a capacity in the order of about \$16.3 billion) – and so there is a clear case for a substantial increase in the annual level of the Financial Assistance Grants. The gap is potentially in the order of \$2 billion meaning an increase in FAGs from \$2.3b to around \$4.3 billion. If the grants were returned to a 1 per cent proportion of Federal taxation revenue they would have been around \$3.5 billion in 2014-15 rising to \$4.2 billion in 2017-18^{56 57}.

Box 1 National principles for allocation of financial assistance grants

The State grants commissions are required to observe the National Principles relating to grants allocation under the *Local Government (Financial Assistance) Act 1995* (Cwlth):

- *Horizontal equalisation* — this principle requires that each local governing body in a jurisdiction is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in that State. Further, it takes account of differences in the expenditure requirement and revenue-raising capacity of local governing bodies.
- *Effort neutrality* — the revenue and expenditure policies of individual local governing bodies shall not, as far as practicable, affect grant determination through the assessment of revenue-raising capacity and expenditure requirements.
- *Minimum grant* — the minimum general purpose grant allocation for a local governing body is to be no less than 30 per cent of its per person share of the total amount of general purpose grants available for allocation among local governing bodies in the States or Territory.
- *Other grant support* — this principle requires recognition of other relevant grant support to local governing bodies to meet any expenditure needs.
- *Aboriginal peoples and Torres Strait Islanders* — financial assistance shall be allocated to councils in a way which recognises the needs of Aboriginal peoples and Torres Strait Islanders within their boundaries.
- *Council amalgamation* — where two or more local governing bodies are amalgamated into a single body, the general purpose grant provided to the new body for each of the four years following amalgamation should be the total of the amounts that would have been provided to the former bodies in each of those years if they had remained separate entities.
- *Identified road component* — the identified road component of the financial assistance grant should be allocated on the basis of the relative needs of local governing bodies for road expenditure. Relative needs should be determined based on length, type, and usage of roads in each local governing area.

Source: DOTARS (2007); CGC (2001).

⁵⁶ Local Government National Report 2012-13. p.5

⁵⁷ 2015-16 Budget Paper No 1. p 4-6

Summary: Local Government Financial Sustainability

Local governments now have greater autonomy than ever to exercise general powers within their competence. Consistent with the expectations and preferences of their local and regional communities, and reflecting past cost and responsibility shifting, their roles now extend across governance, advocacy, service delivery, planning, community development and regulatory functions.

As the Hawker Committee noted in 2003, 'each council provides local solutions to local issues'. As detailed above, the sector is confronted with many funding challenges. Yet, it is already raising most of its maximum possible own-source revenue. Appropriate intergovernmental funding is crucial to the ongoing viability of the sector as a whole, and to numerous individual councils in particular, if the sector is to continue building and strengthening local communities throughout the 21st century.

It is ALGA's view that the current Financial Assistance Grants system is outdated and narrow, and is failing to achieve the horizontal fiscal equalization objective due to the inadequacy of the total funding and its indexation mechanism. ALGA believes the Financial Assistance Grants system therefore requires significant reform if local government is to be placed on a more sustainable financial footing in the interests of the people it serves.

CONCLUSION

Local government is a dynamic and integral feature of Australia's federal governance framework. Its existence pre-dates the coming together of our nation at Federation, and it has played a key role in building, shaping and strengthening Australia's local and regional communities.

There is no singular definition of the role of local government in Australia. What is beyond contention is that local government sits at the heart of Australia's local and regional communities, representing their interests and reflecting their needs, seeking to meet their expectations and accommodate their preferences, consistent with its role as the third sphere of government. To the extent that local government ever lent itself to definition, there is no doubt that its role has become more expansionary and extensive, with an increased and growing focus on human services whilst retaining a role in the delivery of 'property-based services'.

Local government accepts the principle that it must assess its financial competence (that is, be adequately resourced) before taking on new or expanded functions. Sometimes, local government has entered into the delivery of new or expanded services in response to community needs, and in a fully informed financial position to do so. However, at other times, the delivery by local government of new or expanded services has been less voluntary. Cost shifting to the local government sector has occurred as a result of other spheres of government withdrawing the services they once provided to communities or the financial support that once underpinned those services, or as a result of increasing service levels and standards.

In this broad operating environment, local government has used its best efforts to appropriately exploit its only source of taxation revenue – property taxes based on rates. Many studies, including that of the Productivity Commission (2008) have concluded that rates satisfy the criteria of a well-designed tax. Local government relies on rates as its main single source of income. Importantly, it has been found not to have exploited land value increases in Australia, despite some public perceptions otherwise.

Local government realises that all taxes are ultimately paid from taxpayers' income. The income of a local government area is the most reliable measure of the ability of taxpayers to pay their rates. The ability to pay is the most significant limitation on local government's total taxation revenue.

There are a number of constraints that adversely affect local government's capacity to raise taxation revenue. These include unfunded concessions and rebates imposed upon the sector by other spheres of government, rates-exempt land and rates pegging. These constraints raise fundamental issues for other taxpayers, such as equity and fairness, and call into question the roles and responsibilities of each sphere of government in Australia.

Despite the existence of constraints on its single taxation revenue source, local government has clearly sought to raise alternative forms of revenue, in order to fund the delivery of local services and the provision and maintenance of local community infrastructure. User fees and charges have been the main source of local government non-taxation revenue in recent years. The use of such fees and charges, and also of developer contributions, has been found to be a legitimate revenue source consistent with the benefit principle. Local government has consistently raised around four-fifths of its own revenue since at least 1998-99. The Productivity Commission noted that local government own-source revenue accounted for 83 per cent of local government's total revenue and that on average, local councils are raising almost 90 per cent of their total theoretical maximum own-source revenue.

Given the high degree of vertical fiscal imbalance that characterises our federal system, local government considers that the most effective tax system Australia can have into the future must not only raise revenue in a manner that is fair and efficient, but also provide for fair and transparent revenue sharing arrangements. Local government acknowledges the importance of specific purpose payments and general purpose grants. At the same time, local government observes that there has been a decline in the share of general purpose funding from the Commonwealth to the local government sector as a proportion of Commonwealth taxation revenue.

ALGA believes that the current system, under which centrally collected tax revenue is shared, merits serious and urgent review if local government is to continue to meet the economic and social needs of local and regional communities.

Recommendations

The financial sustainability of local government should be ensured through a combination of measures to sustain the rates base, a stronger focus on eliminating cost shifting and increased intergovernmental transfers.

The integrity of the local government rates base should be secured through:

- An end to rate capping/pegging imposed by some state and territory governments.
- Ensuring that local government is fully compensated for rate concessions provided to pensioners
- Limiting rate exemptions to legitimate charitable operations and ensuring commercial entities and non-charitable not for profit organisations are not exempted
- Ensuring that commercial operations undertaken on commonwealth or state government make appropriate rate equivalent payments.

Cost Shifting from the other levels of government onto local government needs to be addressed with a revised, strengthened Intergovernmental Agreement

The level of intergovernmental transfer, particularly through the Financial Assistance Grants, needs to be increased substantially to assist councils to bridge their infrastructure gap, given local government's limited opportunities to raise the necessary revenue through an already well-utilised property rates base.