

ALGA SUBMISSION TO AFTS CONSULTATION PAPER

The Australian Local Government Association (ALGA) welcomes the opportunity to make a further submission to the Australia's Future Taxation System Review Panel (Tax Review Panel) following the release of its consultation paper in December 2008.

This submission to the Australia's Future Taxation System Review follows ALGA's first submission, dated 17 October 2008, which responded to Treasury's paper titled *Architecture of Australia's Tax and Transfer System* (the Architecture paper). In that submission, ALGA described the role of local government in the context of Australia's taxation system. ALGA noted that local government has only one head of taxation power (rates based on property), and also noted that local government raises around 90 per cent of its total revenue, with the main sources of revenue being rates, and user fees and charges.

The submission also detailed the important and expanding role of local government in the modern Australian economy and discussed some of the future funding challenges for local government as it strives to continue to meet the increasingly diverse needs of local and regional communities.

ALGA commends the Tax Review Panel on the consultation paper, and the way in which it highlights the interplay between public policy and the Australian taxation system. ALGA agrees on the importance of ensuring that Australia's tax-transfer system is capable of responding to the multitude of demographic, environmental, social and economic challenges Australia currently confronts or may confront in coming decades, and appreciates the competing tensions that attach to the design and implementation of such a tax-transfer system.

ALGA notes that the consultation paper includes numerous references to local government and to submissions received from local government on the Architecture paper. The consultation paper also includes a number of issues of direct relevance to the local government sector. These issues include: the appropriate allocation of revenue raising powers to the levels of government; the potential future role of user fees and charges in the overall design of Australia's tax system; improvements that might be made to the pricing and funding of Australia's roads; and environmental sustainability.

ALGA notes that the Tax Review Panel will continue to draw upon submissions already received in response to the Architecture paper in shaping its recommendations to the Australian Government at the end of 2009. Accordingly, the purpose of this submission is to respond to new issues identified in the consultation paper and to reiterate local government's position on certain aspects of the tax-transfer system.

Tax Review Panel interpretation of its Terms of Reference

In its previous submission to the Tax Review Panel, ALGA strongly put the case that to be comprehensive, the Tax Review Panel's review of the tax system should not be limited to an examination of revenue raising mechanisms and personal tax transfers but should also extend to current revenue sharing arrangements amongst the three levels of government. ALGA believes this is an important aspect of any review of the taxation system designed to achieve a better functioning, co-operative federal system.

ALGA is pleased that the Tax Review Panel sees the need to improve federal fiscal relations and the federal structure of the tax-transfer system as a key issue for the review (p.28). However, ALGA is disappointed with the Tax Review Panel's conclusion that 'matters relating to the roles of different levels of government, the quantum of intergovernmental transfers and horizontal equalisation' are outside its Terms of Reference. This conclusion appears to be inconsistent with much of the rest of the consultation paper.

For example, in the consultation paper, submissions are sought on whether changes should be made to the assignment of revenue raising powers and intergovernmental transfers in Australia given the overall structure of Australia's federal financial arrangements (see Question 9.1).

Whilst the Tax Review Panel's conclusion may be based on a view that tax is a revenue instrument, and not a policy tool, many of the questions raised by the Tax Review Panel in the consultation paper implicitly require policy direction. For example, questions about retirement income levels, the purpose of taxing tobacco (Question 11.3) and the way taxation on income levels affects workforce participation rates inherently assume a desired policy outcome.

ALGA notes the speech given by the Chair of the Tax Review Panel, Dr Henry, to the 2009 Commissioners' Conference (March 2009), in which he identifies the distribution of revenue between the levels of government as one of the three dimensions being examined by the Tax Review Panel. ALGA agrees that this is a necessary aspect of the tax review. ALGA would further agree with Dr Henry that where part or all of the revenue raised by one level may be given to another level of government, 'there is the question of how this revenue is distributed among governments at the same level and with what conditions'.

In his speech, Dr Henry states that horizontal fiscal equalisation issues are not being examined by the Tax Review Panel because of the methodology review currently being undertaken by the Commonwealth Grants Commission. ALGA notes that the terms of reference for this review concern the distribution of the combined pool of Goods and Services Tax (GST) revenue and Health Care Grants among the states and territories. There is no obvious term of reference incorporating local government.

ALGA considers that the tax review remains an excellent opportunity to consider the quantum of Financial Assistance Grants (FAGs) to local government and therefore the capacity of local government to deliver infrastructure and services at the local level.

Accountability of local government in the overall funding structure of the tax-transfer system

ALGA welcomes the discussion contained in Chapter 9 of the consultation paper regarding the different ways that the expenditure responsibilities of governments at each level can be funded in a federal system, and the significance of Vertical Fiscal Imbalance in Australia's current system.

Obviously, the allocation of revenue raising responsibilities and intergovernmental funding can have implications for the overall taxation system in terms of complexity (or simplicity), inefficiency (or efficiency), crowding out of tax opportunity (or potential substitution by greater quantum of grants), policy administration and accountability.

The discussion in Chapter 9 of 'untied grants' includes the statement that '...sub-national governments that receive untied grants may have diminished accountability to the public' (page 188). Local government receives untied funding from the Australian Government in the form of FAGs. As outlined in ALGA's previous submission, FAGs represent around 7 per cent of local government's total income per annum (or just under \$1.9 billion in 2008-09), and are the largest single component to the sector of externally sourced revenue. Although technically delivered as a form of Specific Purpose Payment, they are distributed for general purposes and are in that sense untied.

The aim of local government FAGs is to help to achieve some form of equalisation of fiscal capacity of local councils, so that community members can access a similar range of services at a similar standard, irrespective of where they live (Grants Commissions have noted however that the quantum of FAGs is insufficient to achieve horizontal fiscal equalisation). Local government does not believe that the receipt of untied grants makes it any less accountable for the proper use and expenditure of those funds than if the grants were tied, or the revenue were own-source income.

Local government is a democratically elected level of government, and is accountable through numerous legal and financial reporting obligations stipulated under state legislation. Local government endorses the principle of accountability as a key element in the delivery of services and infrastructure to local communities.

For example, at the Constitutional Summit – a Special General Assembly of Local Government convened by ALGA in December 2008, local council delegates in endorsing the need for constitutional reform to recognise local government, resolved that:

“To ensure the quality of planning and delivery of services and infrastructure provided to all Australians, and the ongoing sustainability of local government, any constitutional amendment put to the people in a referendum by the Australian Parliament (which could include the insertion of a preamble, an amendment to the current provisions or the insertion of a new Chapter) should reflect the following principles:

The Australian people should be represented in the community by democratically elected and *accountable local government* representatives;

The power of the Commonwealth to provide direct funding to local government should be explicitly recognised; and

If a new preamble is proposed, it should ensure that local government is recognised as one of the components making up the modern Australian Federation.”

ALGA understands the view that in principle, sub-national governments receiving untied grants may not be as accountable as they would be if they received tied grants, or if the revenue was raised directly by the sub-national government. However, in practice, local government has an extensive range of legal, financial and accounting obligations, as well as community obligations, to ensure the use and application of untied grants is appropriate, transparent and accountable.

Local government taxation should remain with local government

For the purposes of clarity, local government has only one source of taxation. It does not raise ‘taxes’ but one single tax. This is in the form of taxation based on property.

Local government taxation based on property meets the standard policy criteria for well-designed taxation – fairness, efficiency, simplicity, sustainability/adequacy. In addition, local government is ideally placed to determine rates on the basis of localised information, and to administer and collect the tax efficiently. Noting the Tax Review Panel’s concern that the sustainability of certain tax bases may be questioned as Australians live and work internationally more often, local government rates have the clear advantage of being sustainable because their base (property) is immobile.

ALGA notes that the Tax Review Panel has commissioned work to further examine the efficiency of Australia’s ‘main taxes’ (page 192) which appears to include local government taxation (Appendix D). ALGA believes that local government rates are among the most efficient taxation in Australia, and do not affect housing affordability. ALGA notes that Chart 9.3 of the consultation paper shows ‘municipal rates’ to be one of the least inefficient taxes, drawing on data from the Property Council of Australia.

In relation to the question about the allocation of revenue raising functions to the three levels of government, it is the strong view of ALGA that it remains appropriate for local government to continue to raise rates based on property. These rates, determined at the local level and against a background of local ratepayers’ capacity to pay, help support the delivery of services and infrastructure to local and regional communities. Local government taxation based on property is necessary for local government to be able to continue delivering local services provided by the local government sector. However, the quantum of funding raised through rates by the local government sector overall is not sufficient to meet the cost of delivering those services.

At a local level, particularly in rural areas, the rates base is very limited and councils are dependant on other sources of revenue. Against this context, it is clear that efforts to impose an income redistribution function on local government through rates is not sustainable.

ALGA welcomes the discussion on 'redistribution in the federation' in the consultation paper, and comments in submissions to the effect that the Australian Government is in the best position to co-ordinate redistribution, consistent with many federal systems.

Musgrave's theory as described in the consultation paper, that in a federal system lower level jurisdictions should avoid using taxes for the purposes of income redistribution and macroeconomic stabilisation, is consistent with ALGA's previous submission in which it was noted that local government is being asked to absorb certain social welfare costs through rates (like concessions and subsidies) although the rating system is not designed for this purpose.

The Tax Review Panel has noted the significance in the context of the review, of population ageing in Australia. As the population ages, the number of people entitled to rate concessions and subsidies can be expected to increase unless there is policy change or taxation reform.

The Tax Review Panel appears to agree with ALGA's earlier submission that local government taxation should not be directed at income redistribution and/or social welfare support. ALGA notes that the Tax Review Panel can see two options for removing this type of discrepancy from our current tax-transfer system – providing uniformity for concessions and subsidies across the states, or providing more transfers or vouchers to recipients directly from the Commonwealth.

ALGA notes however, that any system that relied upon uniformity of concessions offered by states would not be sufficient to overcome a central issue raised in ALGA's earlier submission that some state governments do not fully reimburse local government for the costs of such concessions.

Given the Australian Government raises most of Australia's taxation revenue, ALGA considers that it is more efficient and effective for the Australian Government to increase the level of income support it provides directly to recipients of social welfare benefits. This would have a number of advantages: it would end the use of the rating system as a social welfare mechanism; it would better assist recipients to determine their own consumption possibilities (range and level); and it would provide greater transparency at the national level on the quantum of income support being provided.

The role and significance of user fees and charges

ALGA welcomes the Tax Review Panel's identification of the role that alternative arrangements to taxation, such as user fees and charges, can play and their potential to improve efficiency through the pricing of public resources.

In its earlier submission, ALGA noted that it receives close to 70 per cent of its own-source revenue income from a combination of rates (38 per cent in 2005-06) and user fees and charges (around 30 per cent per annum since 1999-2000).

Consistent with the beneficiary principle, local government applies user charges across a wide range of areas such as waste services, car parks, dog registration and use of recreational and sporting facilities.

Local government has demonstrated a strong but appropriate reliance on user fees and charges.

The National Inquiry into Local Government Finance in 1985 (the Self Report) estimated local government rate revenue in 1980-81 to be \$1,498.4 million, with revenue from fees and charges to be \$156.3 million, out of total revenue of \$3,107.4 million. That is, rate revenue accounted for 48.2% of total revenue and revenue from fees and charges accounted for just over 5%. The combined revenue from the two sources was about \$1,655 million or just over 53% of total local government revenue. In 2006-07, the figure had risen to 68%.

In 2006-07, revenue from user fees and charges (sale of goods and services) accounted for an estimated 30% of local government revenue.

As ALGA noted in its February 2008 response to the Productivity Commission (the Commission) *Draft Report - Assessing Local Government Revenue Raising Capacity*, and in its first submission to the Architecture paper, the trend in local government own-source revenue raising has clearly been towards cost recovery as the provision of goods and services has increasingly relied on cost recovery where appropriate instead of funding by general rate revenue.

The services that governments provide to the community need to be considered as a whole, as do the taxes and charges for government services paid by communities. Local government would therefore note that user fees and charges should be able to be varied to recover costs. This is also consistent with Finding 6.8 of the Productivity Commission in its *Assessing Local Government Revenue Raising Capacity* report (April 2008) that 'there is a case for periodic reviews of the restrictions and regulations imposed on local government by other spheres of government to assess both their rationales and their benefits and costs' (p.128).

At present, statutory fee setting and other constraints imposed by state governments for mandatory council services limit the ability of councils to raise revenue from the sale of some specific goods and services. In many cases, the statutory fee is set at a level well below cost recovery basis. This inflexibility is not generally offset by flexible fee setting arrangements for other goods and services, and so real issues about horizontal equity (who really pays?) come into play.

It is ALGA's view that the application of user charges can bring social, environmental and economic benefits in the funding of government services and infrastructure. Greater use of user fees and charging by other levels of government may overcome some of the concerns about taxes criticised as distortionary, inefficient and ineffective (such as transaction taxes) in submissions on the Architecture paper.

Fuel, roads and transport

ALGA notes the view of the Tax Review Panel that opportunities may exist for direct charging of road use.

By way of background, local government owns and manages around 80 per cent of Australia's total road network, totalling around 650,000 kilometres. The cost of maintaining these roads is the single largest item of expenditure for most councils. Despite welcome funding contributions from the Federal Government the costs are largely borne by councils from property taxes.

ALGA continues to participate with the Commonwealth and the States in the development of COAG road transport reforms including incremental road pricing and other measures arising from the Australian Transport Council initiatives in the development of an economic framework for an efficient transportation marketplace.

ALGA therefore welcomes the Tax Review Panel's willingness to consider road pricing issues in conjunction with the broader taxation issues and notes the Tax Review Panel has commissioned further work on roads and transport more generally.

In its previous submission, ALGA stated that the application of user charges to the use of local roads by heavy vehicles, as part of a national road pricing model, is appropriate from an economic perspective. ALGA acknowledges that any move toward road user charging is complex and will likely prove to be technologically challenging and expensive if the entire road system is to be covered from inception. Whatever arrangements may be developed, even if they are part of a progressive rollout of road user charging to cover the full road system, ALGA asks that:

1. the arrangements do not provide incentives to roads users to avoid directly charged roads in favour of local roads funded from property taxes; and
2. a mechanism is established to fund the upgrading of local roads to meet the requirements of freight efficient vehicles being encouraged under the COAG road transport reforms.

The need for policy consistency within and beyond the tax-transfer system

ALGA recognises the importance of having a tax-transfer system that complements and supports broader non-tax government policies and objectives at the Commonwealth level of government, and that future policy proposals should be assessed for consistency against this system to avoid a repeat of the ad hoc outcomes discussed in the consultation paper being repeated.

All levels of government should strive for consistency against the national tax-transfer system. To ensure the integrity of the tax-transfer system, it is crucial that all levels of government agree to examine their own policies (tax and non-tax) against the overall objectives of the national tax-transfer system. Unilateral actions that are inconsistent with the tax-transfer system at the national level will undermine it and threaten its integrity, with possible implications downstream to local government and their communities.

For example, an increasingly important role that local government has undertaken in recent years is to help communities adapt to the climate change we cannot avoid.

Options have ranged from structural reforms (amending coastal planning and development rules) to institutional reforms (the capture and flare of landfill waste, with the benefit of producing an alternative energy source and reducing carbon emissions) to incentives for different, more environmentally-conscious, behaviour (like encouraging the use of better energy efficient appliances). Local government believes that the design of Australia's tax-transfer system should support environmentally sustainable outcomes and management.

Another critical area of importance to local government is encouraging local populations to be more active and more healthy, through a combination of delivering local community infrastructure (cycle paths, safe walking areas), education and awareness (such as nutrition information and healthy food messages in child care centres), and training/fitness programs. If the public health budget is to be managed sustainably, the tax system should accommodate and be consistent with these objectives.

ALGA notes the consultation paper cites some of the growing costs that will be associated with the ageing population; it is important to provide for the needs of such Australians in a sustainable way that also enables non-ageing Australians to receive good health care and services.

Conclusion

As it stands, the consultation paper has raised important issues for Australia's tax-transfer system from the perspective of local government.

The appropriate allocation of revenue raising responsibilities in our federation between the levels of government is an important question but cannot be considered in isolation from a review of how revenue is shared in the federation. ALGA reiterates its request that the Tax Review Panel re-consider its view and recognise that questions of how taxation revenue is allocated between the levels of government, including local government, are germane to its Terms of Reference.

ALGA considers that issues such as the potential for road user charging may fundamentally reshape the way our federation works and demonstrate real evolution of the tax-transfer system in Australia.

ALGA notes the Tax Review Panel has commissioned a number of papers on issues requiring further expert analysis, such as road user charging, and believes they will make an important contribution to the tax and transfer policy issues under review. ALGA would urge the Tax Review Panel to consider releasing such analysis when it is available, to help further shape the direction of Australia's future tax system.

Finally, ALGA acknowledges the level of interaction it has had with the Tax Review Panel and is satisfied that the Tax Review Panel is aware of the important place of local government in Australia's tax system. ALGA appreciates the invitation to participate at the Tax Review Conference to be hosted by the Tax Review Panel in June 2009, when some of the work commissioned by the Panel may be released. ALGA looks forward to continuing to make a contribution on behalf of more than 560 local councils to the design of Australia's future tax-transfer system.