

## CHAPTER 5

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### ESCALATING THE NATIONAL GRANTS POOLS

1. This chapter examines the current arrangements for calculating the size of the national grants pools (the General Purpose pool and Local Roads pool) and how these arrangements might be simplified.

2. The current arrangements apply the same rate of increase to both national pools and specify how these pools are to be distributed amongst the States and Territories.

3. While the current arrangements are complex, they ensure that:

- (i) unless the Treasurer decides otherwise, each grants pool is maintained in real per capita terms;
- (ii) the increase in the grants pool for the grant year is in line with the expected CPI change<sup>1</sup> for the year; and
- (iii) LGBs receive their full entitlement — each year the grants paid comprise an estimated entitlement for that year plus an adjustment for the previous year's entitlement because of errors in estimating the CPI and population growth change.

4. The three options for calculating grant entitlements are based on a premise that timeliness and LGBs' budgetary processes would be improved if the grants pools were published in the May Federal Budget. This chapter considers the advantages and disadvantages of each option in terms of:

- (i) simplicity;
- (ii) maintaining the real per capita increase in the pool; and
- (iii) whether LGBs receive their 'full' entitlement.

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<sup>1</sup> The grants pools are maintained in real per capita terms but the annual CPI changes are more volatile than the population changes. For that reason, this chapter focuses on the impact of CPI changes.

### CURRENT ARRANGEMENT

5. At present, the size of the grants pools is calculated by applying a factor to the previous year's grants pool.

$$Pool\ this\ year = Pool\ last\ year \times factor\ this\ year$$

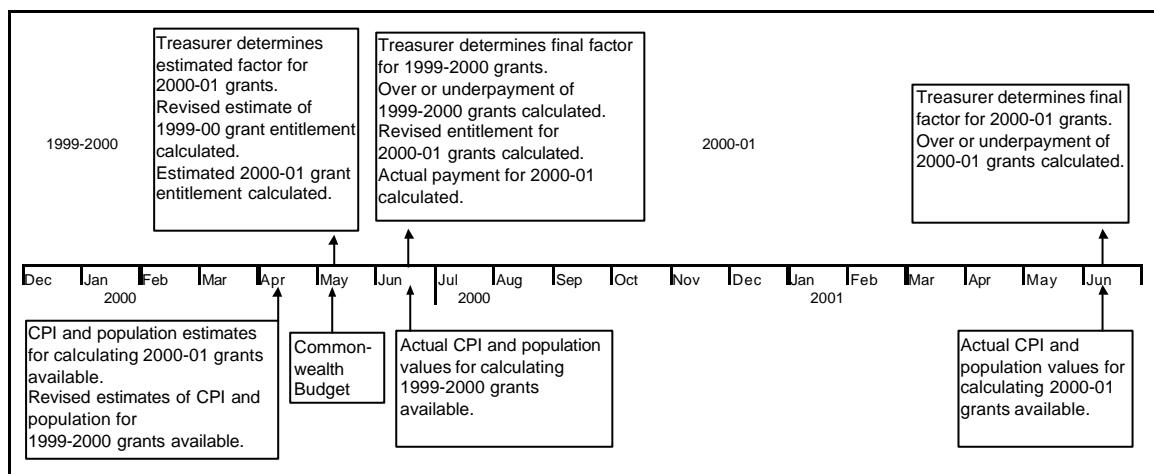
where

$$factor\ this\ year = \frac{CPI\ this\ year}{CPI\ last\ year} \times \frac{population\ this\ year}{population\ last\ year};$$

*CPI this year* = the CPI figure as at March of the relevant financial year (ie the CPI for March 2000 is used to calculate the 1999–2000 grants pool); and

*pop this year* = the population as at December prior to the relevant financial year (that is, population for December 1998 is used to calculate the 1999–2000 grants pool).

**Figure 5-1 THE CURRENT ARRANGEMENT**



6. The current approach uses estimates of CPI and population for the coming financial year to determine an estimated grant entitlement. Once the actual values of CPI and population are known at the end of the financial year, the actual entitlement is calculated. If the estimated entitlement differs from the actual entitlement, an adjustment is made to the grants paid in the following financial year. Grants paid in any year comprise the estimated entitlement plus an adjustment for the previous year's allocation.

7. This is shown in Figure 5-1 above. The table below shows how the availability of data has an effect on the grant calculations. The 2000–01 year is used as the example.

**Table 5-1** HOW DATA AVAILABILITY AFFECTS GRANT CALCULATIONS

Date	Data availability	1999–2000 Calculations	2000–01 Calculations
May 2000	Revised population and CPI estimates for 1999–2000.	Calculate revised factor for 1999–2000. Calculate revised grant entitlement for 1999–2000.	
	Population and CPI estimates for 2000–01.		Calculate an estimated factor for 2000–01. Calculate estimate of grant entitlement for 2000–01.
June 2000	Actual population and CPI values available for 1999–2000.	Calculate a final factor for 1999–2000. Calculate final grant entitlement for 1999–2000 and an adjustment for the difference between estimated and final entitlement.	Use the adjustment to calculate a revised estimated entitlement for 2000–01.
May 2001	Revised population and CPI estimates for 2000–01.		Calculate revised factor for 2000–01. Calculate revised grant entitlement for 2000–01.
June 2001	Actual population and CPI values available for 2000–01.		Calculate a final factor for 2000–01. Calculate final grant entitlement for 2000–01 and an adjustment for the difference between estimated and final entitlement.

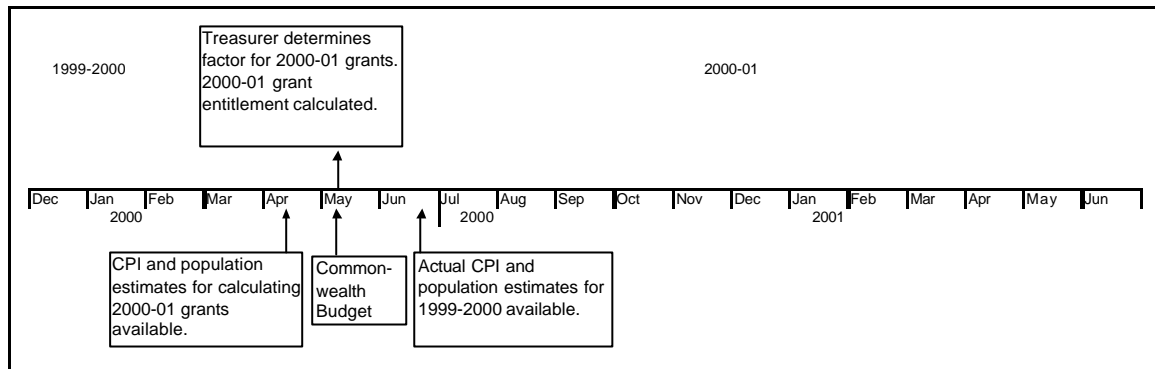
### THREE OPTIONS

#### *Option 1 — Use CPI and Population Estimates*

8. This option uses estimates of CPI and population for the coming financial year to determine the grant entitlement. Grant entitlements are not adjusted for differences between these estimates and the actual values of CPI and population. Actual population and CPI figures are not used because they are available too late — in June, after the Commonwealth Budget in May.

9. This approach is shown in Figure 5-2 and in Table 5-2 below. It uses the same definitions of CPI and population as are used in the current arrangements.

**Figure 5-2** OPTION 1



**Table 5-2** DATA AVAILABILITY AND OPTION 1

Date	Data availability	1999-00 Calculations	2000-01 Calculations
May 2000	Population and CPI estimates for 2000-01.		Calculate a final factor for 2000-01. Calculate grant entitlement for 2000-01.

**Advantages and Disadvantages**

10. The advantages of this option are:
  - the process is simple; and
  - the grant received reflects expected movements in CPI in the 12 months to March of the grant year.
11. The disadvantages are:
  - to the extent that the CPI and population estimates diverge from actual values, the grants pool is not maintained in real per capita terms; and
  - there will be no adjustment in grant estimates for any difference between actual values and estimates.

**Option 2 — Use CPI and Population Estimates but Adjust for Errors in Estimation**

12. This approach uses CPI and population estimates for the coming financial year to determine the estimated grant entitlement. Once the actual values of CPI and population are known (at the end of the financial year) the grant entitlement is calculated and the difference between actual and estimated grants is carried over to the grants paid in the following year.

13. This approach differs from the current approach in two respects:

- the aggregate difference is removed at the national pool level; and
- a different source of CPI and population estimates are used.

14. Under the current approach, any adjustments to payments are removed on the basis of the previous year's assessments. By removing the aggregate difference at the national pool level the adjustment is redistributed on the basis of the current year's assessments.

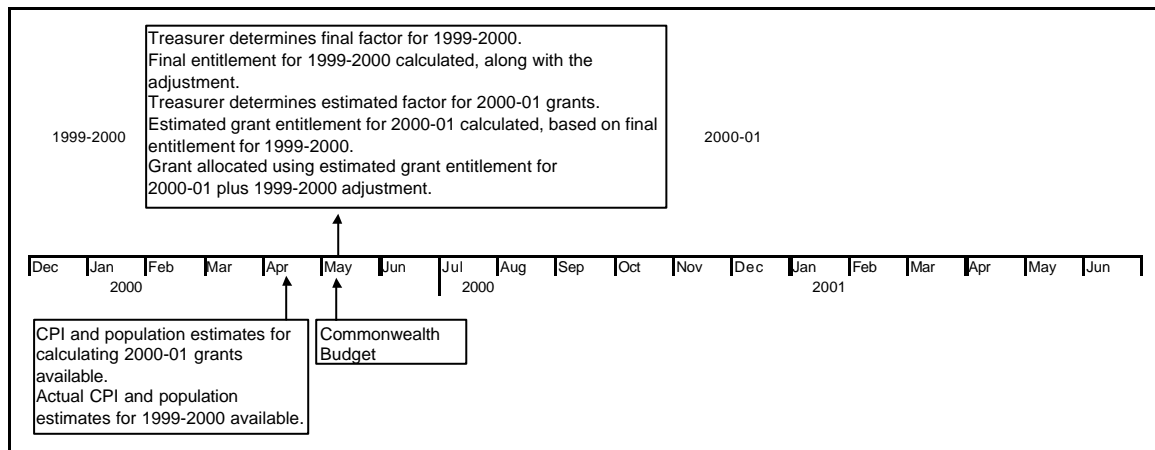
15. This option uses a different source of CPI and population estimates so that actual values are available at the May Budget.

16. Under this approach the CPI and population estimates would be:

- *CPI* movement is based on a calendar year (that is, CPI for December 1998 to December 1999 for 1999–2000)
- *population* as at June two years prior to the current financial year (that is, population for June 1998 for 1999–2000)

17. This is shown in Figure 5-3 and Table 5-3.

**Figure 5-3** OPTION 2



**Table 5-3 DATA AVAILABILITY AND OPTION 2**

Date	Data availability	1999–2000 Calculations	2000–01 Calculations
May 2000	Actual population and CPI values for 1999–2000.	Calculate final factor for 1999–2000. Calculate final grant entitlement for 1999–2000 and an adjustment for the difference between estimated and final entitlement.	
	Population and CPI estimates for 2000–01.		Calculate an estimated factor for 2000–01. Calculate estimate of grant entitlement for 2000–01 less the adjustment for the difference between estimated and final 1999–2000 entitlement.

***Advantages and Disadvantages***

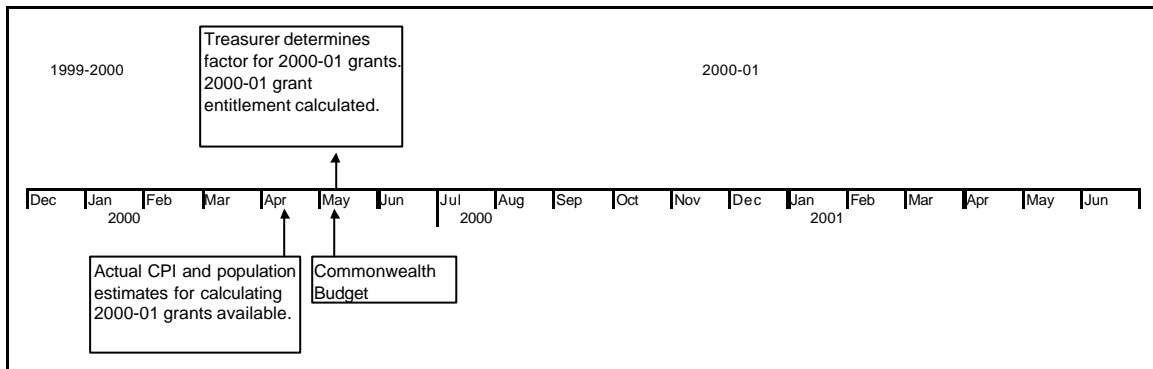
18. The advantages of this approach are:
- the process is slightly more complex than Option 1 but not as complex as the current arrangements;
  - the grants pool will be maintained in real per capita terms; and
  - there will be an adjustment in grants for incorrect estimates but this adjustment is made to the national pool.
19. The disadvantage is:
- the grant received reflects expected movements in CPI for the previous calendar year; and
  - the population data used are not up-to-date.

***Option 3 — Use Actual CPI and Population Values for an Earlier Period***

20. This approach uses actual values of CPI and population for the previous financial year to determine the grant entitlement. It does away with the need for any adjustments in successive years.

21. Different definitions of CPI and population are used:
  - *CPI* movement is for the previous financial year (that is, CPI movement for 1998–99 is used for the 1999–2000 grants); and
  - *population* is at June three years prior to the current financial year (that is, population for June 1997 is used for the 1999–2000 grants).
22. This is shown in Figure 5-4 and Table 5-4.

**Figure 5-4** OPTION 3



**Table 5-4** DATA AVAILABILITY AND OPTION 3

Date	Data availability	1999–00 Calculations	2000–01 Calculations
May 2000	Actual Population and CPI values for 2000–01.		Calculate a final factor for 2000–01. Calculate grant entitlement for 2000–01.

**Advantages and Disadvantages**

23. The advantages are:
  - the process is simple;
  - the grants pool will be maintained in real per capita terms; and
  - there will be no need for an adjustment in grants.
24. The disadvantage is:
  - the grant received reflects movements in CPI from an earlier year; and
  - population data are not up-to-date.

## SOME OBSERVATIONS

25. In comparing these approaches:
- (i) in a low inflation environment, there may be little difference between the three options;
  - (ii) because the grants pool this year equals the grants pool last year multiplied by a factor, use of an estimated CPI which is different from actual CPI to escalate the pool (as in Option 1) can have a long term impact on grants received<sup>2</sup>; and
  - (iii) in periods when the growth in the CPI is increasing, the estimates of CPI are likely to under-estimate the change. Conversely, in periods when the growth in the CPI is declining, the estimates are likely to over-estimate the change.

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2 For instance, if the estimated CPI increase is 4 per cent but the actual CPI increase is 5 per cent, then the grant pool increased using the estimated CPI will in subsequent years always be 1 per cent below what it would have been if the actual value had been used. Of course there will be adjustments for errors in estimation from subsequent years.

## CHAPTER 6

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### HISTORY OF COMMONWEALTH UNTIED FINANCIAL ASSISTANCE TO LOCAL GOVERNMENT

1. The Commonwealth has been providing untied financial assistance to local government since 1974–75. Grants for LGBs in the Northern Territory began in 1979–80 after the Territory achieved self government, and a grant to the ACT for municipal services began in 1988–89, again after self government was granted. Local Roads grants, which had previously been paid as a specific purpose payment to the States for on-passing to local government, became untied and were added to the financial assistance grants in 1991–92<sup>1</sup>, although they remain a separately identified part of the Commonwealth assistance.

2. The amount of financial assistance has grown from \$56 million in 1974–75<sup>2</sup> to over \$1.3 billion in 2000–01. The Commonwealth has always paid these grants through the States — under Section 96 of the Constitution — rather than direct to LGBs. Local government also received about \$125.5 million from the Commonwealth in 2000–01 through specific purpose payments, largely for child care programs administered by local government on behalf of the Commonwealth and funding for aged and disabled persons homes and hostels.

3. **Grants Commission Act 1973.** This Act provided for the Commonwealth Grants Commission to recommend the distribution of grants to each LGB. The grants were to enable each LGB in a region, by reasonable effort, to function at a standard not appreciably below the standards of other LGBs in that and other regions.

4. It allowed the Federal Minister, in consultation with the State Minister, to approve regional organisations to represent LGBs within their region. An approved regional organisation could then apply for financial assistance. After consulting with the State Minister, the Federal Minister could refer the application to the Commonwealth Grants Commission for inquiry and report.

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1 These were previously paid as tied grants to the States under the *Australian Land Transport Development Act 1988*.

2 In 1974–75, a further \$69 million was paid to the States in Local Roads grants.

5. Grants were made under this Act in 1974–75 and 1975–76. Because some LGBs were assessed as being able to finance their own expenditure needs and still provide the average standard of services made available by local government in their region or State, not all LGBs received a grant.

6. **Local Government (Personal Income Tax Sharing) Act 1976.** This Act provided for the annual pool of funds made available by the Commonwealth for local government to be linked to personal income tax receipts. Local government was guaranteed a share of Commonwealth tax collections. The Commonwealth Grants Commission advised on the distribution of the pool between the States and each State was required to establish an LGGC to allocate the funds to LGBs. The distribution of funds to local government moved from one based solely on equalisation to one based partly on per capita grants and partly on equalisation. The per capita grant ensured that every LGB received some assistance.

7. In 1984, a Committee of Inquiry into Local Government Finance, chaired by Professor Peter Self, was established to review all aspects of the operation of the *Local Government (Personal Income Tax Sharing) Act 1976*.

8. **Local Government (Financial Assistance) Act 1986.** Following the Self Inquiry, this Act introduced changes to the arrangements. Annual escalation in the national grants pool for local government became linked to changes in untied grant payments to the States. The distribution of the grant between States moved in stages from the interstate distribution recommended by the Commonwealth Grants Commission in 1976–77 to equal per capita shares for 1989–90. LGGCs were required to move, over five years, to allocate grants in a way that was consistent with ‘principles’ the Commonwealth agreed with each State. This brought some uniformity in approaches between States, without requiring every State to adopt exactly the same approach.

9. **Commonwealth Grants Commission Inquiry 1991.** In March 1990, the Commonwealth Grants Commission was asked to review the interstate distribution of local government General Purpose grants, and:

- (i) calculate a distribution that might apply if the funds were distributed between States on a fiscal equalisation basis; and
- (ii) comment on whether such a distribution should be applied.

10. In its February 1991 Report, the Commission reported that the distribution resulting from equalisation based assessments would be substantially different from equal per capita, noting that the predominant influence would be the different capacities of the States’ local government sectors to raise revenue from rates. It added, however, that while it was feasible to determine an equalisation based distribution that could be used, it was not a practical option because of data limitations and the small size of the pool in relation to total local government sector activity.

11. ***Bringing in Local Roads grants.*** In June 1991, grants for local roads — previously paid as specific purpose road grants to the States — were added to the local government General Purpose grants pool. They remained separately identified but became untied, and were distributed between the States on the same basis as the previous road grants to States. Within States, LGGCs distributed the funds on a ‘road needs’ basis.

12. In 1993, the Commonwealth announced a review of the 1986 Act. It was undertaken by the Australian Urban and Regional Development Review (AURDR).

13. ***Local Government (Financial Assistance) Act 1995.*** This Act was introduced following the AURDR review. It provided for the establishment of National Principles that replaced the separate State principles developed under the 1986 Act. The objective was to guide LGGCs in the distribution of grants between LGBs, thus ensuring greater similarity of approaches between States. Enhancements to the accountability requirements of States required the Commonwealth Minister to present an annual report to Parliament — called the Local Government National Report — on the operation of the Act. Under this Act, Local Roads funding continued to be distributed according to historical shares<sup>3</sup>.

14. Attachment B provides maps showing LGBs’ receipts of assistance under this Act. In each map, the LGBs are classified to one of three broad groups. Two maps are provided for each State, they show:

- General Purpose grants per capita; and
- Local Roads grants per kilometre.

15. Maps have not been provided for the Northern Territory because digitised areas are not available for its Community Government councils or its Association councils.

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3 This followed a decision of the April 1995 Special Premiers’ Conference, which decided to continue to distribute Local Roads funding based on historical shares rather than allowing them to be absorbed into local government General Purpose grants and distributed on an equal per capita basis.

## CHAPTER 7

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### THREE POOL ARRANGEMENT

1. In its report, the Commission concluded that the Commonwealth's intentions in providing assistance to local government were to provide:

- (i) a share of its financial assistance grants to all LGBs;
- (ii) funding to contribute to the costs faced by LGBs in maintaining their local roads; and
- (iii) relatively greater financial assistance to those LGBs, which, because of the greater costs they face in providing services or because of their more limited ability to raise revenue, are relatively more disadvantaged than other LGBs.

2. It said that the implementation of the Commonwealth's intentions would be helped if they were more clearly reflected in the funding arrangements, including the purposes and principles. It proposed arrangements that it thought would:

- (i) provide a clearer statement of what the Commonwealth intends the financial assistance process to achieve;
- (ii) simplify the relationship between the key elements of the process — the purposes, principles and pools; and
- (iii) provide a clearer link between these purposes and the instruments that are being used to achieve them.

3. Given that the Commonwealth assistance is directed to three broad objectives, it recommended the creation of three pools, with each pool reflecting one of the Commonwealth's objectives. It called these pools:

- the Per Capita pool;
- the Local Roads pool; and
- the Relative Need pool.

4. This chapter considers the following issues:
  - (i) how the three pool arrangement could be implemented without changing any LGB's grant allocation; and
  - (ii) how the three pool arrangement could be implemented if the Other Grant Support Principle was applied to the Per Capita and Local Roads grants.

### ***Implementing the Three Pool Arrangement Without Changing Grant Allocations***

5. The proposed three pool arrangement need not, of itself, lead to any changes in grants for individual LGBs. LGGCs could implement it by retaining their current approaches and dividing each LGB's General Purpose assessment into a per capita grant and a balance (relative need) grant.

6. Table 7-1 shows the 1999–00 general purpose and local roads component allocations for Tasmanian LGBs. It also shows LGBs' populations and each LGB's minimum grant as calculated by the Tasmania LGGC<sup>1</sup> — only two LGBs receive the minimum grant, the others receive an equalisation grant.

7. Table 7-2 shows the same grant allocations in a three pool arrangement. Compared with the grant figures in Table 7-1, it shows that:

- the Per Capita grant figures are the same as the minimum grant figures from Table 7-1;
- the Relative Need grant figures are the difference between the General Purpose grant figures in Table 7-1 and the Per Capita grant figures; and
- the local roads component figures are unchanged.

8. Table 7-2 shows that the three pool arrangement could be introduced without affecting the grant allocations of any LGB. The three pool arrangement provides a clearer link between the grants received by an LGB and the three purposes for which the Commonwealth provided its assistance.

9. However, the figures in Table 7-2 are predicated on LGGCs not changing any of their existing practices. In its report, the Commission recommended some changes in those practices. The next section examines how the three pool arrangement would be implemented if the Other Grant Support Principle were applied to the Per Capita and Local Roads grants.

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<sup>1</sup> The minimum grant was calculated as an LGB's population share of 30 per cent of the General Purpose pool.

**Table 7-1** TASMANIAN LGGC, 1999–00 GRANT ALLOCATIONS

Local Governing Body	General Purpose component	Local Roads component	Population	Minimum grant <sup>(a)</sup>
	\$	\$	No.	\$
Break O'Day	662 847	792 699	5 825	81 312
Brighton	745 927	308 528	12 830	179 095
Burnie	983 449	740 865	19 665	274 505
Central Coast	1 178 250	922 150	21 122	294 843
Central Highlands	601 056	791 684	2 512	35 065
Circular Head	812 390	912 942	8 493	118 554
Clarence	1 058 413	764 165	49 158	686 199
Derwent Valley	546 525	489 244	9 844	137 413
Devonport	776 923	594 305	24 667	344 328
Dorset	798 038	1 080 111	7 400	103 297
Flinders	367 860	363 969	946	13 205
George Town	554 860	362 622	6 823	95 243
Glamorgan/Spring Bay	364 618	417 366	4 164	58 126
Glenorchy	615 832	791 473	44 117	615 832
Hobart	649 124	835 258	46 502	649 124
Huon Valley	932 169	1 016 514	13 494	188 364
Kentish	629 603	657 036	5 468	76 328
King Island	350 958	399 728	1 810	25 266
Kingborough	959 583	789 531	28 260	394 483
Latrobe	400 119	321 909	7 947	110 933
Launceston	1 538 090	1 533 217	63 237	882 729
Meander	1 048 256	1 084 758	17 289	241 338
Northern Midlands	1 128 984	1 190 216	11 816	164 940
Sorell	600 817	477 875	10 878	151 847
Southern Midlands	711 312	1 219 117	5 590	78 031
Tasman	261 661	216 127	2 244	31 324
Waratah/Wynyard	942 615	741 810	13 954	194 785
West Coast	722 789	333 328	5 937	82 875
West Tamar	1 013 831	529 640	19 893	277 688
	21 956 899	20 678 187	471 885	6 587 070

(a) Calculated as an LGB's population share of 30 per cent of the General Purpose pool.

Source: Tasmania State Grants Commission, Annual Report for 1999–00.

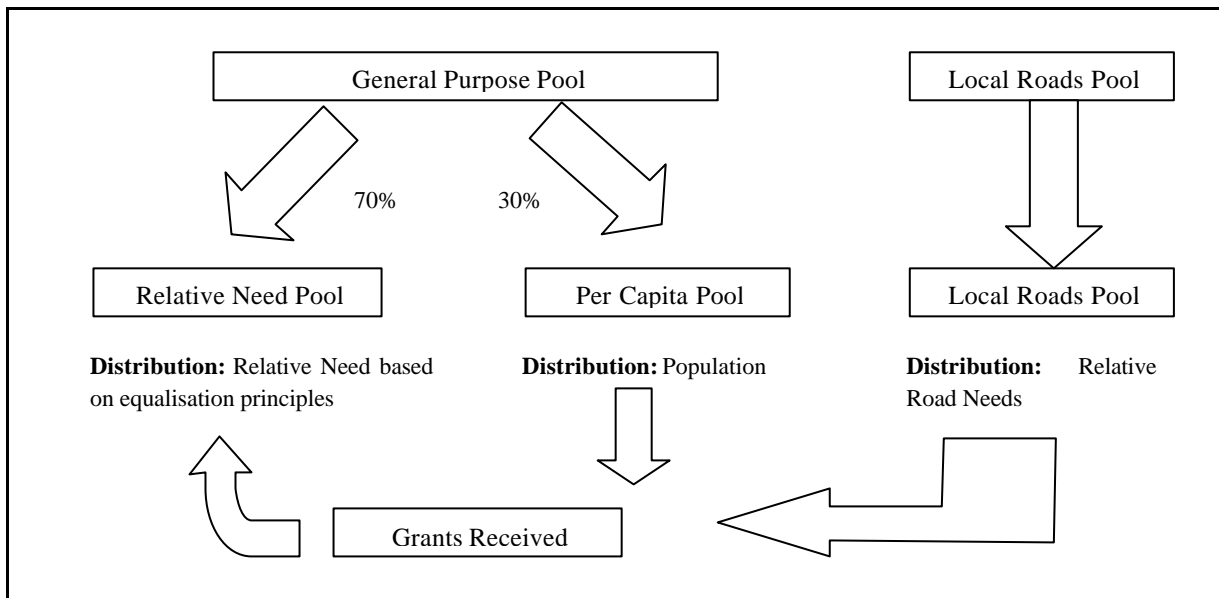
**Table 7-2** TASMANIAN LGGC, 1999–00 GRANT ALLOCATIONS ON A THREE POOL ARRANGEMENT

Local Governing Body	Per Capita grant	Relative Need grant	General Purpose component	Local Roads component
	\$	\$	\$	\$
Break O'Day	81 312	581 535	662 847	792 699
Brighton	179 095	566 832	745 927	308 528
Burnie	274 505	708 944	983 449	740 865
Central Coast	294 843	883 407	1 178 250	922 150
Central Highlands	35 065	565 991	601 056	791 684
Circular Head	118 554	693 836	812 390	912 942
Clarence	686 199	372 213	1 058 413	764 165
Derwent Valley	137 413	409 112	546 525	489 244
Devonport	344 328	432 595	776 923	594 305
Dorset	103 297	694 741	798 038	1 080 111
Flinders	13 205	354 655	367 860	363 969
George Town	95 243	459 618	554 860	362 622
Glamorgan/Spring Bay	58 126	306 493	364 618	417 366
Glenorchy	615 832	0	615 832	791 473
Hobart	649 124	0	649 124	835 258
Huon Valley	188 364	743 806	932 169	1 016 514
Kentish	76 328	553 275	629 603	657 036
King Island	25 266	325 692	350 958	399 728
Kingborough	394 483	565 100	959 583	789 531
Latrobe	110 933	289 186	400 119	321 909
Launceston	882 729	655 362	1 538 090	1 533 217
Meander	241 338	806 917	1 048 256	1 084 758
Northern Midlands	164 940	964 044	1 128 984	1 190 216
Sorell	151 847	448 970	600 817	477 875
Southern Midlands	78 031	633 281	711 312	1 219 117
Tasman	31 324	230 337	261 661	216 127
Waratah/Wynyard	194 785	747 831	942 615	741 810
West Coast	82 875	639 914	722 789	333 328
West Tamar	277 688	736 143	1 013 831	529 640
	6 587 070	15 369 829	21 956 899	20 678 187

**Implementing the Three Pool Arrangement Consistent with the Other Grant Support Principle**

10. Figure 7-1 shows:
- the existing General Purpose pool is segmented into a Relative Need and a Per Capita pool;
  - the existing Local Roads pool remains a Local Roads pool;
  - the Per Capita pool and the Local Roads pool are separate pools with separate allocation processes;
  - the Relative Need pool is a separate pool with its own allocation process, but the Per Capita and Local Roads grants feed into the allocation process.

**Figure 7-1** RELATIONSHIP BETWEEN GRANT POOLS



11. The Other Grant Support Principle creates the link between the three pools. Equalisation principles require an assessment of how much each LGB is able to raise from all of the revenue sources available to it. The Other Grant Support Principle requires LGGCs to treat other grants — whether provided for general or special purposes and whether provided by the Commonwealth or the State — like any other source of revenue and to take them into account when assessing the overall financial capacity of each LGB. Omitting grant assistance would not be consistent with a comprehensive assessment of needs.

12. Since the Per Capita and Local Roads grants are used to finance LGBs' expenditure, it is appropriate that the assessment of each LGB's financial capacity take account of these sources of revenue. Chapter 10 discusses the treatment of other grant assistance in more detail. It uses Local Roads grants as an example.

13. **Implications.** The implications of implementing the three pool arrangement consistent with the Other Grant Support Principle are that:

- (i) the Per Capita and Local Roads pools will be treated as if they were completely separate programs — but they will be taken into account when assessing an LGB's financial capacity;
- (ii) the Relative Need pool will be 70 per cent of what was the General Purpose pool; and
- (iii) the remaining 30 per cent, the Per Capita pool, should continue to enter LGGCs' distribution models as a source of revenue. It should enter in the form of grants received rather than in the form of the pool available for distribution — this issue is discussed further in Chapter 11.

14. In its report, the Commission said that all LGBs<sup>2</sup> would benefit from the Per Capita and Local Roads pools, but only disadvantaged LGBs would have access to the Relative Need pool.

15. It will be important to ensure that each LGB's financial capacity is accurately assessed. One of the themes of the Commission's report was that equalisation principles require a comprehensive assessment of needs. By comprehensive it meant an assessment of:

- each area of expenditure and revenue — most LGGCs restrict this to recurrent expenditures and revenues and, given the difficulties of measuring capital needs, this is sensible;
- a proper assessment of the influences that affect the cost of providing services or the capacity to raise revenue of LGBs — this requires an assessment of all influences including the needs of all population groups; and
- both relative advantage and relative disadvantage for each service and revenue — if relative advantage and disadvantage are not measured it will not be possible to correctly determine the overall disadvantage of one LGB relative to the others.

16. A comprehensive assessment of needs is required to ensure that only disadvantaged LGBs have access to the Relative Need pool.

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2 A very small number of LGBs do not have local roads responsibilities, they would not have access to the Local Roads pool.

## CHAPTER 8

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### MINIMUM GRANT

1. The terms of reference for the review included a requirement for the Commission to examine and report on:

the appropriateness of the current National Principles and, in particular, the retention of or variations of the minimum grant for the general purpose component in Section 6 of the Act.

2. The Commission undertook some analysis of the current minimum grant arrangement and the effects of variations to it. This chapter presents the results of that analysis.

#### *The Current Arrangement*

3. The minimum grant criterion is set out in Section 6(2)(b) of the *Local Government (Financial Assistance) Act 1995*. It ensures that every LGB receives a share of the General Purpose pool:

not less than the amount to which it would be entitled if 30 per cent of the total amount of its State's General Purpose grants were allocated on a per capita basis.

4. In 2000–01, the minimum grant at the 30 per cent level equates to about \$14 per capita. An LGB assessed to have an equalisation outcome less than this figure receives the minimum grant. An LGB assessed to have an equalisation outcome more than this figure receives its equalisation outcome.

5. Although this concept appears simple, it masks some difficulties.

6. First, the LGGCs use different approaches to assess equalisation outcomes. Since the equalisation outcomes are one of the two points of comparison, these differences between States influence which, and how many, LGBs are deemed to be minimum grant LGBs. Later chapters consider the impact of the different equalisation models and methods used by LGGCs to arrive at their equalisation outcomes.

7. Second, there is a link between minimum grant LGBs and other LGBs. Under the current arrangements, minimum grants and equalisation grants are both funded from the General Purpose pool. Removing money from the General Purpose pool to

finance minimum grants reduces the extent to which horizontal equalisation (for the non-minimum grant LGBs) can be achieved. Because of this link, the calculation of minimum grants is done in a step-wise process.

**Example:**

LGB A's equalisation outcome is assessed to be less than the \$14 per capita threshold and it receives its minimum grant. This reduces the pool available to finance equalisation outcomes, so that the equalisation outcomes for all LGBs are reduced. LGB B's reduced equalisation outcome now falls below the threshold and it receives its minimum grant. Another iteration of calculations is required to determine whether other LGBs' reduced equalisation outcomes now fall below the threshold. Because of this link, the LGGCs use an iterative approach to calculate minimum grant outcomes.

***Limitation of the Analyses***

8. The analysis was based on 1999–2000 information provided by all LGGCs except the Northern Territory. It compared the equalisation outcomes assessed for that year with a number of minimum grant thresholds. The Northern Territory had no minimum grant LGBs.

9. The results must be qualified as there are a number of reasons why actual outcomes could differ from the results that have been provided. These include:

- (i) differences in LGGCs' choices of model and methods — no adjustments for these differences were made;
- (ii) the LGGCs' use of capping and collaring procedures — these limits have been ignored for the purposes of the analyses; and
- (iii) the feedback between minimum grant outcomes and what remains of the pool to finance equalisation outcomes — the number of iterations has been limited to two.

10. As discussed above, whether an LGB is or is not a minimum grant recipient will depend upon its equalisation outcome. The outcome for any LGB is a reflection of the existing methods and models of the LGGC in its State. If adjustments were made to LGGCs' models and methods to standardise them, the existing list of minimum grant LGBs would change, but such changes are not known.

***Changing the Minimum Grant Threshold***

11. The existing threshold is created by the requirement that each LGB must receive at least the amount it would have received if 30 per cent of the funds made available to the State were distributed on a per capita basis. Six threshold levels were considered:

- 50 per cent, or \$23.50 per capita;
- 40 per cent, or \$18.80 per capita;

- 30 per cent, or \$14.10 per capita;
- 20 per cent, or \$9.40 per capita;
- 10 per cent, or \$4.70 per capita; and
- zero.

12. The zero threshold is the same as having no minimum grant. It is not the same as a ‘full’ horizontal equalisation outcome as full horizontal equalisation would involve taking revenue from LGBs with a negative equalisation assessment and sharing it among the remaining LGBs. Such inter-LGB transfers are not feasible.

13. By definition, minimum grant LGBs are overequalised because they receive more than their assessed equalisation outcome. They are able to function at a standard higher than other LGBs within their State (those that receive their underequalised outcomes). Minimum grant LGBs have the choice of providing services above the State average or providing the average State service and making a lower revenue effort.

### ***Results of the Analyses***

14. ***The number of minimum grant LGBs.*** Table 8-1 shows the number of minimum grant LGBs under various thresholds, and Table 8-2 shows the percentage that these LGBs comprise of all LGBs in each State.

**Table 8-1** NUMBER OF MINIMUM GRANT LGBS, VARIOUS THRESHOLDS<sup>(a)</sup>

State	Minimum Grant Threshold					
	0%	10%	20%	30%	40%	50%
	No.	No.	No.	No.	No.	No.
New South Wales	14	20	21	24	27	31
Victoria	6	6	6	6	8	11
Queensland	8	9	9	12	15	17
Western Australia	22	24	26	29	32	33
South Australia	21	21	21	22	23	24
Tasmania	1	1	1	1	1	2
Northern Territory <sup>(b)</sup>	..	..	..	..	..	..
<b>Total</b>	<b>72</b>	<b>81</b>	<b>84</b>	<b>94</b>	<b>106</b>	<b>118</b>

(a) The numbers of LGBs in this table are not actual numbers but estimates based on the analysis undertaken. The size of minimum grant LGBs can differ (for example, Brisbane City Council is one LGB).

(b) The Northern Territory’s method of assessment does not result in any LGB receiving a minimum grant.

**Table 8-2** PERCENTAGE OF LGBS ON THE MINIMUM GRANT, VARIOUS THRESHOLDS

State	Minimum Grant Threshold					
	0%	10%	20%	30%	40%	50%
	%	%	%	%	%	%
New South Wales	7.8	11.1	11.7	13.3	15.0	17.2
Victoria	7.7	7.7	7.7	7.7	10.3	14.1
Queensland	5.0	5.6	5.6	7.5	9.4	10.6
Western Australia	15.5	16.9	18.3	20.4	22.5	23.2
South Australia	28.0	28.0	28.0	29.3	30.7	32.0
Tasmania	3.4	3.4	3.4	3.4	3.4	6.9
Northern Territory <sup>(a)</sup>	..	..	..	..	..	..
Total	10.8	12.2	12.7	14.2	16.0	17.8

(a) The Northern Territory's method of assessment does not result in any LGB receiving a minimum grant.

15. The first column of Table 8-1 tells us that 72 LGBs were assessed to have negative equalisation outcomes in 1999–2000. These LGBs would be minimum grant LGBs under any threshold. The remaining columns tell us how the number of minimum grant LGBs increases as the minimum grant threshold is increased from zero to 50 per cent (\$23.50 per capita). Increasing the threshold from zero to 50 per cent moves another 46 LGBs onto the minimum grant. The biggest jumps in the number of new minimum grant LGBs occurs when the threshold is increased from 30 to 40 per cent and from 40 to 50 per cent.

16. *Population in minimum grant LGBs.* While the number of LGBs on the minimum grant is important, so also is the population within those LGBs. An LGB's population determines the size of its grant. Table 8-3 shows the number of people located in minimum grant LGBs at various threshold levels. The biggest increase occurs when the threshold is increased from 30 to 40 per cent (an increase of 1.2 million people). Table 8-4 shows the percentage of each State's population living in minimum grant LGBs.

**Table 8-3** POPULATION LOCATED IN MINIMUM GRANT LGBS, VARIOUS THRESHOLDS

State	Minimum Grant Threshold					
	0%	10%	20%	30%	40%	50%
	m	m	m	m	m	m
New South Wales	0.8	1.4	1.5	1.7	1.8	2.3
Victoria	0.5	0.5	0.5	0.5	0.5	0.5
Queensland	0.7	0.7	0.7	1.0	2.0	2.1
Western Australia	0.9	1.0	1.1	1.2	1.2	1.3
South Australia	0.8	0.8	0.8	0.9	0.9	0.9
Tasmania	0.0	0.0	0.0	0.0	0.0	0.1
Northern Territory	0.0	0.0	0.0	0.0	0.0	0.0
Total	3.8	4.5	4.7	5.3	6.5	7.1

**Table 8-4** PERCENTAGE OF POPULATION IN MINIMUM GRANT LGBS, VARIOUS THRESHOLDS

State	Minimum Grant Threshold					
	0%	10%	20%	30%	40%	50%
	%	%	%	%	%	%
New South Wales	12.0	22.3	23.4	26.4	29.0	36.1
Victoria	11.0	11.0	11.0	11.0	11.0	11.0
Queensland	20.8	21.3	21.3	29.8	57.5	59.4
Western Australia	47.5	53.0	57.4	65.1	65.6	71.2
South Australia	56.2	56.2	56.2	57.3	57.3	58.9
Tasmania	9.9	9.9	9.9	9.9	9.9	19.2
Northern Territory	0.0	0.0	0.0	0.0	0.0	0.0
Total	20.6	24.8	25.6	29.1	35.3	39.1

17. *The amount of minimum grants.* Table 8-5 sets out the amounts required to fund the minimum grant outcomes for each of the six threshold levels. Table 8-6 shows the percentage that these amounts comprise of States' General Purpose pools.

**Table 8-5** AMOUNT REQUIRED TO FINANCE MINIMUM GRANT OUTCOMES, VARIOUS THRESHOLDS

State	Minimum Grant Threshold					
	0%	10%	20%	30%	40%	50%
	\$m	\$m	\$m	\$m	\$m	\$m
New South Wales	0.0	6.6	13.9	23.6	34.5	55.7
Victoria	0.0	2.4	4.8	7.2	14.2	20.6
Queensland	0.0	3.5	6.9	14.5	37.4	48.2
Western Australia	0.0	4.6	9.9	16.8	24.3	31.7
South Australia	0.0	3.9	7.8	11.9	16.4	20.6
Tasmania	0.0	0.2	0.4	0.6	0.9	2.1
Northern Territory	0.0	0.0	0.0	0.0	0.0	0.0
Total	0.0	21.2	43.8	74.7	127.7	179.0

**Table 8-6** PERCENTAGE MINIMUM GRANTS COMPRISE OF EACH STATE'S GENERAL PURPOSE POOL, VARIOUS THRESHOLDS

State	Minimum Grant Threshold					
	0%	10%	20%	30%	40%	50%
	%	%	%	%	%	%
New South Wales	0.0	2.2	4.7	7.9	11.6	18.7
Victoria	0.0	1.1	2.2	3.3	6.5	9.4
Queensland	0.0	2.1	4.3	8.9	23.0	29.7
Western Australia	0.0	5.3	11.5	19.5	28.3	36.8
South Australia	0.0	5.6	11.2	17.2	23.5	29.7
Tasmania	0.0	1.0	2.0	3.0	3.9	9.6
Total	0.0	2.5	5.1	8.7	14.9	20.9

18. Tables 8-5 and 8-6 suggest that increasing the minimum grant threshold has ever larger effects on the amount needed to finance the minimum grant requirement. There are two reasons why this should be so. First, as the threshold is increased, more LGBs are captured by it. Second, as the threshold is increased, the minimum grant per capita is increased and applied not only to the newly captured LGBs but to the LGBs that were deemed to be minimum grant LGBs at the previous threshold level.

**Example:**

The 10 per cent threshold implies a minimum grant of \$4.70 per capita. This per capita amount is applied not only to the nine LGBs assessed to have equalisation outcomes between zero and \$4.70 per capita (10 per cent of the pool), but also to the 72 LGBs assessed to have negative equalisation outcomes.

19. Table 8-5 shows that if the threshold is increased from 0 to 10 per cent, \$21.2 million (2.5 per cent of the General Purpose pool) is required to finance the minimum grant arrangements. Increasing the threshold another 10 per cent requires an addition \$22.6 million. Thereafter, each successive 10 per cent increase in threshold requires \$30.9 million, \$53.0 million and \$51.3 million.

20. Table 8-7 provides a summary of the results for Australia as a whole.

**Table 8-7** SUMMARY OF RESULTS BY THRESHOLD LEVEL

Threshold level	Increase in the number of minimum grant LGBs	Additional amount required to finance the minimum grant requirement	Average amount per new LGB
	No.	\$m	\$m
0 per cent	72	0.0	0.0
10 per cent	9	21.2	2.4 <sup>(a)</sup>
20 per cent	3	22.6	7.5
30 per cent	10	30.9	3.1
40 per cent	12	53.0	4.4
50 per cent	12	51.3	4.3

(a) The amount falls to \$0.3 million if the \$21.2 million is apportioned across the 72 negative equalisation outcome LGBs as well as the nine LGBs with equalisation outcomes less than \$4.7 per capita.

21. The choice of threshold level is a matter of judgement — how much redistribution from equalisation to minimum grant is ‘just right’? Table 8-7 suggests that:

- there is no obvious reason for preferring one threshold level over another;
- redistributions associated with increasing the threshold level from 30 per cent are greater than the redistributions associated with reducing the level; and
- increasing the existing 30 per cent to 40 per cent would increase the size of the distribution by \$53 million and increasing it by another 10 per cent to 50 per cent would increase the redistribution by another \$51.3 million.

22. In the consultation phase of this review, many LGBs said they supported the retention of the existing 30 per cent level. There was some support for a reduction but little support for an increase in the level.

### ***What’s the Effect on Other LGBs?***

23. Another consideration is the effect that the minimum grants are having on other LGBs. Table 8-8 shows the average payment made to LGBs getting an equalisation

based grant in each State, and how it changes as the threshold is increased<sup>1</sup>. The last column compares the average grant under a 50 per cent threshold with the same outcome if there were no minimum grant (the zero threshold). The table also shows the ratio of these per capita amounts compared to the zero threshold amount.

**Table 8-8** EFFECT OF THE MINIMUM GRANT ON OTHER LGBS, VARIOUS THRESHOLDS

State	Minimum Grant Threshold						Percentage difference
	0%	10%	20%	30%	40%	50%	
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	%
New South Wales	466	458	448	436	422	406	-12.8
Victoria	211	209	207	204	202	200	-5.5
Queensland	3296	3226	3156	3056	2882	2657	-19.4
Western Australia	6868	6868	6490	6015	5525	4962	-27.7
South Australia	666	661	622	582	542	500	-25.0
Tasmania	356	352	349	345	342	335	-5.9
New South Wales	1.00	0.98	0.96	0.94	0.91	0.87	-12.8
Victoria	1.00	0.99	0.98	0.97	0.96	0.95	-5.5
Queensland	1.00	0.98	0.96	0.93	0.87	0.81	-19.4
Western Australia	1.00	1.00	0.94	0.88	0.80	0.72	-27.7
South Australia	1.00	0.99	0.93	0.87	0.81	0.75	-25.0
Tasmania	1.00	0.99	0.98	0.97	0.96	0.94	-5.9

24. Table 8-8 shows also that the level of volatility is different for different States. The ratios:

- suggest greater volatility in Queensland, Western Australia and South Australia; and
- suggest that the relative change in equalisation outcomes is smallest at the zero and 10 per cent thresholds and largest at the 50 per cent threshold.

25. The analysis suggests that, in terms of the effect on equalisation outcomes, the thresholds could be grouped into three:

- (i) low: the zero or 10 per cent thresholds;

<sup>1</sup> This reduction occurs not because the LGB's equalisation assessment has changed but because the share of the General Purpose pool that it attracts has reduced. Its share reduces because increasing the minimum grant threshold takes more money out of the General Purpose pool. The LGB's share of the reduced pool remains the same but its grants reduce because of the reduced pool.

- (ii) medium: the 20 and 30 per cent thresholds; and
- (iii) high: the 40 and 50 per cent thresholds.

26. This analysis provides some justification for not increasing the minimum grant threshold level. The relevant considerations are:

- the size of the redistributions that would be required; and
- the increased volatility in the outcomes of non-minimum grant LGBs.

27. However it also suggests that reducing the percentage threshold level will not release a large amount of funds for the LGBs receiving equalisation outcomes — unless big changes are made to the percentage threshold. If the threshold is reduced to 20 per cent, \$30.9 million (a little more than \$2 per capita<sup>2</sup>) is released. This rises to \$53.5 million (about \$4 per capita) if the percentage is reduced to 10 per cent and \$74.7 million (\$5 per capita) if it is removed completely.

28. **Conclusion.** If the current arrangement of a minimum grant is retained, the existing threshold should be retained.

### *A Different Arrangement*

29. In its report, the Commission suggested that there should be a separate pool for each purpose that has a different distributional objective. The Per Capita pool would require greater amounts of money than the existing minimum grant arrangements — because the per capita amount would be extended to all LGBs, not simply those whose equalisation outcome is less than the per capita threshold. Table 8-9 compares the funding required under a Per Capita pool arrangement with that required under the current arrangement.

**Table 8-9** AMOUNT REQUIRED TO FUND THE MINIMUM GRANT ARRANGEMENT, VARIOUS THRESHOLDS

State	Minimum Grant Threshold					
	0%	10%	20%	30%	40%	50%
	\$m	\$m	\$m	\$m	\$m	\$m
Per Capita pool arrangement <sup>(a)</sup>	0.0	85.7	171.4	257.2	342.9	428.6
Current arrangement	0.0	21.2	43.8	74.7	127.7	179.0
Difference	0.0	64.5	127.6	182.5	215.2	249.6

(a) Amount is equal to population multiplied by the per capita threshold.

2 The per capita amount is calculated using the number of people located outside minimum grant LGBs. This number changes as the threshold changes.

### ***What Treatment Should Apply to the Per Capita Grants?***

30. This section outlines the implications for assessments of the relative disadvantage of LGBs of treating the Per Capita grants by inclusion and exclusion.

31. ***Inclusion.*** The large changes in the amount required to fund the Per Capita grants will not affect the equalisation assessments, if the Per Capita grant allocations are treated by the inclusion method. In these circumstances, the total amount received by each LGB would be the same as they currently receive<sup>3</sup>. Chapter 10 explains why the large changes are not relevant when the inclusion method is used.

32. If the new Per Capita pool arrangement is adopted and these grants are treated by inclusion (for the purposes of equalisation assessments), the existing threshold should be retained.

33. ***Exclusion.*** If the Per Capita grants are treated by exclusion, they remain outside the equalisation process. This can lead to a situation of some LGBs receiving more assistance than might otherwise be warranted.

**Example:**

Assumptions: Two councils, A and B. Council A has 40 residents, Council B 10. Their total expenditure is exactly the same — \$100, and this is also their assessed standardised expenditure. There is \$150 in General Purpose grants and \$50 in Per Capita grants (\$40 to Council A, \$10 to Council B).

Under inclusion, Council A's net expenditure would be \$60 (\$100 less its \$40 Per Capita grant) and Council B's net expenditure would be \$90 (\$100 less its \$10 Per Capita grant). Allocating the General Purpose grant 60:90 would leave both in the position of having sufficient funding to finance their expenditure.

Under exclusion, the expenditure standard reduces so that their equalisation assessments both fall to \$75. The Per Capita grants are ignored so that the \$150 General Purpose grants are divided on a 75:75 basis. Council A receives \$115 (\$75 in General Purpose grants and \$40 in Per Capita grants) to finance its expenditure of \$100. Council B receives \$85 (\$75 in General Purpose grants and \$10 in Per Capita grants) to finance its expenditure of \$100.

34. The example demonstrates that Council A would receive more grants under exclusion than inclusion. This is because its large share of Per Capita grants is ignored under exclusion and it retains the benefit of that large share. It receives less grants under inclusion because its Per Capita grants are treated as being available to finance its expenditure requirement. Other things being equal, the more Per Capita grants it receives, the less General Purpose grants it needs.

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3 Under the new arrangements, their equalisation grant would equal their equalisation outcome less any grant from the Per Capita pool. Their total grant is the sum of their equalisation grant plus their Per Capita grant. Thus the only change is that they receive their allocation in two grants rather than one.