



Australian Government

Commonwealth Grants Commission

**Financial Assistance Grants for
Local Government
2013**

Canberra

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Australian Government
Commonwealth Grants Commission

10 December 2013

The Hon Joe Hockey MP
Treasurer
Parliament House
CANBERRA ACT 2600


Dear Treasurer

As members of the Commonwealth Grants Commission appointed under the *Commonwealth Grants Commission Act 1973*, and in response to terms of reference provided by your predecessor the Hon Wayne Swan on 9 November 2012, we provide this report on tangible measures for improving the impact of the Local Government Financial Assistance Grants on the effectiveness of local governments and their ability to provide services to their residents within the current funding envelope. We have also addressed the specific terms of reference relating to the national principles, tied and untied funding, the minimum grants principle and the relative needs of local governments.

Yours sincerely



G J Smith
Chairperson



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Member



P M Faulkner AO
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ACKNOWLEDGMENTS

We appreciate the ready co-operation extended to the commission and its staff during this inquiry by Commonwealth, State and Territory Local Government Departments, Local Government Grants Commissions and their staff, Local Government Associations, Local Governing Bodies, other interested parties and other Commonwealth agencies.

We also acknowledge the commitment and capable contribution by staff of the commission.

TERMS OF REFERENCE



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Mr Alan Henderson AM
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Commonwealth Grants Commission
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Dear Mr Henderson

I am writing to convey to you the terms of reference for a Review on Improving the Impact of the Financial Assistance Grants on Local Government Financial Sustainability (the Review).

The terms of reference require the Commission to provide a report to the Australian Government by 31 December 2013, noting that the Commission will also be required to produce the 2013 Update of the GST Revenue Sharing Relativities and potentially consider issues arising from the Government's response to the final report of the GST Distribution Review. A draft (interim) report is not required to be prepared for this Review.

For the avoidance of doubt, references to the current funding envelope and to the relative need of local governments in the terms of reference relate to funding for each state provided through Financial Assistance Grants, exclusive of the South Australian supplementary roads funding.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Wayne Swan'.

WAYNE SWAN

9 November 2012

Terms of Reference for Review into Improving the Impact of Financial Assistance Grants on Local Government Financial Sustainability

COMMONWEALTH GRANTS COMMISSION ACT 1973

I, Wayne Maxwell Swan, Deputy Prime Minister and Treasurer, pursuant to section 17 of the *Commonwealth Grants Commission Act 1973*, refer to the Commission for inquiry into and report upon, by 31 December 2013, the intrastate distribution of Financial Assistance Grants (FAGs) paid under sections 9 and 12 of the *Local Government (Financial Assistance) Act 1995*.

2. The objective of the Review is to identify tangible measures for improving the impact of the Local Government FAGs on the effectiveness of local governments and their ability to provide services to their residents within the current funding envelope.

3. The Commission should examine the impacts of FAGs on local government bodies and its appropriateness by focusing on:

(a) examining in the intrastate context whether the national principles that guide the allocation of the general purpose grants remain valid and are conceptually consistent with each other;

(b) evaluating the economic and financial benefits of untied vs tied funding for enhancing the effectiveness of local governments and their ability to ensure effective services for their residents;

(c) identifying the impact of the Minimum Grants principle on the intra-state distribution of FAGs; and

(d) assessing the relative need of local governments in each State and Territory with a particular focus on those that service regional and remote communities.

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EXECUTIVE SUMMARY

Existing Commonwealth financial assistance grant arrangements are complicated, having evolved over time, but in general they meet the wide range of objectives set out in the Act.

Financial assistance grants to local government should continue to be made on an untied basis.

The effectiveness of local governments and their ability to provide services to their residents could be improved, within the current funding envelope if:

- up to 5% of general purpose funds were available to promote structural reform or facilitate collaborative projects and
- States had greater flexibility and responsibility in deciding how much of their State's general purpose grants were used to support all councils on an equal per capita basis (between 20 and 30% of the funds), with the remaining funds used to support fiscally weaker councils.

In response to the terms of reference, we have examined the impact of financial assistance grants (FAGs) on councils and considered options which could improve their effectiveness and ability to deliver services. Our consideration takes into account the framework of purposes established by the Act and current funding envelopes, the circumstances of local government and views expressed to us in submissions and consultations.

FINDINGS

Circumstances of local government

- There is a great diversity in the nature of councils within States in terms of their population and geographic size and their service delivery responsibilities and revenue raising capacity.

- In all States, rural and remote councils are assessed by local government grant commissions (LGGCs) to be fiscally weaker than metropolitan and regional city councils and there is evidence the assessed disparities are increasing.
- There is also greater diversity within some States than in others. There are high levels of diversity in the assessed fiscal capacities of Queensland and Western Australia and lower levels in Victoria, Tasmania and the Northern Territory.
- Grant arrangements should accommodate this diversity.

Role of State and Commonwealth governments

- While the Commonwealth and States provide about the same grant support for local government, States have a much larger overall role. The legislative, structural and financial frameworks they establish have a greater influence over the sustainability, effectiveness and ability of councils to deliver services.
- Grant arrangements should give State governments a role in implementation to ensure the way grants are distributed is consistent with their local government policies and to allow them to reflect State specific circumstances. Greater flexibility would allow the existing funding envelope to be better utilised.
- LGGCs face a complex task capturing the diverse nature of local government in their State, which should result in some State specific methodologies. However sometimes their methods differ for other reasons, resulting in outcomes that are not consistent nationally. As consistency of methods is a goal of the Act, this is an issue that needs to be addressed.
- Existing Commonwealth financial assistance grant arrangements are complicated, having evolved over time, but in general they meet the wide range of objectives set out in the Act.
- The adjustment costs of large changes to these arrangements would not be sufficiently offset by benefits and major changes are not warranted.
- However some modest changes are appropriate. Ongoing structural change designed to improve council effectiveness could be facilitated using part of the general revenue pool. Doing this builds on and widens the support provided by the amalgamation principle. It would allow States to work with their local government sector, or groups of councils, to identify worthwhile changes which would lower service delivery costs or improve revenues.
- Other changes could be made to better reflect the subsidiarity principle, to better reflect the relative fiscal capacities of councils and to improve accountability and transparency in the distribution and use of the funds.

Financial assistance grants

Impact on local government (Chapter 2)

- Financial assistance grants provide financial support to all councils.

- Financial assistance grants reduce disparities among councils, though the extent to which they do so varies among States.
- For some councils, financial assistance grants represent a very small portion of their overall revenue and are unlikely to have a significant impact on council operations. For others they are important, contributing a significant part of overall revenue and underpinning service delivery.
- The impact of financial assistance grants varies among States depending on the methods used to assess grant requirements. Consistency, an objective of the Act, could be improved if methodologies converged, while still allowing differences among States in the operational environments facing councils to be recognised.

National principles (Chapter 3)

- The Act and the national principles form a consistent package.
- Each principle is consistent with at least one purpose and is valid, but they could be better presented. Clarifying the links between the grant purposes, principles and available funds would lead to more effective and transparent grant arrangements.
- The grant purpose of increasing efficiency and effectiveness could be better achieved by a more flexible grant design.
- The Aboriginal and Torres Strait Islander principle should remain as a separate principle and provide flexibility for States in the delivery of grants to Indigenous councils and communities.

Tied and untied grants (Chapter 4)

- Financial assistance grants should continue to be tied in the hands of the States to ensure it is all passed to local government. Consistent with that, and the need for accountability, States would administer the funds and assure the Commonwealth minister that funds have been allocated according to the Act.
- Financial assistance grants should continue to be untied in the hands of local government. Tying the grants is unlikely to increase the effectiveness of councils, or their ability to ensure effective services for their residents. Local decisions on the use of these funds are more likely to lead to their effective use. Current arrangements see administrative costs minimised and proportional to the level of funds provided.

Impact of the minimum grant principle (Chapter 5)

- The minimum grant principle ensures every council receives a general purpose grant increasing the capacity of all councils to deliver services.
- Within a fixed funding envelope, the larger the minimum grant the less is available to reduce the disparities in fiscal capacities among local governments within a State.

- The minimum grant is not large (about \$20 per capita in recent years) and for many councils it represents a very small part of their revenue. Some 18% of councils, home to 39% of the population received only the minimum grant in addition to their identified roads grants in 2011-12.
- The minimum grant has different impacts in each State. In part, this is a reflection of the degree of diversity in the councils in each State.
- Over time the number of local governments receiving only the minimum grant component of general purpose grants has increased. The measured fiscal disparity of councils has increased with more councils now judged to warrant no equalisation payments, and equalisation grants going to fewer but much fiscally weaker councils.

IMPROVING EFFECTIVENESS

- Overall, we have not found grounds for major change in current arrangements.
- We consider the scheme could be more responsive to differing State circumstances if State governments were given some discretion, within limits established by the Commonwealth, on how much of the funding envelope in their State should be directed to reduce fiscal disparities (at least 65% of the general purpose funds) rather than be provided uniformly to all local governments (between 20 and 30% of the general purpose funds).
- We consider that if government wanted to direct part of the existing funding envelope towards improving the effectiveness of councils that could be done by making a small part of general purpose funding (up to 5%) available to facilitate structural change or collaborative projects which States and their local governments considered would improve the robustness of local government.
- We consider that there are small changes which could be made to improve the operation of the scheme. These include:
 - The funding envelope should be treated as four pools — a common pool from which all would receive a grant, a relative needs pool to reduce disparities in fiscal capacities, a roads pool to assist with road needs and, if government decides to do so, a pool for structural reform and collaborative projects. This would make the scheme's operation simpler and more transparent
 - The national principles guiding local government grants commissions should be aligned with these pools. This would include expanding the amalgamation principle to support a broader range of structural reforms.
 - The methodology adopted by individual LGGCs could be more uniform among States and extended to include council capital requirements to better capture some of the challenges facing local government.
- Details of our recommendations are in Chapter 7.

CHAPTER 1

RESPONDING TO THE TERMS OF REFERENCE

- 1 On 9 November 2012, the Treasurer asked the commission to examine the impact of financial assistance grants (FAGs) on local governments with the aim of identifying tangible measures for improving the effectiveness of local governments¹ and their ability to provide services to their residents. This must be done within the current funding envelope for local government in each State.²
- 2 This chapter explains how we have approached the task.

THE REVIEW PROCESS

- 3 A special division of the commission was established to undertake this review comprising Chairman Alan Henderson and Commissioners Smith, Appleyard and Faulkner. The composition changed on 1 July 2013 with the appointment of Mr Smith as Chairman and Mr Henderson as Commissioner.
- 4 The commission has consulted interested parties and analysed available data to obtain an understanding of the current impact of FAGs on local government. In November 2012, we circulated an issues paper that sought submissions from interested parties on the issues relevant to the terms of reference and assistance with data. The commission received 29 submissions in response to the issues paper from local government associations, grants commissions, councils and consultants. It held hearings in relation to 10 of those submissions in Canberra and Adelaide.

¹ In this report, the term councils is used to refer to local governments and local governing bodies eligible to receive grants under the Act.

² In this report, the term States is used to refer to the States and the Northern Territory. References to States do not include the ACT, unless specified.

- 5 In July 2013, we sought feedback on a South Australian Government submission which suggested the general purpose grants and the identified local roads grants be combined into the one funding pool.
- 6 Attachment A provides a list of all submissions and attendees at hearings. The submissions and records of the hearings are available on the commission's website at: <http://www.cgc.gov.au>.
- 7 The commission collected data from Commonwealth departments, local government grants commissions (LGGCs) and the Australian Bureau of Statistics. Not all data were consistent with each other or available for all years of our analysis. These inconsistencies are noted where required throughout the report.
- 8 In satisfying the requirements of the terms of reference, we have relied on the assessments of the relative needs of each council made by the LGGC in each State — we have not undertaken our own calculations. The differences in the LGGC methods, which we have not considered in detail, do not compromise the intrastate comparisons which are the focus of this inquiry.

THE CONTEXT FOR THE REVIEW

- 9 **The Act.** The *Local Government (Financial Assistance) Act 1995* (the Act) says the grants to local government are to be provided through:
 - an untied general purpose grant paid to each State on an equal per capita basis for on-passing to local governments as horizontal fiscal equalisation payments or, at a minimum, 30% of the pool distributed on an equal per capita basis
 - an untied but separately identified local roads grant paid to each State according to a historical distribution for on-passing on the basis of roads needs.
- 10 Section 3 of the Act (see Box 1-1) and the operation of the grant program indicate the Parliament's purposes in providing financial support to local government are:
 - to provide some assistance to every council, thereby improving their financial capacity and the certainty of their funding
 - to provide relatively more assistance to the more needy councils
 - to improve the efficiency and effectiveness of councils
 - to improve services provided by councils to Aboriginal and Torres Strait Islander communities.
- 11 It also has goals of improving the transparency and accountability of the States in allocating the grants to their councils and promoting consistency in allocation methods across States. These goals relate to the operation of the grant processes.

- 12 The Act's provisions on the size of the equal per capita and equalisation grants and the separate existence of the identified local roads grant reflect the prevailing views on the trade-offs necessary to progress the various purposes with the funds available.

Box 1-1 Purposes and goals of the financial assistance grants

3 Objects of Act

- (1) This section explains the objects of the Parliament in enacting this Act.
- (2) The Parliament wishes to provide financial assistance to the States for the purposes of improving:
- (a) the financial capacity of local governing bodies; and
 - (b) the capacity of local governing bodies to provide their residents with an equitable level of services; and
 - (c) the certainty of funding for local governing bodies; and
 - (d) the efficiency and effectiveness of local governing bodies; and
 - (e) the provision by local governing bodies of services to Aboriginal and Torres Strait Islander communities.
- (3) The financial assistance is to be provided by the making to the States, for local government purposes, of general grants under section 9 and additional funding under section 12.
- (4) In providing this financial assistance the Parliament's goals are to:
- (a) increase the transparency and accountability of the States in respect of the allocation of funds under this Act to local governing bodies; and
 - (b) promote consistency in the methods by which grants are allocated to achieve equitable levels of services by local governing bodies.

Source: The *Local Government (Financial Assistance) Act 1995*, amended 2012.

- 13 The Act requires the establishment of a LGGC in each State to advise on the allocation of the funds. To help achieve consistency in those allocations, they must be prepared according to a set of national principles established by the Commonwealth Minister. Those principles, which are reproduced in Chapter 3, are:
- the horizontal equalisation principle
 - the effort neutrality principle
 - the minimum grant principle
 - the other grant support principle
 - the Aboriginal peoples and Torres Strait Islanders principle
 - the council amalgamation principle
 - the local roads principle.
- 14 We presume the Commonwealth wishes to retain the grant purposes and goals set out in the Act and have interpreted the requirements of the terms of reference in the context of the Act.

INTERPRETING THE REQUIREMENTS OF THE TERMS OF REFERENCE

- 15 **The objective of this review.** The terms of reference are reproduced in Box 1-2. They say the objective of the review is to identify measures for improving the impact of FAGs on the effectiveness and ability to deliver services of local governments.

Box 1-2 Terms of reference

Terms of Reference for Review into Improving the Impact of Financial Assistance Grants on Local Government Financial Sustainability

I, Wayne Maxwell Swan, Deputy Prime Minister and Treasurer, pursuant to section 17 of the *Commonwealth Grants Commission Act 1973*, refer to the Commission for inquiry into and report upon, by 31 December 2013, the intrastate distribution of Financial Assistance Grants (FAGs) paid under sections 9 and 12 of the *Local Government (Financial Assistance) Act 1995*.

2. The objective of the Review is to identify tangible measures for improving the impact of the Local Government FAGs on the effectiveness of local governments and their ability to provide services to their residents within the current funding envelope.

3. The Commission should examine the impacts of FAGs on local government bodies and its appropriateness by focusing on:

- (a) examining in the intrastate context whether the national principles that guide the allocation of the general purpose grants remain valid and are conceptually consistent with each other;
- (b) evaluating the economic and financial benefits of untied vs tied funding for enhancing the effectiveness of local governments and their ability to ensure effective services for their residents;
- (c) identifying the impact of the Minimum Grants principle on the intra-state distribution of FAGs; and
- (d) assessing the relative need of local governments in each State and Territory with a particular focus on those that service regional and remote communities.

- 16 Our interpretation of some of the main phrases in the terms of reference follows.

What are tangible measures?

- 17 We consider tangible measures to be changes to how funds are allocated to councils in each State to improve the effectiveness and service delivery of the local government sector in each State.
- 18 We consider a grant design and distribution that facilitates best decision making consistent with increasing effectiveness and service delivery capacity is the objective of the terms of reference (noting that the review objective thus has two elements). Increased effectiveness and capacity to deliver services is measured in terms of outcomes for all councils in a State, not individual councils.

What is meant by effectiveness?

- 19 The Act says one of the purposes of providing FAGs is to improve the efficiency and effectiveness of local governing bodies. However, it does not define the terms and funds are not specifically allocated for this purpose.
- 20 We have defined effectiveness broadly to mean how well the services councils deliver are aligned to the services residents seek, having regard to the cost of the services, the revenues residents are prepared to contribute, other available revenues and the degree to which objectives are efficiently achieved and targeted problems resolved.

What is meant by ability to deliver services?

- 21 The Act says one of the purposes of providing FAGs is to improve the capacity of local governing bodies to provide their residents with an equitable level of services. Ability to deliver services therefore, in the context of the Act, has been taken to include the ability or capacity of councils in each State to deliver equal or comparable services.
- 22 Since insufficient funds are available to achieve full equality, we conclude the aim is to improve the capacity of councils across a State to deliver an average level of services, having regard to the cost of those services and the revenues residents can contribute towards those costs. FAGs can only reduce inequalities in fiscal capacities across councils in a State.

Current funding envelope

- 23 The letter from the Treasurer forwarding the terms of reference indicates the 'current funding envelope' should be taken to mean the total Commonwealth financial assistance (general purpose and identified local roads grants) paid under the Act to each State for local government. The current funding envelope excludes the supplementary funding paid to South Australian local governing bodies for local roads, other Commonwealth payments to each State for local government and other payments made by each State government to councils.
- 24 We consider the terms of reference clearly indicate that issues relating to the amount of FAGs, its indexation in future years and its distribution between States are beyond the scope of this inquiry. We have not considered or reported arguments relating to these issues in this report.

Circumstances of local government

- 25 Some parts of the reference suggest the circumstances of local government may have changed in recent years and that these changes may be relevant to our consideration of the program. By circumstances, we will have regard to the legal, intergovernmental, financial, service delivery and revenue raising environments in which local government operates.

REPORTING OUR FINDINGS AND CONCLUSIONS

- 26 Chapter 2 of this report describes the current circumstances of local government in Australia and the impact of FAGs on local government. Chapters 3, 4, 5 and 6 report our findings on the specific issues raised in the terms of reference. Chapter 7 summarises the impact of FAGs on local government and outlines our recommendations and conclusions on tangible measures.
- 27 Attachment B provides some observations on matters LGGCs might consider to improve the equity and consistency of their distribution of relative needs grants. Attachment C provides more detailed analysis of the financial position of local government.

CHAPTER 2

LOCAL GOVERNMENT IN AUSTRALIA

- 1 This chapter provides a context for the inquiry by outlining relevant aspects of the local government landscape. It describes: the system of local government in Australia; the nature of local governments, including the services they deliver and the revenues they raise; the current intergovernmental arrangements, including the impact of the financial assistance grants (FAGs) on local government; and the financial position of local government.

THE LEGAL FRAMEWORK

- 2 Constitutionally, local government is the responsibility of the States. States provide the legislative framework in which local government operates, and oversee its operations. States can create or abolish a system of local government, dismiss councillors and appoint administrators, change council boundaries and abolish individual councils.
- 3 The local government act in each State sets out the roles and responsibilities of its councils. Those acts define service delivery responsibilities, revenue raising powers and borrowing rights. They also establish accountability and performance reporting requirements which require individual councils to prepare and make available to their residents and the State various financial and other plans and report on the results of their activities.¹

¹ For example, the local government act in New South Wales requires each council to have a community strategic plan covering at least 10 years. This must be supported by a long-term resourcing strategy that includes long-term financial planning, workforce management planning and asset management planning. Each council must also have an annual operational plan that includes a statement of its revenue policy and the activities it will engage in during the year. It must also prepare an annual report, including audited financial statements, to its community on its work and activities. An end of term report must be produced every four years on the effectiveness of the four-year delivery program for achieving the vision of the long-term community strategic plan.

- 4 Despite this, each State's local government legislation imposes few, if any, limitations on the services its councils can provide. Individual councils have considerable freedom to set their own policies. However, they do this in the context of many other State decisions on whether particular services are better provided by State government agencies or local government. Such decisions strongly affect the services councils provide.
- 5 State legislation imposes constraints on the revenue councils can raise.² Some States cap the revenue collected by councils. For example, New South Wales caps the growth in revenue from rates and charges and Queensland caps infrastructure charges. The Northern Territory Government imposes conditional rating arrangements over pastoral leases and mining tenements and historical State Agreement Acts in Western Australia can restrict councils to rating the unimproved value of land used for resource projects.
- 6 State governments impose some constraints on borrowing by councils because they are exposed to a financial risk if a local government defaults on its borrowings. Some States, such as Tasmania, require their councils to obtain the approval of the State Treasurer before they access borrowings. In Western Australia, they must borrow through the West Australian Treasury Corporation. New South Wales only requires borrowing to be in Australia and in Australian currency. South Australia places virtually no constraints on the source, quantum, term and type of borrowings, but requires councils to have a financial management plan and seek independent expert advice before entering complex and sophisticated types of financing arrangements.
- 7 If a council becomes insolvent or non-functional, the State is obliged to step in. In the past, States have dismissed councillors and appointed administrators, forced amalgamations and, in a few cases, provided some emergency financial support when councils have failed.
- 8 In summary, State governments through the local government legislation and other decisions have a major role in determining the roles and responsibilities of their local government sectors. As a result, those roles and responsibilities differ between States.

THE LOCAL GOVERNMENT SECTOR IN EACH STATE

- 9 In 2011-12, 565 councils across Australia received financial assistance grants. However, the number, type and size of councils differ across States as a result of differences in State policies. For example:

² Some Commonwealth legislation also affects local governments. In particular, the Aboriginal Land Rights (NT) Act precludes the rating of Aboriginal land (unless there is leasehold tenure over it) and over 50% of the Northern Territory is Aboriginal land.

- New South Wales has county councils to provide special services such as water or environmental services.
- Councils in Victoria, Queensland, Western Australia and Tasmania cover virtually the whole of the State, while there are unincorporated areas in New South Wales, South Australia and the Northern Territory where local government functions are provided by non-local governing bodies constituted by the State or private bodies.
- Queensland, Western Australia, South Australia and the Northern Territory have designated Indigenous councils.

10 Table 2-1 shows the distribution of these different types of councils across the States.

Table 2-1 Councils eligible to receive financial assistance grants, 2011-12

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Municipal and regional councils(a)	150	79	37	114	68	29	na	6	483
Remote councils(a)	2	0	20	23	0	0	na	1	46
Unincorporated areas	3	0	0	0	1	0	na	1	5
Indigenous councils	0	0	16	1	5	0	na	9	31
Total no. of councils receiving FAGs	155	79	73	138	74	29	na	17	565

(a) Excludes unincorporated areas and Indigenous councils.

na not applicable.

Source: 2009-10 Local Government National Report and the then Department of Regional Australia, Local Government, Arts and Sport.

11 The population and scale of regions serviced by individual councils also vary enormously. For instance, in 2011-12:

- population varied from around 57 for Silverton Shire (New South Wales) to 1 067 279 for Brisbane City Council (Queensland)
- area varied from two square kilometres for the Shire of Peppermint Grove (Western Australia) to 371 696 square kilometres for East Pilbara Shire (Western Australia)
- population density varied from slightly under two people per 1 000 square kilometres for Menzies Shire (Western Australia) to 7 713 people per square kilometre for Waverley Council (New South Wales)
- the length of local roads varied from nine kilometres for Peppermint Grove Shire (Western Australia) to 7 748 kilometres for Toowoomba Council (Queensland).

12 The services provided by councils and the revenues raised to finance them differ significantly across Australia (see Table 2-2).

Table 2-2 Local government operating statement, 2011-12 (a)

	NSW	Vic	Qld	WA	SA	Tas	NT	Aust	Aust
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	%
GFS Revenue									
Taxation revenue	474	650	645	651	703	619	388	592	35.8
Current grants and subsidies	190	172	172	245	162	207	626	191	11.5
<i>of which FAGs are</i>	<i>115</i>	<i>112</i>	<i>115</i>	<i>132</i>	<i>110</i>	<i>169</i>	<i>164</i>	<i>118</i>	<i>7.2</i>
Capital grants	54	52	306	47	42	52	115	104	6.3
Sales of goods and services	471	264	592	342	200	277	451	405	24.5
Other income	242	430	431	569	142	333	566	361	21.9
Total	1 432	1 568	2 146	1 853	1 249	1 488	2 146	1 653	100.0
Less									
GFS expenses									
General public services	230	186	428	165	79	217	613	245	17.9
Social security and welfare	50	157	15	58	69	59	106	73	5.3
Housing and community amenities	355	255	369	205	262	266	422	308	22.5
Recreation and culture	181	211	184	299	237	203	243	207	15.1
Transport and communications	257	225	601	322	251	355	175	327	23.9
Public debt transactions	31	9	61	13	24	8	4	28	2.1
Other	211	166	136	209	177	138	383	182	13.3
Total	1 315	1 209	1 793	1 272	1 100	1 248	1 946	1 370	100.0
Equals									
GFS Net Operating Balance	117	359	353	581	149	240	200	283	
Less									
Net acquisition of non-financial assets(b)	98	265	435	146	123	105	- 128	214	
Equals									
GFS Net Lending(+)/Borrowing(-)	18	94	- 82	435	27	135	328	69	

(a) The ACT is not included because it does not have a separate local government sector in GFS.

(b) Net acquisition of non-financial assets is calculated as gross fixed capital formation less depreciation. In 2011-12, the Northern Territory's gross fixed capital formation is lower than its depreciation expenses.

Source: ABS Government Finance Statistics (5512.0) and Australian Demographic Statistics (3101.0).

- 13 The largest revenue source was municipal rates. It was about 36% of all revenue, varying from 56% in South Australia to 18% in the Northern Territory. Councils in the Northern Territory were more reliant on grants and subsidies (35% of their revenue) than those in other States (grants were 14% of revenue in Victoria).
- 14 There were considerable differences in the spending patterns of the local government sectors in each State. Transport and communications, including roads, was the most important function for councils in Queensland, Western Australia and Tasmania. Housing and community services were the most important function in New South Wales, Victoria and South Australia. Human services, including health, welfare and education services, were more important in Victoria than in other States.

- 15 The differences reflect the diverse circumstances in which local government operates, interstate differences in State policies on the services they provide, and Commonwealth and State influences on revenue raising capacity. For instance:
- Water supply and sewerage is a local government function in Tasmania, rural New South Wales and outside south-east in Queensland, but a State responsibility elsewhere.
 - The Brisbane City Council provides urban public transport services which are a State responsibility elsewhere.
 - Victorian councils have been assigned a larger role in providing welfare services, especially aged care, than those in other States.
 - The relatively low revenue from rates in the Northern Territory (35% less than the national per capita average) in part reflects the Commonwealth's Land Rights legislation which prevents councils imposing rates on Aboriginal land.
- 16 Within States, differences in circumstances lead to some noticeable differences in the priorities councils attach to various services. For example, housing and community amenities are relatively more important in the budgets of councils in urban areas than they are in remote areas. But large remote area councils in the Northern Territory also devote a large proportion of their budgets to those services. Roads are a very important function for rural and remote area councils but much less so for those in urban areas.
- 17 The range of services has also changed over time. Councils have moved from providing a limited range of mainly property related services to a much broader range of services, and the services provided differ, depending on the location of the councils. Councils generally acknowledge this movement reflects the increasing demands of their residents. However, a need to fill gaps, as illustrated by the decisions of some remote councils to subsidise a local doctor or to run the supermarket, has also contributed. Attachment C provides details.
- 18 These few examples highlight the considerable diversity in local government between and within States. More information on this diversity and how it affects the number of minimum grant councils and the relative needs of councils is in Chapters 5 and 6.

INTERGOVERNMENTAL FINANCIAL RELATIONS

Government financial assistance to local government

- 19 Reflecting their constitutional responsibility for local government, States were the main source of financial assistance for councils prior to 1974.

- 20 In 1974, the Commonwealth began providing untied financial assistance to local government through the States.³ The Commonwealth said it was providing this financial assistance to 'make the third tier of government a genuine partner in the (Federal) system and to give local government access to the nation's finances'.⁴
- 21 In 2000, the Commonwealth and the States agreed the Commonwealth would transfer its responsibility for funding local government to the States as part of the package of changes accompanying the introduction of the GST. However, this was subsequently changed and the Commonwealth retained the responsibility. Since then the Commonwealth has maintained and extended its financial assistance for local government.
- 22 In 2011-12, the Commonwealth contribution to local government in the States, the ACT and the Northern Territory was almost as large as that of the States and Territories. The Commonwealth provided \$2.7 billion (\$118 per capita) in financial assistance grants plus another \$560 million (\$25 per capita) in capital grants and other payments. The States and Territories provided \$3.5 billion (\$156 per capita) of recurrent and capital assistance to their councils. The Commonwealth contributions represented 8.8% of local government total revenue and the State and Territory contributions were 9.6%.⁵

Commonwealth assistance and its distribution

- 23 **Financial assistance grants.** The financial assistance grants provided to States for on-passing to local government have two components:
- a general purpose component, the interstate distribution of which is based on populations and
 - an identified local road component, the interstate distribution of which is based on fixed historical shares.
- 24 Both components of the grants are tied in the hands of the States but untied in the hands of councils, allowing each council to spend them according to its priorities.
- 25 The total grant paid increases annually in line with changes in population and the Consumer Price Index, to maintain its real per capita value. Table 2-3 shows the interstate distribution of the financial assistance paid in 2011-12.

³ Payment to the Northern Territory began in 1986-87. Payments to the ACT began in 1988-89.

⁴ The Hon Gough Whitlam, Prime Minister, Second Reading Speech, *Grants Commission Bill 1973*, House of Representatives, 17 May 1973.

⁵ These figures include the ACT. The Commonwealth contribution to the States and the Northern Territory was 8.5% of their local government sector revenues. The State and Northern Territory contribution was 9.3%.

Table 2-3 Commonwealth financial assistance grants, 2011-12 (a)

Component	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
General purpose	600.7	460.3	372.2	194.2	136.7	42.7	30.5	19.3	1 856.6
Identified local roads	239.0	169.8	154.4	126.0	45.3	43.7	26.4	19.3	823.8
Total	839.8	630.2	526.6	320.2	182.0	86.3	56.9	38.6	2 680.4
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
General purpose	82	82	82	82	82	82	82	82	82
Identified local roads	33	30	34	50	28	87	70	82	36
Total	115	112	115	132	110	169	152	164	118

(a) Since 2008-09, the Commonwealth has prepaid the first quarter payment from the next financial year to assist local government's cash management. The prepayment for 2011-12 was the first two quarters of 2012-13. This table shows the cash payment received by councils, so the reported 2011-12 financial assistance grants comprise payments for the last three quarters of 2011-12 and the first two quarters of 2012-13.

Source: Commonwealth of Australia's Final Budget Outcome 2011-12.

26 The financial assistance grants were a relatively small proportion of total council revenue, as shown in Table 2-4, varying between 5.4% in Queensland and 11.3% in Tasmania. The relatively low figure for Queensland is partly because the State provided well above average support to its councils in 2011-12 (including assistance for the public transport services provided by the Brisbane City Council and operating assistance for the Indigenous councils) and above average revenue from sales of goods and services, interest and other sources.

Table 2-4 Financial assistance grants as proportion of council revenue, 2011-12 (a)

Component	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust(b)
	%	%	%	%	%	%	%	%	%
General purpose	5.8	5.2	3.8	4.3	6.6	5.6	na	3.8	5.0
Identified local roads	2.3	1.9	1.6	2.8	2.2	5.7	na	3.8	2.2
Total	8.0	7.1	5.4	7.1	8.8	11.3	na	7.7	7.2

(a) The figures are based on the amounts paid in 2011-12 — that is, the amounts for five quarters as in Table 2-3.

(b) The Australian proportions exclude the ACT because data on local government sector revenue for the ACT are not readily available.

Source: ABS Government Finance Statistics (5512.0) and Commonwealth of Australia's Final Budget Outcome 2011-12.

27 Overall, financial assistance grants have declined from 7.6% of total sector revenue in 2002-03 to 7.2% in 2011-12. This decline has happened even though the amounts paid in 2011-12 include payments for an extra quarter. If the payment for the extra

quarter is excluded from the 2011-12 figures, they would have represented 5.7% of the national local government sector revenue.

- 28 **The intrastate distribution of financial assistance grants.** In the States, local government grants commissions (LGGCs) recommend the intrastate distribution of both components of the FAGs. Their recommendations must be prepared in accordance with the Act and a set of national principles for allocating grants (see Chapter 3).
- 29 The distribution of these grants ensures all councils within a State receive a share of identified roads funding based on local roads needs and some general purpose funding based on their populations. The rest of the general purpose funding is used to address fiscal disparities between councils in each State.
- 30 The importance of the financial assistance grants to council budgets varies noticeably within States, depending on the circumstances of councils. Table 2-5 shows the financial assistance grants are noticeably more important in the budgets of non-minimum grant and rural and remote councils than they are for minimum grant and urban councils.

Table 2-5 Financial assistance grants as proportion of revenue, by type of council, 2011-12 (a)

	NSW	Vic	Qld	WA	SA	Tas	NT
	%	%	%	%	%	%	%
Minimum grant councils	3.5	2.3	2.6	3.5	3.5	4.7	7.4
Other councils	9.3	9.7	7.8	15.0	14.9	15.8	9.4
Urban councils (b)	6.3	6.7	3.8	4.1	5.6	6.8	6.0
Rural and remote councils	18.3	17.7	13.9	16.6	20.0	22.5	9.3

(a) The figures are based on the amounts paid in 2011-12, that is, the amounts for five quarters as in Table 2-3.

(b) Urban councils include those in metropolitan areas, regional towns and fringe urban areas.

Source: Commission analysis based on data provided by ABS and the then Department of Regional Australia, Local Government, Arts and Sport.

- 31 **Other financial assistance.** The Commonwealth also provides some payments for specific purposes⁶ direct to councils. Table 2-6 lists those made in 2011-12.

⁶ Commonwealth Budget Paper No. 3 no longer has a separate chapter for local government and payments to local government are shown with all other payments to the States for specific purposes.

Table 2-6 Commonwealth direct payments to local government, 2011-12

	NSW	Vic	Qld	WA	SA	Tas	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Healthy communities	6.4	5.6	5.0	3.6	3.1	0.8	0.8	25.5
Building better regional cities	15.0	4.0	5.0	6.0	0.0	0.0	0.0	30.0
Cloncurry community precinct	0.0	0.0	2.4	0.0	0.0	0.0	0.0	2.4
East Kimberley development package - Other infrastructure	0.0	0.0	0.0	1.0	0.0	0.0	0.0	1.0
King George V sports and community precinct	0.0	0.0	0.0	0.0	0.0	8.7	0.0	8.7
Local Government and regional development - infrastructure employment projects	0.0	1.3	0.1	0.0	0.0	0.0	0.0	1.4
Off-network projects	7.8	1.6	51.0	3.8	0.0	0.0	0.0	64.2
Nation Building Program – supplementary	3.4	6.5	7.1	5.9	0.2	0.3	0.0	23.3
Roads to recovery	79.7	70.2	67.6	48.5	28.4	10.9	4.4	309.6
North Penrith Thornton Park Car Park	2.0	0.0	0.0	0.0	0.0	0.0	0.0	2.0
Regional and local community infrastructure program	32.8	26.1	12.2	3.7	5.1	1.6	0.0	81.4
Water for the future	0.9	0.0	0.0	1.0	2.0	5.2	0.0	9.1
Total	148.1	115.3	150.4	73.5	38.6	27.4	5.2	558.6

Source: Commonwealth of Australia's Final Budget Outcome, 2011-12.

State financial assistance to local government

- 32 The form and extent of State financial support for local government differ across the States. Table 2-7 shows the support provided by the States for each service.
- The amounts provided vary substantially from State to State — from a low of \$55 per capita in South Australia to a high of \$556 per capita in the Northern Territory in 2011-12.
 - All States provide specific purpose grants for services to communities (including water and electricity concessions and subsidies, Indigenous services and community amenities), roads and recreation and culture.
 - The support is provided for a mix of recurrent and capital expenditures. ABS data show it was split approximately half and half between recurrent and capital purposes in 2011-12.
- 33 Queensland and the Northern Territory provide operational subsidies to predominantly Indigenous councils.

Table 2-7 State financial support (a) for local government by function, 2011-12

	NSW	Vic	Qld	WA	SA	Tas	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
General public services	1.1	159.7	25.6	0.5	8.2	0.2	0.1	195.4
Public order and safety	125.4	4.2	16.6	39.9	0.4	0.0	4.1	190.5
Education	0.0	0.3	0.0	0.0	1.2	0.0	6.0	7.4
Health	0.0	3.3	4.5	0.4	0.0	0.1	6.3	14.6
Social security and welfare	0.0	0.1	97.5	0.0	23.4	14.7	3.2	138.9
Housing, community amenities	115.9	83.1	210.1	268.7	39.7	0.4	75.6	793.4
Recreation and culture	40.0	34.8	99.5	22.4	1.9	1.5	5.3	205.5
Fuel and energy	0.0	0.0	0.0	0.0	0.0	0.0	10.7	10.8
Agriculture, forestry and fishing	19.0	2.5	0.2	0.4	0.0	0.3	0.7	23.1
Mining, manufacturing, construction	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Transport and communications	85.5	93.3	661.8	142.3	14.9	4.0	9.5	1 011.5
Other economic affairs	2.2	63.3	11.0	5.5	1.3	0.8	1.0	85.1
Public debt transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	402.1	68.4	374.2	-40.1	0.0	11.7	7.9	824.3
Total	791.2	513.0	1 501.0	440.2	91.0	33.8	130.4	3 500.5

(a) Includes recurrent and capital grants and subsidies, and assets donated to the local government general government sector. On-passed Commonwealth general revenue or roads funding is not included.

Source: Unpublished government finance statistics provided by the States.

THE FINANCIAL POSITION OF LOCAL GOVERNMENT

State local government sector financial outcomes, 2011-12

- 34 ABS Government Finance Statistics for 2011-12 (see Attachment C) show local government sector revenue exceeded expenses in all States – the sector had a net operating surplus. With the exception of Queensland, the revenue also exceeded the combined expenses and investment – overall, the sector was a net lender and added to its financial balances in that year.
- 35 When judged on the basis of operating results alone, the aggregate local government sector of each State appears to be financially healthy, with 2011-12 net operating surpluses ranging between \$117 per capita in New South Wales and \$581 per capita in Western Australia. Even when net infrastructure acquisitions are taken into account, the outcomes remain positive in most States — net lending varied between

\$18 and \$435 per capita in New South Wales and Western Australia respectively. Queensland was the exception with a net borrowing outcome of \$82 per capita.

- 36 We also examined the outcomes for groups of similar types of councils in each State. We classified the councils in each State into eight groups. (The groups were metropolitan, regional towns, large urban fringe, small urban fringe, large agricultural, small agricultural, large remote and small remote). At this level there was more variability in outcomes. Most groups had surpluses after acquiring extra infrastructure, but the following groups had to borrow to provide infrastructure:
- the metropolitan group in Queensland
 - the metropolitan and urban fringe groups in Victoria
 - the small urban fringe group in Western Australia and South Australia
 - the small agricultural group in the Northern Territory.
- 37 Urban councils experiencing strong population growth have been identified as a disadvantaged group of councils in some submissions, primarily because they have had to borrow to meet the infrastructure needs of their residents. The Australian Centre of Excellence for Local Government⁷, however, suggested such actions are appropriate as it spreads the financial responsibility across those receiving benefits from the infrastructure and the growth in the council's revenue bases will provide the capacity to repay the loans.

State local government sector financial outcomes over time

- 38 The average per capita operating result of the local government sector grew from a surplus of \$62 per capita to \$283 per capita between 2002-03 and 2011-12. This growth was the result of several factors:
- local government revenue raising efforts have increased more than their service provision — local government rate revenue grew by 83% and its total own-source revenue grew by 97% between 2002-03 and 2011-12 which exceeded the 75% increase in expenses
 - there were increases in capital assistance from the Commonwealth and States
 - the Commonwealth paid five quarters' worth of FAGs in 2011-12. Excluding the grants for the extra quarter would reduce the 2011-12 operating surplus by \$25 per capita to \$258 per capita.
- 39 The value of local government infrastructure almost doubled from \$6 000 per capita in 2002-03 to \$11 000 per capita in 2011-12, reflecting increased investment, partly encouraged by the higher Commonwealth capital assistance. For example, investment in 2011-12 was more than three times that in 2002-03. In most States,

⁷ J Comrie, *In Our Hands: Strengthening Local Government Revenue for the 21st Century*. Australian Centre of Excellence for Local Government, University of Technology, Sydney, 2013, p. 41.

this was funded by the increasing operating surpluses. In Queensland, it was also funded by borrowing.

- 40 Putting the local government sector's finances into some perspective, we note: the growth in its taxation revenue since 2002-03 (83%) was greater than that of the Commonwealth (63%) and the States (64%).
- 41 While not the only indicators of financial strength, the revenue growth, annual operating results and asset stocks of State local government sectors suggest that, as a whole, they are in a relatively strong financial position.

Sustainability

- 42 The picture of sound current financial circumstances for the local government sector as a whole implied by our analysis contrasts with the widespread concerns expressed over the last decade about the potential unsustainability of many councils in all States, particularly ones in regional and remote areas with low rate bases.
- 43 Those concerns stemmed from the findings of State inquiries into the financial sustainability of local government in New South Wales, Western Australia, South Australia, Tasmania and the Northern Territory and an Australian Local Government Association sponsored overview inquiry. Those inquiries generally used a definition of 'financial sustainability' similar to the following one from the New South Wales study.

A council's finances should be considered sustainable in the long term only if its financial capacity is sufficient – for the foreseeable future – to allow the council to meet its expected financial requirements over time without having to introduce substantial or disruptive revenue (and expenditure) adjustments⁸.
- 44 On the basis of data relating to operating and capital performance⁹ for the early to mid-2000s, the inquiries found a substantial proportion of councils in the States examined were unsustainable or at risk of becoming unsustainable on their then current policy settings. For example, the national study sponsored by the Australian Local Government Association¹⁰ concluded 10 to 30% of councils had sustainability issues, given their policies at that time. It said those councils were 'likely to be developing infrastructure backlogs due to service expansions, moderate operating cost growth, minimal revenue growth giving rise to persistent underlying operating deficits and constraints on renewal expenditure'. The study found most large metropolitan councils were viable or could improve their situation themselves. Rural

⁸ P Allan, *Are Councils Sustainable? Final Report: Findings and Recommendations*, NSW Local Government and Shires Associations, Sydney, 2006.

⁹ The studies used measures such as operating surplus ratio (operating surplus relative to rates revenue), net financial liabilities ratio and capital renewal ratios (net capital spending on asset renewal relative to depreciation).

¹⁰ PricewaterhouseCoopers, *National Financial Sustainability Study of Local Government*, November 2006. This study brought together the results of a number of State studies and also undertook an analysis of financial indicators for a sample of local governments.

remote and rural agricultural councils tended to have bigger sustainability issues. The study suggested management quality, financial discipline and council size had significant effects on sustainability.

- 45 The results of the individual State studies varied noticeably — a 2006 study in New South Wales concluded the long term viability of 25% of councils was threatened; a 2006 study in Western Australia found 58% of councils covering 21% of the population were unsustainable on their then current policies; a 2005 study in South Australia found almost 40% of councils covering about 33% of the State population were unsustainable given their then current policies; a 2007 study in Tasmania said 20% of councils covering 8% of the population were unsustainable; and a 2012 study of the Northern Territory's shire councils (but not its urban councils) found they were all unsustainable. Variation in council structures, roles, responsibilities, policies and circumstances and in the study methods contributed towards these different results.
- 46 The studies provided impetus for a range of actions by the Commonwealth, the States, State local government associations and individual councils aimed at improving council effectiveness, efficiency and sustainability. The actions included council amalgamations, encouraging greater co-operation between councils (through joint service provision, resource sharing, group purchasing and staff exchanges) and requiring and promoting better council processes (including long term financial management and workforce planning, improved financial and performance reporting and better asset management).
- 47 More recent studies and ongoing monitoring and reporting in some States, such as New South Wales, Victoria and Queensland, suggest these actions may be leading to some improvements in council sustainability.
- 48 The different impressions of local government financial positions created by our analysis of ABS data for 2011-12 and the sustainability studies partly arise because of the Commonwealth capital grants and the prepayments of FAGs in 2011-12. They also appear to result from several important differences between the studies:
 - our analyses are done at high levels of aggregation whereas the sustainability studies are done at the individual council level
 - our analyses are based on net operating and net lending results only whereas the studies use several extra indicators to build a broader picture of council finances, including taking account of the 'health' of council infrastructure and the extent to which local governments are deferring asset maintenance and other non-essential tasks to produce operating surpluses
 - many of the studies were done in the early 2000s and many programs have been implemented to help improve sustainability since then. However, a recent

New South Wales study¹¹ still concluded the sustainability of 25% of councils, especially those in coastal and near coastal areas in the north of the State, was weak or very weak. Since its methods differed from those of the earlier studies the precise extent of change is unclear.

REVENUE EFFORT AND LEVEL OF SERVICE PROVISION

Revenue effort

- 49 Table 2-8, shows how the revenue raising efforts of different types of councils in recent years compare with the average effort of councils in their State, as measured by each LGGC. Relative revenue effort is calculated as the actual revenue of the council group divided by the revenue the LGGC has estimated the group would collect if the councils in it followed the average revenue raising policies and imposed the average tax rates on their revenue bases (that is, made the average revenue raising effort). Relative efforts above one indicate the group is making an above average effort to raise revenue, while a figure below one indicates it is making a below average effort. For example, minimum grant councils in New South Wales are raising 60% of the revenue they are assessed to be able to raise by the LGGC if they made the average effort of all New South Wales councils.
- 50 However, caution should be exercised in interpreting these results. They may reflect factors other than differences in revenue raising effort; for example, if differences between councils in the types of revenues they can collect (such as parking fees) are not accurately captured in the assessments.
- 51 The table suggests revenue raising efforts are below average in: minimum grant councils in all States (except the Northern Territory); metropolitan area councils in all States; small urban fringe councils in New South Wales and Tasmania; large agricultural area councils in Tasmania and the Northern Territory; and large remote area councils in the Northern Territory. Other councils appear to be making above average efforts.
- 52 A Productivity Commission study used a different broader measure of the revenue base (the aggregate after tax income of the local government's community) but still concluded urban developed councils tend to draw relatively lightly, and rural and remote councils relatively heavily, on their revenue bases.¹²

¹¹ New South Wales Treasury Corporation (T Corp), *Financial sustainability of the New South Wales local government sector*, 2013.

¹² Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, 2008, Figure 3, page xxvi. The Productivity Commission measured the revenue base of a council in terms of the aggregate after-tax income of its community.

Table 2-8 Relative revenue raising efforts of different groups of councils (a)(b)

	NSW	Vic	Qld	WA	SA	Tas	NT
Minimum grant councils	0.60	0.88	na	0.95	0.90	0.88	1.00
Other councils	1.26	1.08	na	1.12	1.19	1.09	1.02
Metropolitan area councils	0.79	0.87	na	0.95	0.89	0.87	0.97
Regional town councils	1.42	1.36	na	1.25	1.29	1.23	1.37
Small urban fringe councils	0.97	1.20	na	1.09	1.05	0.89	1.29
Large agricultural councils	1.39	1.40	na	1.22	1.20	0.97	0.43
Large remote area councils	2.45	na	na	1.15	na	na	0.91

(a) Relative revenue effort is calculated as the actual revenue of the council group divided by the revenue the LGGC has estimated the group would collect if councils in the group followed the average revenue raising policies and imposed the average tax rates) on their revenue bases (that is, made the average revenue raising effort. Relative efforts above one indicate the council is making an above average effort to raise its own revenue, while a figure below one indicates it is making a below average effort.

(b) Figures are not comparable between States because they relate to different years. They relate to: 2009-10 for South Australia and Tasmania; 2010-11 for the Northern Territory; 2011-12 for Victoria; 2012-13 for New South Wales; and 2013-14 for Western Australia.

na indicates sufficient data were not available for these States or councils.

Source: Commission analysis based on data provided by each LGGC.

53 An Australian Centre of Excellence for Local Government paper¹³ notes the local government sector has made sound progress in improving its financial performance recently, but suggests ‘more needs to be done ... to further strengthen the revenue raising and overall financial capabilities of local governments’. It suggests many councils could generate more rate revenue and increase revenue from user charges for services that are primarily of a private good nature. It also recognises that not all councils have the capacity to raise more revenue.

Level of service provision

54 Table 2-9 shows how the level of service provision by different types of councils in recent years compares with the average provision of councils in their State, as measured by the LGGC. A relative level of service above one indicates the group of councils is providing an above average level of service, while a figure below one indicates it is providing below average services. For example, minimum grant councils in Victoria spend 20% more than they would spend if they were delivering the average level of services provided by all Victorian councils.

¹³ Comrie, op. cit. p.4.

Table 2-9 Relative level of service provision for different groups of councils (a)(b)

	NSW	Vic	Qld	WA	SA	Tas	NT
Minimum grant councils	na	1.20	na	1.13	1.14	1.36	0.71
Other councils	na	0.94	na	0.82	0.88	0.87	1.40
Metropolitan area councils	na	1.07	na	1.20	1.18	1.96	0.84
Regional town councils	na	0.97	na	0.96	0.78	1.09	0.71
Small urban fringe councils	na	1.20	na	0.99	0.84	1.04	0.57
Large agricultural councils	na	0.82	na	0.97	0.77	0.73	0.45
Large remote area councils	na	na	na	0.93	na	na	na

(a) Relative level of service provision is calculated as the group's actual spending divided by the spending the LGGC has estimated the group would make if it followed the average service delivery policies in its circumstances (that is, delivered the average level of services to its residents). Relative service provision above one indicates the local government is providing an above average level of services, while a figure below one indicates it is providing a below average level.

(b) Figures are not comparable between States because they relate to different years. They relate to: 2009-10 for South Australia and Tasmania; 2010-11 for the Northern Territory; 2011-12 for Victoria; and 2013-14 for Western Australia.

na indicates sufficient data were not available for these States or councils.

Source: Commission analysis based on data provided by each LGGC.

55 As with the revenue effort calculations, care must be taken in interpreting the figures because they can reflect the different choices LGGCs make in designing assessments. For example, if LGGCs assess cost adjusters of one and above, their assessments of the spending by high cost councils are likely to be overstated, resulting in low implied levels of service provision.

56 The table suggests above average levels of services are provided by: minimum grant councils in all States (except the Northern Territory); metropolitan area councils in all States (except the Northern Territory); regional councils in Tasmania; small urban fringe councils in Victoria and Tasmania. Other councils appear to be providing below average levels of service.

57 The apparent above average level of service provision by minimum grant councils is possible despite their below average revenue efforts and their small general purpose grants. This highlights the overall strength of their financial capacities.

FINDINGS

58 We have found the following.

- Local governments and their operations are primarily the responsibility of State governments. The legislative, structural and financial frameworks they establish have a great deal of influence over the sustainability, effectiveness and ability of councils to deliver services.

- There is a great diversity in the nature of councils within States in terms of their population and geographic size and their service delivery responsibilities and revenue raising capacity. There is also greater diversity within some State sectors than others.
- The Commonwealth financial assistance grants are a relatively small component of the total revenue of the local government sector — nationally, they were 7.2% of local government sector revenue in 2011-12 or about 5.7% if the prepayment made in that year is excluded.
- Financial assistance grants are a very small component of the total revenue of many councils, especially minimum grant councils. For these councils, the grants they receive is often smaller than the extra revenue they could raise at average rates or their spending on above average services.
- However, financial assistance grants can be significant elements of the revenue of other councils, especially rural and remote councils.
- The apparent overall financial strength of the local government sector in most States contrasts with the widespread concerns about sustainability. Those concerns may be due to infrastructure backlogs or reduced service levels which have arisen because councils have attempted to maintain balanced budgets.

CHAPTER 3

THE NATIONAL PRINCIPLES

- 1 This chapter responds to Clause 3(a) of the reference which asks us to examine:
in the intrastate context whether the national principles that guide the allocation of the general purpose grants remain valid and are conceptually consistent with each other.
- 2 *The Local Government (Financial Assistance) Act 1995* (the Act) requires the allocation of grants to councils in each State to accord with the national principles set out in Box 3-1. They are sub-divided into two groups — one group relates to the general purpose grants provided under section 9 of the Act and the other to the additional funding (usually called identified local roads grants) provided under section 12.

THE VALIDITY AND CONCEPTUAL CONSISTENCY OF THE NATIONAL PRINCIPLES

- 3 The national principles are intended to guide the intrastate allocation of grants to help achieve, in a consistent way, the purposes and goals of the Act. Our views on their validity are based on how well they support those purposes and goals
- 4 In general, submissions supported the national principles and said they were valid and consistent with the objectives of the Act. Nevertheless, many submissions saw competition between the horizontal equalisation and minimum grant principles.

Box 3-1 National principles for allocating financial assistance grants

In recommending Financial Assistance Grant allocations to local governing bodies, the local government grants commissions are required to make their recommendations in line with the national principles formulated under the *Local Government (Financial Assistance) Act 1995*.

The main objective of having national principles is to establish a nationally consistent basis for distributing financial assistance grants to local government under the Act.

General Purpose Grants

The national principles relating to allocation of general purpose grants payable under section 9 of the Act among local governing bodies are as follows:

1. Horizontal equalisation

General purpose grants will be allocated to local governing bodies, as far as practicable, on a full horizontal equalisation basis as defined by the Act. This is a basis that ensures each local governing body in the State or Territory is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in the State or Territory. It takes account of differences in the expenditure required by those local governing bodies in the performance of their functions and in the capacity of those local governing bodies to raise revenue.

2. Effort neutrality

An effort or policy neutral approach will be used in assessing the expenditure requirements and revenue-raising capacity of each local governing body. This means as far as practicable, that policies of individual local governing bodies in terms of expenditure and revenue effort will not affect grant determination.

3. Minimum grant

The minimum general purpose grant allocation for a local governing body in a year will be not less than the amount to which the local governing body would be entitled if 30 per cent of the total amount of general purpose grants to which the State or Territory is entitled under section 9 of the Act in respect of the year were allocated among local governing bodies in the State or Territory on a per capita basis.

4. Other grant support

Other relevant grant support provided to local governing bodies to meet any of the expenditure needs assessed should be taken into account using an inclusion approach.

5. Aboriginal peoples and Torres Strait Islanders

Financial assistance shall be allocated to local governing bodies in a way, which recognises the needs of Aboriginal peoples and Torres Strait Islanders within their boundaries.

6. 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.

Local Road Grants

The national principle relating to allocation of the amounts payable under section 12 of the Act (the identified road component of the financial assistance grants) among local governing bodies is:

1. Identified road component

The identified road component of the financial assistance grants should be allocated to local governing bodies as far as practicable on the basis of the relative needs of each local governing body for roads expenditure and to preserve its road assets. In assessing road needs, relevant considerations include length, type and usage of roads in each local governing area.

- 5 There was widespread acceptance that providing more assistance to councils who need it most was a central feature of the arrangements. This led some submissions to seek a reduction in the minimum grants and changes to the principle. They argued councils receiving minimum grants had high capacities to raise revenue. They said relaxing the minimum grant principle would provide more funds for councils with relatively high needs and a more equitable level of services across all councils in a State. Most submissions, however, said minimum grants should remain at the 30% level because:
- they reflect the revenue sharing history of the grants and the universality of the grants program
 - they provide certainty and stability in the grant outcomes
 - they are a safeguard against deficiencies in the grant allocation process
 - they recognise the difficulties of assessing relative revenue raising capacity
 - they keep all councils engaged in the process.
- 6 If the principles are considered in isolation, there is competition between them. However, the principles must be interpreted in the context of the Act which seeks progress on each purpose. It also resolves the competition between the minimum grant and equalisation principles by specifying each council must receive a minimum grant, setting the size of that grant and stating full horizontal equalisation is to be sought 'as far as practicable'.
- 7 ***The horizontal equalisation principle.*** This principle says the general purpose grants are to be allocated among councils in a State, as far as practicable, on a full horizontal equalisation basis. Its description of full horizontal equalisation is the same as section 6(3) of the Act.
- 8 This principle results in higher grants for councils with relatively low financial capacities. It is consistent with, and supports, the grant purpose of improving the capacity of councils to provide their residents with an equitable level of services (the equitable services purpose). It is a valid principle.
- 9 In practice, the general purpose grants given to each State are insufficient to equalise capacities which would require all councils to be raised to the capacity of the strongest council. Indeed, they are insufficient to raise all low capacity councils to the average. For example, the grants to Victoria, South Australia and Tasmania fund only 30% to 45% of the relative needs of their local governments with below average financial capacity. Currently, larger grants are provided to councils with low capacities, raising them towards the average and reducing the gaps in relative needs. Some submissions suggested rewriting the equalisation principle in terms of relative needs would make its aim much clearer and better align with actual outcomes.

- 10 Consistent with the existing funding envelope, it would be desirable to clarify the principle by removing the language of full equalisation and replacing it with the aim of reducing disparities in relative needs.
- 11 If the Commonwealth wishes to retain the existing guidance that councils assessed to have below average fiscal capacities should receive relative needs grants the following formulation, or something similar, would be appropriate.

The grants should ensure each council in the State or Territory with a positive relative need has its fiscal capacity raised towards the average budget outcome of councils in the State or Territory. The relative need calculations should take account of differences between councils in the expenditure required to perform their functions and in their capacity to raise revenue if they operate at average levels.
- 12 ***The effort neutrality and other grant support principles.*** These two principles prescribe essential aspects of horizontal equalisation.
 - The effort neutrality principle aims to ensure each council's grant is not directly affected by its own policies and does not create incentives for grant seeking behaviour. It helps ensure actions of individual councils are not driven by grant outcomes.
 - The other grant support principle seeks to avoid the same relative needs being funded in the allocation of the general revenue grant and by other grants councils may receive from the Commonwealth or State governments — it aims to avoid 'double dipping'.
- 13 Submissions did not argue against the intent of these principles, but some said implementation of the effort neutrality principle could be improved because the averaging process used to derive the standard policies gives more weight to the policies of some councils (such as those with high land values). It also meant the average service standards included spending on services only a few councils need to provide, such as regional services.
- 14 Other submissions highlighted interstate differences in the implementation of the other grant support principle. They illustrated the point by noting some States include all the Roads to Recovery grants in determining the general revenue grants but others exclude up to 50% of them.
- 15 These two principles aim to ensure the intrastate allocation of grants reflects only differences in council circumstances and does not double count needs already funded by other grants. These aims are fundamental to a system which seeks to reduce differences in capacity to provide services. We conclude they are valid principles.
- 16 ***The Aboriginal peoples and Torres Strait Islanders principle.*** The Act says one of the purposes of the financial assistance grants is to improve services provided by councils to Aboriginal and Torres Strait Islander communities. We have taken this purpose to mean giving councils the capacity to meet the additional cost of delivering services to

Indigenous communities and other Indigenous residents within their boundaries. The validity of the associated national principle is judged against this interpretation.

- 17 It is possible to interpret the grant purpose as relating only to Indigenous communities rather than Indigenous residents, or as intending service levels for Indigenous communities may differ from services provided to other communities (for example, to address backlogs). We have not done so. If government considers an alternate interpretation is intended then our conclusion on the validity of this national principle may need to be revisited.
- 18 In our view, the Aboriginal peoples and Torres Strait Islander principle aims to ensure the grant allocations recognise the needs of Indigenous people within the boundaries of each council. We consider it is consistent with our interpretation of the Aboriginal peoples and Torres Strait Islanders grant purpose and the equalisation purpose as it ensures the grant allocations recognise the impact of Indigenous people on the financial capacities of councils. Most local government grants commissions (LGGCs) appear to interpret this principle in the equalisation context as their determinations of the amounts councils would spend to provide the average services include Indigenous allowances or cost adjusters. The South Australian LGGC has adopted a different approach to calculate the grants of the five Aboriginal community councils recognised as local governing bodies¹. The Queensland and Northern Territory LGGCs exclude part of the State financial aid received by their Indigenous councils from the determination of their general purpose grants. But those approaches can be seen as consistent with the equalisation purpose.
- 19 A revised equalisation principle, like that in paragraph 11, requiring all material influences on local government spending and revenue raising to be taken into account would cover the equalisation aspects of the Aboriginal peoples and Torres Strait Islander principle. However, having regard to the subsidiarity principle and the differing circumstances of the States, we consider a specific principle is desirable to provide flexibility for States to make specific provision for Indigenous communities consistent with the grant purpose.
- 20 ***The minimum grant principle.*** This principle repeats section 6(2)(b) of the Act in specifying the basis for calculating the minimum grant for each council. As such, it supports the grant purpose of improving the financial capacity of councils. Since it ensures each council receives some funds, it also supports the purpose of improving the certainty of funding. The operation of this principle is discussed further in Chapter 5.

¹ Per capita grants for the Indigenous communities were initially established in 1994-95, following a study of the expenditure needs and revenue raising capacities of the communities and comparisons with surrounding councils and communities in other States. Grants have been increased since then at the same rate as the State's total funding from general purpose and the identified roads grants.

- 21 We conclude this principle is valid and consistent with two of the grant purposes.
- 22 ***The council amalgamation principle.*** When councils amalgamate, the greater economies of scale mean the general purpose grant of the new council can be less than the sum of the grants the individual councils would have received. The amalgamation principle, which defers the grant adjustments for four years, was introduced to reduce the disincentives to amalgamations arising from them.
- 23 One submission said this principle constrains the application of the horizontal equalisation principle, because the extra grants provided to amalgamated councils are funded by reducing those for all non-minimum grant councils in the State. However, we note the amalgamation principle was introduced to reduce the disincentives the grant process created for amalgamations. As such, it reflects a Commonwealth decision to trade-off some support for the equalisation purpose to gain support for the efficiency and effectiveness purpose.
- 24 The impact of that trade-off is limited by the low number of amalgamations in recent years. The number of councils in Australia has been relatively stable since 2008 (when Queensland and the Northern Territory introduced major reforms) and the principle does not currently affect grant allocations. It may do so in the future however, as some States are reviewing the structure of their local governments.
- 25 By reducing the grant effects of amalgamations the current principle may distort evaluations in favour of amalgamation compared with alternative efficiency and effectiveness improving initiatives. Furthermore, as one submission noted, it is not strictly feasible for LGGCs to apply this principle because once councils amalgamate much of the data needed to determine the grants they would have otherwise received are no longer available.
- 26 Some submissions also suggested new principles and changes in grant design were required to address efficiency and effectiveness, value for money and financial sustainability issues which have been important to local government in recent years. We note the amalgamation principle is the only national principle explicitly supporting the efficiency and effectiveness purpose. (The Act provides some indirect support for the purpose because it requires the grants be untied in the hands of councils and it requires the Commonwealth minister to report annually on the performance of councils in improving their efficiency.)
- 27 We conclude the amalgamation principle is valid as it supports the efficiency and effectiveness purpose. However, as discussed in Chapter 7, we consider a broader and more flexible approach, which includes changes in grant design, would better support improvements in efficiency and effectiveness.
- 28 ***The local roads principle.*** This principle guides the distribution of the identified local roads grants. It provides for every council with responsibility for roads to receive a share of the grants in accordance with its relative need to spend on roads and to

preserve its road assets. It also provides guidance on the relevant factors to be reflected in the grant distribution — the length, type and use of roads.

- 29 The principle is valid as it supports the grant purposes of improving the financial capacity of councils and certainty of funding by helping them meet their responsibilities arising from their existing road networks. While it explicitly recognises spending provided for asset preservation, the grant distributions are affected by the past policies of individual councils on the size and nature of their road network. It would be desirable for the principle to be broadened to reflect differences between councils in their need to invest in additional roads and to increase the policy neutrality of the grant distribution.
- 30 ***Implementation of the national principles.*** Some submissions drew attention to issues with the implementation of the principles, including those listed below.
- The use of average revenue rates may not adequately reflect the average revenue policies when there are significant differences in land values across councils, suggesting clarification of the effort neutrality principle may be needed.
 - The methods of assessing some needs allowances (such as those for regional services or for Aboriginal peoples and Torres Strait Islanders) may be inappropriate if they do not reflect both the average spending on a service and differences between councils in the need to provide that service.
 - The application of caps and other constraints on the allowances for some factors can lead to similar factors having different effects across States and to insufficient recognition of relative needs within States.
- 31 Some State local government associations also said differences in grant outcomes for broadly similar councils in different States suggested some principles were not implemented consistently. For example, they noted differences in the treatment of similar specific purpose grants received by councils suggested interstate differences in the implementation of the other grant support principle.
- 32 The submissions sought clarification of the principles to improve the extent to which equalisation and national consistency is achieved in the allocation of grants.
- 33 Many of the interstate differences causing the concerns raised in the submissions reflect decisions and judgments by the LGGCs on the best way of capturing the circumstances of their State. LGGCs need the flexibility to make those judgments. However, some extra guidance on the interpretation and application of the principles could improve equalisation and the interstate consistency of the methodological frameworks. It may also improve the transparency and accountability of the process and make the LGGCs tasks easier. Such guidance is in Attachment B.

FINDINGS

- 34 Many submissions considered there were unacceptable levels of competition between the national principles, especially between the minimum grant and horizontal fiscal equalisation principles.
- 35 When seen in isolation some principles compete with each other. However, individual principles must be interpreted in the context of the Act's intentions that: progress is to be made towards each grant purpose; each council must receive a minimum grant; and the minimum grant provision constrains horizontal equalisation.
- 36 Overall, we conclude the Act and the national principles form a consistent package, albeit a package that requires trade-offs as in many areas of public policy. Each principle is consistent with at least one purpose and is valid, but they could be better presented. Clarifying the links between the grant purposes, principles and available funds would lead to more effective and transparent grant arrangements.
- 37 We consider the language of full equalisation should be replaced with relative needs. The grant purpose of increasing efficiency and effectiveness could be better achieved by a more flexible grant design. Extra guidance on the implementation of some principles could improve equalisation and the national consistency of their implementation, so long as it does not constrain the ability of LGGCs to reflect the circumstances of their councils in the grant allocations. These issues are taken further in Chapter 7 and Attachment B.

CHAPTER 4

ECONOMIC AND FINANCIAL BENEFITS OF TIED AND UNTIED GRANTS

- 1 This chapter responds to Clause 3 (b) of the reference which asks us to evaluate:
the economic and financial benefits of untied vs tied funding for enhancing the effectiveness of local governments and their ability to ensure effective services for their residents.
- 2 This clause asks us whether tied or untied funding is more likely to result in councils providing effective services to their residents and why.

WHAT IS TIED AND UNTIED FUNDING?

- 3 Tied funding is funding the recipients must use for the purpose nominated by the funding provider or in accordance with other conditions the provider sets. Recipients are usually required to report to the funding provider on the use of the funds.
- 4 Untied funding is funding the recipients can use for any purpose and in any manner they deem appropriate. The recipients are not required to report to the funding provider on the use of the funds.
- 5 Consistent with the approach adopted in several submissions, we also make a distinction between:
 - **tied funding** that must be used by the recipients in a prescribed way, for a nominated purpose or to provide a particular service and
 - **conditional funding**, where the recipient must meet conditions not directly related to a particular function, to be eligible to receive funding.¹ They may be free to decide how the funds are used once they meet the eligibility conditions.

¹ The conditions may be more specific than the requirement to be a local governing body as defined in section 4 of the Act. They could include meeting certain reporting requirements.

HOW DOES TIED AND UNTIED FUNDING CURRENTLY WORK?

- 6 Councils currently receive a range of grants and payments from the Commonwealth and State governments, as set out in Chapter 2 and Attachment C.

Financial assistance grants from the Commonwealth

- 7 Section 15 of the Act says financial assistance grants are tied in the hands of State governments, since they must be passed on, in full, to local governments and the State must provide a report and audit certificate to the Commonwealth certifying that happened. Section 15 also says the grants are untied in the hands of councils.
- 8 The financial assistance grants represented around 7% of total local government revenue in 2011-12, but their importance varied between councils. They are provided in two components: a general purpose component and a local road component. The components differ in the way they are allocated between States and to councils within each State. Both components are untied even though some councils use the identified local roads grants only for local roads purposes, and most spend more on roads than the identified local roads grants.

Commonwealth tied payments

- 9 The Commonwealth has made a range of tied payments to councils in recent years. They were around 2% of local government revenue in 2011-12. The most significant payments are those made under the Nation Building Program, which began in 2008-09, and included Roads to Recovery payments. The Commonwealth also made National Partnership payments direct to councils in the areas of preventive health, affordable housing, infrastructure and environment. Payments were also made through the States under the Digital Regions Initiative.

State funding to local government

- 10 States provide funding to local government for capital and recurrent purposes. While we have limited information on these grants, the majority appear to be tied, although the payments by Queensland to its Indigenous councils and the operational grant paid by the Northern Territory to Shire Councils are untied. State grants represented around 10% of local government revenue in 2011-12.

THE ARGUMENTS FOR AND AGAINST TIED AND UNTIED FUNDING

Tied funding

- 11 The main reason for tying funding is to influence the range or level of services provided by the recipients. Typically, tied grants are intended to increase the level (or

guarantee a minimum level) of spending on functions that are the responsibility of the recipient. Other reasons for tying funding, include:

- to compensate for the presence of positive or negative externalities
- to compensate recipients for costs incurred in implementing provider government programs
- to offer additional incentives for funding national (or State) priorities and 'merit goods'
- to ensure minority groups receive a minimum level of services
- to address issues of non-resident use of local services
- to improve the long term management of governments
- to allow the funding provider to take some credit for the service provided.²

- 12 Whether tied funding achieves the objective of increasing the level of spending depends on the incentives and constraints the funding arrangements impose on recipients. Arrangements which require recipients to make a matching financial contribution in the particular area of expenditure to be eligible for the grants provided are more likely to increase the level of spending. In some cases, matching funds are required to be additional to the previous spending on the function.
- 13 Tied funding often has many accountability conditions which give the funding provider the capacity to see that funds are used as required and the objectives of the transfer are met. Typically, recipients are required to provide an audit report and acquittal detailing funds disbursement and adherence to conditions. They may also be required to report on a more regular basis, such as at project 'milestones'.
- 14 Tied funding often means decisions on how the funds are used are made at a distance from those affected by the program. Funding providers may have more limited knowledge of local community preferences than recipients and funding conditions may be made without reference to local circumstances.
- 15 Tied grants may also entail considerable administrative and compliance costs. These include the costs to recipients of reporting on project costs, delivery and outcomes, and preparing audit certificates and acquittals. They may also include the costs of preparing funding applications and proposals. The funding providers may incur costs associated with program development, funds distribution and monitoring.
- 16 The conditions and objectives of a tied grant scheme are likely to be more practical and better adhered to if the scheme is jointly designed. Recipients are also likely to establish better and more efficient administrative systems when tied funding is expected to be long-term in nature, rather than 'one-off'.

² B Searle & J Martinez-Vazquez, 'The Nature and Functions of Tied Grants', in: *Fiscal Equalization: Challenges in the Design of Intergovernmental Transfers*, B Searle & J Martinez-Vazquez (eds), Springer, New York, 2007.

Untied funding

- 17 Untied funding gives recipients scope to determine how it is used. It allows for local decision making which reflects the circumstances and preferences of the local community. Recipients have control over the range and level of services they provide.
- 18 Untied funding is consistent with the principle of subsidiarity which says devolving economic functions to lower levels of government should be preferred unless sound arguments can be advanced for centralised economic power.³ That principle supports the argument that national governments should be responsible for the provision of national public goods, regulation of national markets, welfare programs, macroeconomic policy and international trade, with other public goods provided by sub-national governments.
- 19 The principle of subsidiarity implies powers and responsibilities should be given to the lowest level of government at which they can be effectively carried out. For example, responsibilities may be given to a higher level of government when they affect multiple lower level jurisdictions, or when the advantage of larger scale outweighs the benefit of better tailoring outcomes to meet constituents needs. Lower tiers of government are 'closer' to their constituents and better able to reflect their preferences in decision making, which should lead to more effective services.
- 20 The principle also implies national government transfers to lower levels of government should be untied, except when there are issues of national importance or if uniform standards of service across jurisdictions are desirable.
- 21 The subsidiarity principle was adopted by Australian governments as one of the four key pillars of intergovernmental relations in 1991, albeit mainly in relation to funding arrangements between the Commonwealth and the States.
- 22 Since expenditure funded from untied grants cannot be distinguished from that funded from own-source revenue, it is virtually impossible for recipients to report to grant providers on how the funds were spent. As a consequence, recipients are not usually required to report to grant providers on the use of untied grants. This may lead to reduced accountability to the grant provider. Local governments, however, are accountable more broadly to their constituents who provide most of their revenues and tend to hold them responsible for the totality of their spending decisions and the effectiveness of services provided. To ensure that reporting and accountability is as effective as possible, State government legislation imposes considerable obligations on councils to report on their service delivery plans, outcomes and financial activities.

³ R Boadway & A Shah, *Fiscal Federalism: Principles and Practice of Multiorder Governance*, Cambridge University Press, New York, 2009.

- 23 Recipients tend to prefer untied funding due to the freedom it gives them to set their spending priorities and its lower administrative and compliance costs. Untied funding also enables recipients to plan for, and deal with, local needs as they arise, including the need for emergency spending.

What submissions say about whether financial assistance grants should be tied or untied

- 24 There was a strong consensus in submissions from local government grants commissions (LGGCs), local government associations and councils on the following.
- Financial assistance grants should remain untied in the hands of councils since they are best placed to understand, and respond to, the needs and preferences of their local communities. Many submissions argued tying the grants would undermine local autonomy and could result in an inefficient allocation of resources. Others said experience with existing tied grants indicated local needs often have to be adjusted to meet generic funding conditions.
 - The current process was relatively inexpensive to administer.
 - Tying the grants was likely to increase compliance and administrative costs for both councils and the Commonwealth, and would disproportionately affect small rural councils. The Victorian LGGC said the costs of tying the grants would either need to be met directly by the Commonwealth or sourced from within the pool of funding.
- 25 There was little discussion of the benefits of tied grants and whether they outweigh the costs. A few submissions said tying financial assistance grants may make councils more accountable to the Commonwealth, but accountability to their communities was generally considered more important. The then Department of Regional Australia, Local Government, Arts and Sport said tying grants to specific outcomes would capture the performance of councils more specifically and provide clearer information to the Australian community on where Commonwealth funding goes. However, it recognised this may reduce the flexibility of councils to respond to changed circumstances and would require investment in a monitoring, reporting and evaluation framework at the Commonwealth, State and local government levels.
- 26 Some submissions accepted there was a role for tied funding if the Commonwealth or State has a particular policy objective, such as a specific road project. One submission proposed tying general purpose grants to general infrastructure spending and tying the local roads component to spending on local roads and related assets. Another supported making funding conditional on improved sustainability, and better asset and financial management. It said existing reporting mechanisms, such as the Victorian performance reporting framework, could be used.

EVALUATING THE ARGUMENTS

- 27 The relative merits of tied and untied grants revolve around their administrative costs and their effects on accountability and service delivery.

What are the costs of administering the existing tied and untied grants?

- 28 Data from several Commonwealth departments suggest their costs of managing tied grants to councils and ensuring annual reporting requirements are fulfilled represent between 1% and 9% of the total funding provided. Their costs tend to be higher in the initial stages of a program, when extra resources are required for program design and implementation, but fall over the life of the program. This pattern is most evident when a competitive selection process is employed, due to the significant task of assessing applications.
- 29 The cost to councils of applying for tied grants and complying with reporting requirements can be a significant proportion of the grant they receive. Submissions confirmed the costs are high. For example, one council said costs of acquitting and reporting were 2% to 3% of its total revenue from tied grants. Another said it employed a grants coordinator at an annual cost of around \$80 000.
- 30 The Tasmanian Government submission said the costs to councils of administering tied grants were likely to include a significant fixed component, which would be a proportionally larger burden on small councils.
- 31 The costs associated with administering the untied financial assistance grants are much lower. Information from the then Department of Regional Australia, Local Government, Arts and Sport indicates the costs to the Commonwealth of distributing the grants and fulfilling the annual reporting requirements of the Act are about 0.01% of the total funding. Information from submissions and annual reports indicates the States incur costs of a similar magnitude. The State costs consist almost entirely of the operating costs of their LGGCs.
- 32 Submissions from several councils indicated their costs arising from the financial assistance grants process were significantly lower than for tied grants, due to the lower reporting requirements. The principal cost is that of preparing their annual return to the LGGC. While some councils said this can be significant relative to the grant they receive, the New South Wales LGGC said its data requirements have not changed for many years and, as such, local governments should have reporting mechanisms in place to minimise the cost impact. It considered the cost burden on councils was not significant.

What are the implications of the current approach for accountability?

- 33 Accountability for tied Commonwealth assistance to councils is high because the agreements under which it is provided usually contain specific conditions and reporting requirements councils must meet. There are often penalties for non-compliance. The Commonwealth Auditor-General has also audited some of the larger grant programs.
- 34 The untied nature of financial assistance grants (FAGs) means there are no similar requirements for reporting to the Commonwealth. The then Department of Regional Australia, Local Government, Arts and Sport said although it is required to report annually to Parliament on the operation of the Act, the Act provided no mechanism for it to seek and gather information on how councils spend their FAGs. It said this made it difficult to present to the Australian community practical and tangible indicators of the Commonwealth investment in local government and make clear the value for money of that investment. It said many local communities appear unaware that the Commonwealth provides annual financial assistance to their council.

What are the implications of the current approach for service delivery?

- 35 FAGs, tied grants from the Commonwealth and grants from State governments are provided for different purposes and to achieve different objectives.
- 36 Among other things, the FAGs are intended to contribute towards the operating costs of all councils and improve the capacity of the financially weaker councils to provide services. While their untied nature makes it difficult to quantify their impact on service delivery, it is consistent with and achieves those broad aims.
- 37 On the other hand, submissions indicated grants tied to particular services can limit the flexibility of service delivery. They can result in the over or under provision of services or services that do not best meet the preferences of residents, if their design does not adequately take account of local conditions. One council observed local needs often have to be 'reshaped' to fit generic funding conditions and tied grants often do not achieve optimal value. It also said tied grants can place strains on council finances due to their matching requirements or because capital grants do not allow for the on-going operation and maintenance of the new infrastructure. Such considerations together with a lack of untied resources meant it was reaching the point where it may have to refuse tied grants.
- 38 A review of the sustainability of Northern Territory councils also noted falling levels of untied funding limited the discretion of remote councils and restricted their ability to direct funds to core service delivery. It recommended that the present funding arrangements should be changed to allow a greater proportion of untied funding.

FINDINGS

- 39 We consider the Commonwealth funding should continue to be tied in the hands of the States to ensure it is all passed to councils. Consistent with that, States would administer the funds and assure the Commonwealth minister that funds have been allocated according to the Act.
- 40 Accountability to the Commonwealth (and Commonwealth taxpayers) would be greater if FAGs were also tied in the hands of councils. However, we doubt it would increase the effectiveness of local government, or its ability to ensure effective services, because the administrative costs would be too high relative to the level of funds provided and the benefits of the extra accountability.
- 41 Given the vastly different circumstances in which councils operate in different parts of the country, we consider they are best placed to determine the range and level of local government-type services (and the appropriate level of rates and charges) to meet the preferences of their residents. That is, local decisions on the use of these funds are more likely to lead to their effective use. We conclude the funding should not be tied in the hands of local government.
- 42 We do, however, believe it is appropriate to place some conditions on local government's receipt of the funds. Those conditions could include meeting State legislative requirements relating to financial and asset planning and annual reporting and continuing to provide timely data to LGGCs. That is, councils must be accountable to their residents and the States.

CHAPTER 5

IMPACT OF MINIMUM GRANTS ON THE INTRASTATE DISTRIBUTION OF GENERAL PURPOSE GRANTS

- 1 This chapter responds to Clause 3 (c) of the terms of reference which asks us to identify the impact of the minimum grant principle on the intra-state distribution of financial assistance grants.
- 2 We addressed this issue by examining the current minimum grant arrangements and the impact of varying the proportion of the general purpose grants allocated to councils on a per capita basis. We also consider how a simpler approach to minimum grants might improve the process.
- 3 The *Local Government (Financial Assistance) Act 1995* (the Act) says the general purpose grant funds paid to each State are to be distributed to councils in the State on an equalisation basis, but each must receive at least its population share of 30% of the general purpose grant received by the State.
- 4 Most local government grants commissions (LGGCs) implement this requirement by adopting a three-step approach to distribute the total general purpose grants.¹
 - **Step 1.** LGGCs determine the assessed relative needs of each council (also called the council's equalisation requirement) as the difference between:
 - the budget outcome the council would have if it provided the average level of services to its residents and made the average effort to raise revenue (including other grant support), and
 - the State average budget outcome.

Some councils have positive assessed relative needs (implying assistance is required for them to achieve the average outcome), some have negative

¹ Department of Regional Australia, Local Government, Arts and Sport, *2009-10 Local Government National Report*, 2012, pp. 189-190. Some LGGCs follow a different process.

assessed relative needs (implying their assessed budget outcome is better than the average).

- **Step 2.** If a council's assessed relative needs are negative or less than its minimum grant, they are replaced with its minimum grant. Councils receiving a minimum grant are referred to as 'minimum grant councils'.
- **Step 3.** The balance of the general purpose grants is then distributed to non-minimum grant councils.

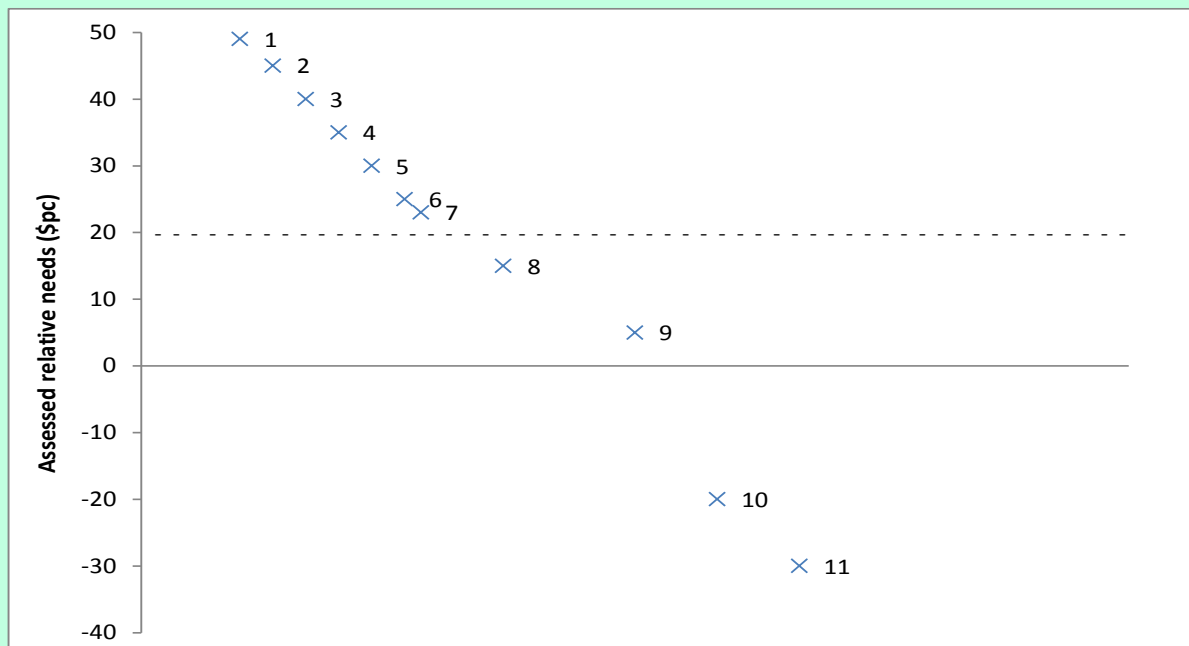
Box 5-1 Approach adopted by most LGGCs to determining minimum grant councils

The figure below illustrates the approach most LGGCs adopt to determining minimum grant councils.

Councils 8 to 11 would receive only the minimum grant, if it is \$20 per capita, because their assessed relative needs are negative (implying they are financially strong) or positive but below the minimum of \$20 per capita (their financial strength is below average, but relatively close to it).

Councils 1 to 7 have assessed relative needs which exceed the minimum grant. The general purpose funds that remain after giving the minimum grants to councils 8 to 11 are shared among them to meet a part of their relative needs. The allocation process may require several iterations because the LGGCs must ensure the proportion of every council's relative needs that are met is equal to or above its minimum grant.

Illustration of minimum and non-minimum grant councils



Source: Commission calculation.

If the minimum grant is reduced to \$10, council 8 would cease to be a minimum grant council and councils 9 to 11 would receive smaller grants.

- 5 Some LGGCs, such as the Tasmanian LGGC, adopt a different approach under which the general purpose funds are subdivided into two pools. One pool provides each council with its minimum grant (it is 30% of the general purpose funds received by the State) and the second pool is distributed to the councils with below average fiscal capacities.
 - **Step 1.** The minimum grant pool is distributed to each council on an equal per capita basis.
 - **Step 2.** The assessed relative needs of each council are determined as the difference between:
 - the budget outcome the council would have if it provided the average level of services to its residents and made the average effort to raise revenue (including its equal per capita grant and other grant support), and
 - the State average budget outcome (including the equal per capita grants).
 - **Step 3.** The relative needs pool is shared among all the councils with positive assessed relative needs (that is, those with below average fiscal capacities). Each of these councils has the same proportion of its relative needs met. Councils with negative assessed relative needs receive no funds from this pool.
- 6 Under this two pool approach, a change in the size of the equal per capita grant (that is, the minimum grant) changes the amount received by minimum grant councils, but does not change councils from minimum to non-minimum council status. This is because distributing funds to all councils on an equal per capita basis does not change the extent to which their capacities differ from one another or from the State average position. It has the same impact on every council and on the average.
- 7 The two approaches to deciding minimum grant councils can have different grant outcomes for some councils.
 - Under the approach followed by most LGGCs, non-minimum grant councils (those with positive assessed relative needs above the minimum grant) receive a grant equivalent to their minimum grant plus a contribution towards their relative needs, while councils whose positive assessed needs are below the minimum grant receive only the minimum. Changes in the size of the minimum grant can change a council's status.
 - Under the two pool approach, every council receives their minimum grant and all councils with positive assessed needs receive a contribution towards their relative needs. Changes in the size of the minimum grant do not change a council's status.

MINIMUM GRANT COUNCILS IN 2011-12

- 8 In per capita terms the minimum grant is not large — about \$19 to \$20 per capita in each year since 2008-09. As shown in Table 5-1, minimum grants were on average a small part of the total revenue of the recipients in all States in 2011-12.

Table 5-1 Minimum grants as proportion of minimum grant council revenue, 2011-12 (a)

	NSW	Vic	Qld	WA	SA	Tas	NT
	%	%	%	%	%	%	%
Percentage of revenue	2.5	1.8	1.5	2.0	2.2	1.7	2.5

(a) The figures are based on the accrual amounts for 2011-12, that is, the amounts for four quarters.

Source: Commission analysis based on data provided by ABS and the then Department of Regional Australia, Local Government, Arts and Sport.

- 9 Data from the then Department of Regional Australia, Local Government, Arts and Sport indicate the LGGCs assessed 104 councils (18% of the national total of 565 councils) as minimum grant councils in 2011-12 (see Table 5-2). They were home to 41% of the population. However, the figures vary considerably from State to State reflecting differences in the structure of local government and local circumstances. For example, only 8% of Queensland councils were on minimum grants but, because the Brisbane City Council was one of them, they covered 58% of the population. Over 20% of councils in Western Australia, South Australia and the Northern Territory received minimum grants and they covered between 55 and 75% of the State populations.

Table 5-2 General purpose grant recipients, 2011-12

	NSW	Vic	Qld	WA	SA	Tas	NT	Total
Number of councils	155	79	73	138	74	29	17	565
Number of minimum grant councils	23	13	6	31	21	4	6	104
Proportion of councils receiving a minimum grant (%)	15	16	8	22	28	14	35	18
Proportion of State population in minimum grant councils (%)	27	29	58	75	55	36	71	41

Source: Data provided by the then Department of Regional Australia, Local Government, Arts and Sport.

- 10 Table 5-3 shows 12% of general purpose funding, or \$178 million, was paid to minimum grant councils in 2011-12. The highest proportion was in Western Australia at 23%. The converse of these figures is that approximately 75% of councils in Western Australia, covering less than half the State population, have relative needs which exceed the minimum grant.

Table 5-3 General purpose funding to minimum grant councils, 2011-12

	NSW	Vic	Qld	WA	SA	Tas	NT	Total
General purpose funding paid to minimum grant councils (\$m)	38	31	51	34	18	4	3	178
Proportion of general purpose funding paid to minimum grant councils (%)	8	9	17	23	17	11	22	12

Source: Data provided by the then Department of Regional Australia, Local Government, Arts and Sport.

CHANGES IN MINIMUM GRANT COUNCILS OVER TIME

- 11 Table 5-4 and Figure 5-1 show the number of minimum grant councils has increased from 77 in 2002-03 to 104 in 2011-12, despite a significant fall in the number of councils.² Most of the increase was in urban areas.

Table 5-4 Number of minimum grant councils

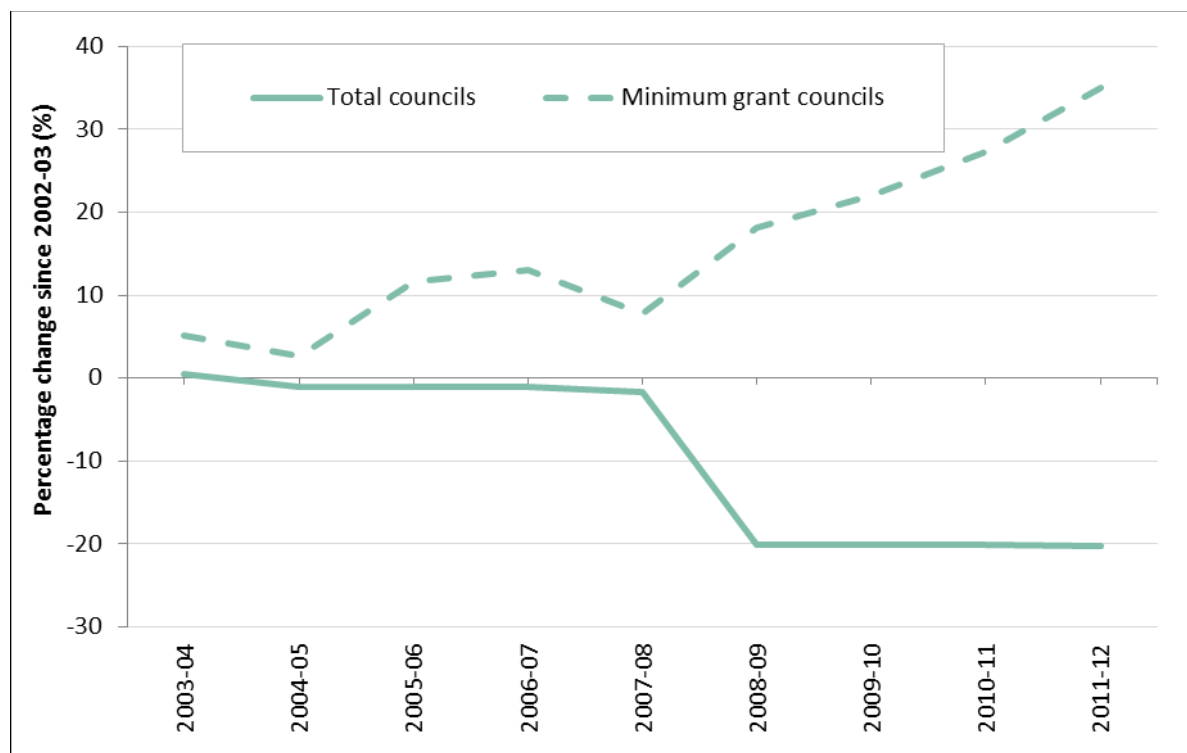
	2002-03	2005-06	2008-09	2011-12
Urban councils	77	83	87	99
Rural councils	0	3	4	5
All councils	77	86	91	104
Proportion of councils receiving minimum grants (%)	11	12	16	18
Proportion of State population in minimum grant councils (%)	32	32	34	41

Source: Data provided by the then Department of Regional Australia, Local Government, Arts and Sport.

- 12 The increased number of minimum grant councils resulted in the proportion of general purpose grants paid to minimum grant councils increasing from 9.7% of the total general purpose grants in 2002-03 to 12.2% in 2011-12 (see Table 5-5). However, the 104 minimum grant councils in 2011-12 received 13.7% of the general purpose grants in 2002-03.
- 13 The increase in the number of minimum grant councils and the proportion of grants paid to them is due, in part, to an increase in the divergence of council circumstances, which is discussed further in Chapter 6.
- 14 Overall, the proportion of the general revenue grants paid to non-minimum grant councils has declined over time. However, within that proportion, the grants to the fiscally weakest councils have increased. This increase has been financed by the less fiscally weak councils — it has not been financed by minimum grant councils since the minimum grant acts as a floor.

² The number fell due to amalgamations in Queensland and the Northern Territory in 2008-09.

Figure 5-1 Percentage change in number of councils since 2002-03



Source: Data provided by the then Department of Regional Australia, Local Government, Arts and Sport.

Table 5-5 Proportion of general purpose grants paid to minimum grant councils

	2002-03	2005-06	2008-09	2011-12
	%	%	%	%
Urban councils	9.7	9.6	10.2	12.2
Rural councils	0.0	0.0	0.1	0.1
All councils	9.7	9.7	10.3	12.2

Source: Data provided by the then Department of Regional Australia, Local Government, Arts and Sport.

CHANGING THE MINIMUM GRANT

- 15 The question of the appropriate minimum grant threshold requires a judgment about the appropriate balance between the grant purposes of improving the capacity of all councils and reducing the disparities in their fiscal capacities.
- 16 Submissions generally supported the view that it was appropriate for all councils to receive some general purpose funding. However, many also argued the growing divergence in council circumstances suggested the fiscally weaker councils required a larger share of the assistance.

- 17 There is no obvious analytical basis for deciding the appropriate balance between the two grant purposes. It is possible that the appropriate balance is different in different States. In a State where the councils are more homogeneous, more weight could be given to improving every council's fiscal capacity. In a State where councils are more diverse, more weight could be given to reducing disparities. This suggests it may be appropriate for the proportion of the general purpose grants distributed on an equal per capita basis to vary between States.

The effect of different proportions

- 18 Under the approach adopted by most LGGCs, changing the threshold for minimum grants can change the amount required to fund them because it can change the number of minimum grant councils as well as the per capita size of the grant.
- 19 Under the two pool approach set out in paragraph 5, the number of minimum grant councils does not change with changes in the proportion of the general purpose grants distributed equal per capita. However, increases (or decreases) in the amount distributed equal per capita mean less (more) money is available to reduce the gaps in fiscal capacities — implying the extent of factoring back of assessed relative needs would be increased (reduced).
- 20 We used data provided by the LGGCs to estimate the number of minimum grant councils, the proportion of State populations living in them and the amount required to fund minimum grants if the minimum grant was:
- zero
 - \$13 per capita (the amount if 20% of general purpose grants were distributed equal per capita)
 - \$20 per capita (the amount if 30% of general purpose grants were distributed equal per capita)
 - \$27 per capita (the amount if 40% of general purpose grants were distributed equal per capita).
- 21 **The number of councils receiving only the minimum grant and proportion of population living in them.** Table 5-6 shows the number of councils which would only receive the minimum per capita grant and the proportion of each State's population living in them for each minimum grant threshold. For most States the numbers rise as the minimum grant rises.
- 22 If all of the funds were distributed equal per capita, all councils would be, by definition, minimum (and maximum) grant councils.

Table 5-6 Number of minimum grant councils and their population (a)

	Minimum grant threshold (%)							
	0		20		30		40	
	No of councils	Prop'n of State pop	No of councils	Prop'n of State pop	No of councils	Prop'n of State pop	No of councils	Prop'n of State pop
	No.	%	No.	%	No.	%	No.	%
New South Wales	14	12	20	24	24	27	27	32
Victoria	7	14	9	18	12	27	13	28
Queensland (b)	1	24	2	35	4	46	4	46
Western Australia	30	73	31	74	33	76	38	83
South Australia	17	45	19	52	20	54	21	56
Tasmania	6	54	6	54	6	54	6	54
Northern Territory	5	58	5	58	5	58	5	58
Total	80	25	92	33	104	39	114	42

(a) Data relate to 2012-13, except data for Victoria and South Australia relate to 2011-12 and data for Tasmania relate to 2009-10.

(b) The calculations assume factoring back is only on a proportional basis whereas the State actually factors back using an average of a proportional and an equalisation approach.

Note: The number of minimum grant councils under the 0% threshold represents those councils the LGGCs assessed as having assessed revenues above their assessed expenses. The data used to derive this table differ from those used in Table 5-2. They relate to a more recent year. This together with differences in the analysis means the number of minimum grant councils and the proportion of State populations living in them differ from those in Table 5-2.

Source: Commission calculation.

- 23 The first column in Table 5-6 indicates, if there was no minimum grant, LGGCs would assess 80 councils to have above average fiscal capacities and they would not receive a grant. With the current threshold another 24 councils are minimum grant councils. The methods adopted by the LGGCs in Tasmania and the Northern Territory mean their numbers of minimum grant councils do not change.
- 24 **How much would be paid to councils which receive only the minimum grants?** The amount required to finance the minimum grant depends on the per capita size of the grant and the population living in the minimum grant councils.
- 25 Table 5-7 shows how much would be paid to minimum grant councils at each threshold. It shows \$172 million³ would have been required in 2012-13 under the current threshold where councils receive at least 30% of the per capita general purpose funds received by the State. This equates to 12% of the general purpose

³ This is the amount which would be paid to councils which receive only the minimum grant. It excludes the amount paid to councils which receive equalisation payments.

funds. The ratio is lower for New South Wales and Victoria — the States where below average proportions of the population live in minimum grant councils.

Table 5-7 Amount required to finance minimum grants (a)

	Minimum grant threshold (%)							
	0		20		30		40	
	Funds for min grants	Prop'n of GPGs	Funds for min grants	Prop'n of GPGs	Funds for min grants	Prop'n of GPGs	Funds for min grants	Prop'n of GPGs
	\$m	%	\$m	%	\$m	%	\$m	%
New South Wales	0	0	23	5	39	8	62	13
Victoria	0	0	14	4	30	8	43	11
Queensland	0	0	21	7	41	14	54	18
Western Australia	0	0	24	15	37	23	53	33
South Australia	0	0	11	10	18	16	24	22
Tasmania	0	0	3	11	5	16	7	22
Northern Territory	0	0	2	12	3	17	4	23
Total	0	0	98	7	172	12	246	17

(a) Data relate to 2012-13, except data for Victoria and South Australia relate to 2011-12 and data for Tasmania relate to 2009-10.

Note: The table shows the amounts which would be paid to minimum grant councils only. It does not include any amounts paid to other councils.

The data used to derive this table differ from those used in Table 5-2. They relate to a more recent year. This together with differences in the analysis means the funds required for minimum grants differ from those in Table 5-2.

GPGs — general purpose grants.

Source: Commission calculation.

- 26 In most States, changing the minimum grant threshold changes the total amount required to finance them in two ways. First, as the threshold is increased (or reduced) it increases (or reduces) the amount required for each person living in minimum grant councils. Second, it changes the number of councils which would receive it. For example, reducing the proportion of grants distributed equal per capita from the current 30% to 20% would reduce the amount paid per capita by \$7 (from \$20 to \$13) and it would reduce the number of councils receiving only the minimum from 104 to 92. This would make an extra \$74 million available for the fiscally weaker councils, including the 12 councils which would be considered to require more than the minimum grant.
- 27 The analysis indicates that under the arrangements currently used in most States, larger minimum grants mean there are more minimum grant councils and less money is available to reduce fiscal disparities. Smaller minimum grants mean fiscal disparities

can be reduced to a greater extent. However, the size of the minimum grants means the changes are moderate.

- 28 Even if no funds were allocated on an equal per capita basis (that is, there were no minimum grant), full equalisation would not be possible. The total general purpose funding is insufficient to meet all assessed needs.

FINDINGS

- 29 The minimum grant principle ensures every council, including those with very strong fiscal capacities, receive a general purpose grant.
- 30 Councils which receive only the minimum grant (excluding the identified road grant component) have above average fiscal capacities in all States. However, under the processes used in most States, councils whose capacities are slightly below average (meaning their assessed relative needs are below the minimum grant amount) also receive only the minimum.
- 31 The minimum grant has different impacts in each State. In part, this is a reflection of the degree of diversity in the councils in each State.
- 32 Minimum grants achieve the grant purposes of improving the fiscal capacities of local governments and improving certainty of funding. As such, they should continue to be a feature of the financial assistance grant process. However, the differences between States in the structure and circumstances of their local governments suggest the same sized minimum grant threshold may not be appropriate in all States.
- 33 The approach LGGCs use to identify minimum grant councils appears to be important. For example, if the two pool approach were applied in New South Wales, 10 more councils, covering 15% of the State population, would receive relative needs grants.

CHAPTER 6

RELATIVE NEEDS OF COUNCILS IN EACH STATE

- 1 This chapter responds to Clause 3(d) of the terms of reference which asks us:
to assess the relative need of local governments in each State and Territory with a particular focus on those that service regional and remote communities.
- 2 Our analysis is based on an examination of the assessments of relative needs made by the local government grants commissions (LGGCs) as part of their grant allocation processes. We have not calculated the relative need of each council in every State using our methods.
- 3 Since LGGCs use different methods to calculate relative needs and because relative needs can be affected by State government policies on the structure of local government boundaries, caution is required in making interstate comparisons. An indication of some ways LGGC methods differ is in Attachment B.

WHAT IS RELATIVE NEED?

- 4 Relative need is a measure of fiscal capacity based on the principle of horizontal equalisation, which LGGCs are required to apply in allocating the general purpose grants among local governments in each State.
- 5 Consistent with the Act, LGGCs make assessments of what councils would spend and the revenue they would raise if they applied the average of the policies of all councils in the State. The gap between them is the council's assessed budget outcome. A council's relative need (or its assessed grant) is calculated as its assessed outcome less the average outcome. Relative needs may be positive (implying a grant is required if the council is to achieve the average outcome) or negative (indicating the council is fiscally stronger than the average and does not require a general purpose grant for equalisation purposes).

Do LGGCs assessments capture the main differences in relative needs?

- 6 Broadly speaking, the LGGCs' assessments reflect innate differences between councils. While LGGCs use different methods, the underlying distribution of general purpose grants is similar in all States. In each case, rural and remote councils are assessed to have the greatest relative needs.
- 7 The LGGCs assessments are consistent with the findings of the many local government reports and inquiries done over the last decade, such as those mentioned below.
 - The majority of councils 'at risk' of financial unsustainability in New South Wales are smaller rural and remote councils. An overriding consideration for rural councils is the weakness of their revenue bases relative to their service delivery and infrastructure tasks.¹
 - The less financially viable councils tend to be smaller (often rural, remote or small metropolitan councils), usually with constrained own-source revenue streams and a lack of economies of scale.²
 - Rural and remote councils have higher expenditure per capita, on average, compared with urban councils. This is because they maintain more kilometres of roads per capita, cannot capture scale economies, have to pay higher costs for many inputs and provide a relatively more extensive service mix.³

HOW DO THE RELATIVE NEEDS OF COUNCILS DIFFER?

- 8 The local government sector is inherently diverse and there are large differences in the relative needs of councils. We used LGGC assessment data to estimate the amount required in each State:
 - to raise disadvantaged councils to the average fiscal capacity
 - to provide all councils with the same capacity — that is, how much would be required to raise every council to the capacity of the fiscally strongest council in the State.
- 9 We then derived the ratio between those amounts (see the first row in Table 6-1). It captures the degree of diversity in a State. In Western Australia, the amount needed to provide all councils with the same fiscal capacity (the capacity of the strongest council) is almost 24 times larger than the amount needed to lift disadvantaged councils to the average capacity. However, it is only three times larger in the

¹ Independent Local Government Review Panel, *Future directions for NSW Local Government: Twenty Essential Steps*, April 2013.

² PricewaterhouseCoopers, *National Sustainability Study of Local Government*, November 2006, p. 9. The study was commissioned by the Australian Local Government Association.

³ Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, 2008.

Northern Territory. This implies there is a greater diversity between the average and the fiscally strongest council in Western Australia than in the Northern Territory.

- 10 Table 6-1 also provides an indication of the spread of the relative needs in each State — we have called this the per capita assessed grant relativities. It compares the per capita relative needs (before factoring back) of the fiscally strongest and weakest councils to the average in each State. A negative figure means the council is fiscally strong and has negative relative needs.

Table 6-1 Diversity between councils in each State

	NSW	Vic	Qld	WA	SA	Tas	NT
Ratio of strongest to average (a)	na	9.3	na	23.7	11.3	6.2	2.8
Per capita assessed grant relativities before factoring back (b)							
Weakest	na	18.8	na	416.1	18.2	17.1	5.4
Strongest	na	-9.3	na	-23.7	-11.3	-6.2	-2.8
Per capita actual grant relativities (c)							
Weakest	16.2	8.6	134.6	255.5	21.6	10.9	4.0
Strongest	0.3	0.3	0.3	0.3	0.3	0.3	0.3

(a) This is the ratio of the amount required to provide all councils with the same capacity as the fiscally strongest council in the State divided by the amount required to provide the weakest councils with the average capacity. State data relate to different time periods as follows: Tasmania - 2009-10; Victoria and Northern Territory – 2010-11; Western Australia and South Australia - 2012-13.

(b) Per capita assessed grant relativities are a council's *assessed* grants per capita divided by the State average grant per capita. Assessed grants are calculated before minimum grants and factoring back. State data relate to different time periods as follows: Tasmania - 2009-10; Victoria and Northern Territory – 2010-11; Western Australia and South Australia - 2012-13.

(c) Per capita relativities are a council's *actual* grants per capita divided by the State average grant per capita. Actual grants are calculated after minimum grants and factoring back. Data for all States are for 2011-12.

na not available.

Source: Commission calculation based on data provided by the then Department of Regional Australia, Local Government, Arts and Sport and LGGCs.

- 11 Table 6-1 provides a third measure of diversity which relates a council's actual grant per capita to the average grant per capita — we have called this the per capita actual grant relativities. It allows for the effects of the minimum grants (all councils with above average capacities have per capita actual grant relativities of 0.3) and the factoring back required because the total of all positive relative needs in each State exceeds the available funds.
- 12 All the measures in Table 6-1 highlight the high levels of diversity in Queensland and Western Australia. The table also suggests lower levels of diversity in Victoria, Tasmania and the Northern Territory.

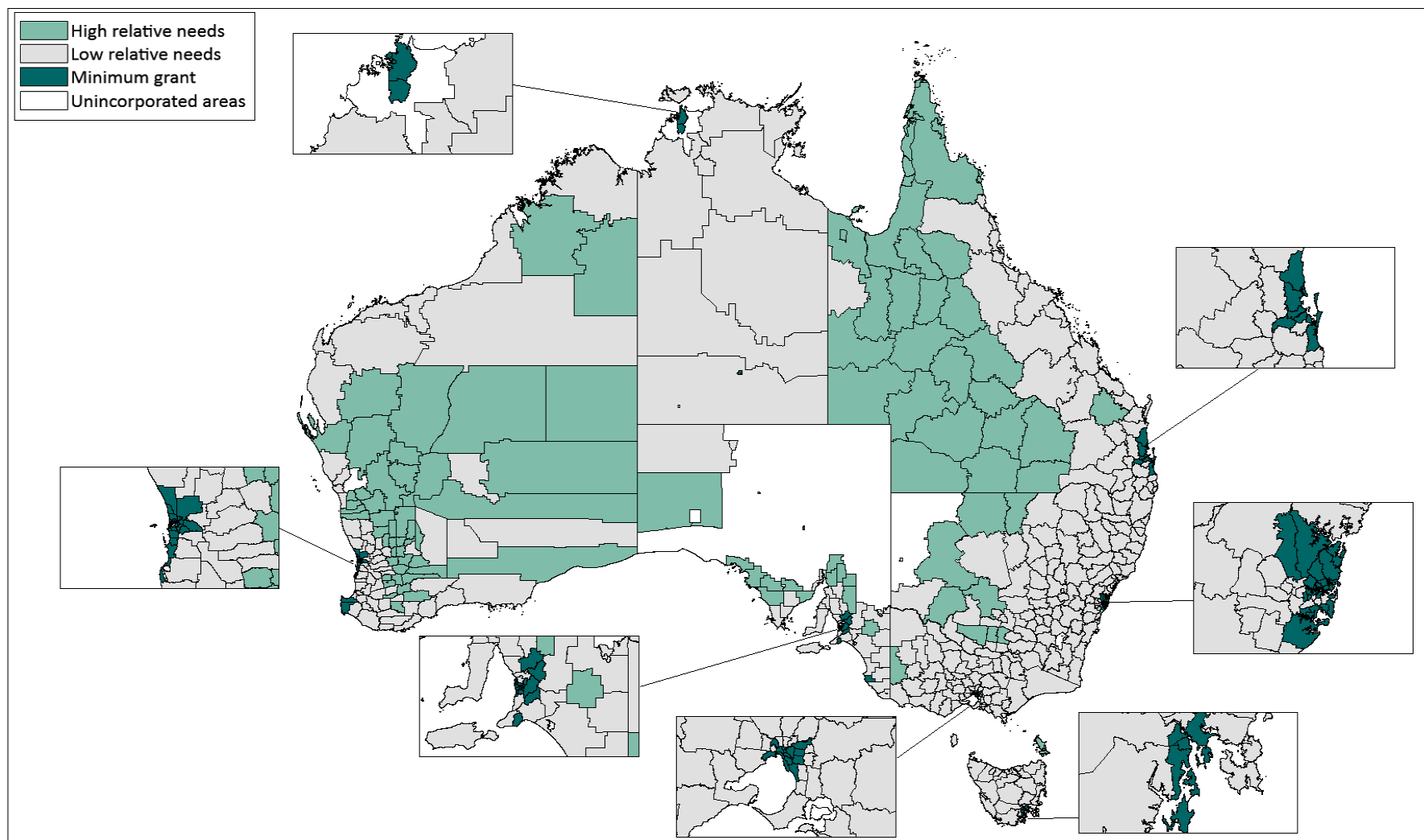
- 13 Since all the figures in Table 6-1 are derived from LGGC assessments, they cannot be used to compare the circumstances of councils in different States. While the table suggests there is less diversity among councils in the Northern Territory than in other States, it says nothing about how relative needs in the Northern Territory compare with those elsewhere. All non-minimum grant councils in the Territory face high service delivery costs and low revenue capacities because they are remote and their populations are highly dispersed across the local government area and contain high proportions of Indigenous people.

HOW DO THE RELATIVE NEEDS OF DIFFERENT TYPES OF COUNCILS DIFFER?

- 14 The relative needs of different types of councils vary. Some have low or negative relative needs (low costs relative to their revenues), while others have high relative needs (high costs relative to their revenues).
- 15 Figure 6-1 provides an overview of the relative fiscal strengths of councils based on the actual grants they receive.⁴ Councils receiving minimum grants (and therefore having very low or negative relative needs) are the fiscally strongest councils and tend to be located in major population centres.
- 16 Councils whose grants are more than eight times the average (and therefore have very low fiscal capacities) are the fiscally weakest councils. The figure suggests they are generally rural and remote councils.
- 17 The apparent absence of high relative need councils in the Northern Territory reflects the homogeneity of its rural and remote councils relative to each other — not that they are better placed than those in other States.

⁴ The analysis is based on the relationship between the actual per capita grant received by each council and the State average per capita grant. Councils whose grant is high relative to the average are those with high relative needs, implying they are fiscally weak. Councils whose per capita grants are low relative to the average have low relative needs, implying they are fiscally strong.

Figure 6-1 Councils classified by actual grant relativities, 2011-12



Source: Commission calculation using data from then Department of Regional Australia, Local Government, Arts and Sport.

- 18 Table 6-2 shows the predominant geographic characteristics of councils with the greatest relative needs (those receiving the largest per capita grant) and those receiving the minimum grant in each State. The former tend to be remote or rural agricultural councils and the latter tend to be urban councils.

Table 6-2 Geographic characteristics of councils

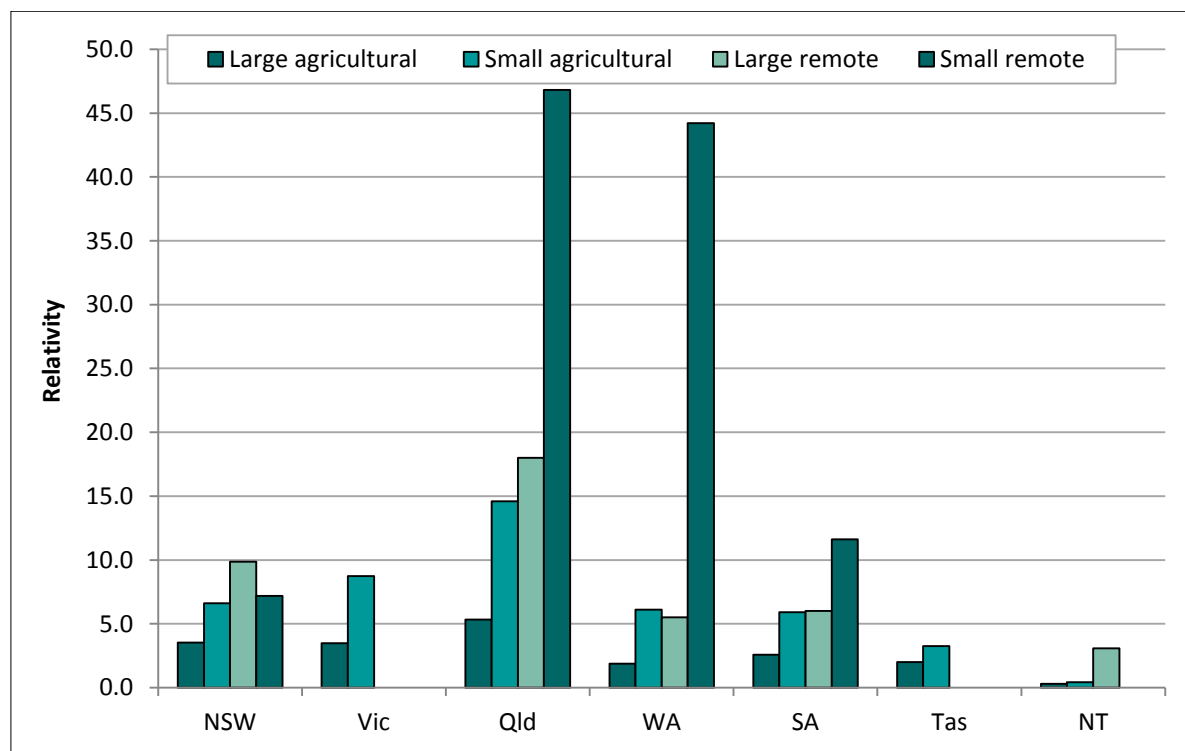
State	Largest per capita grant	Predominant geographic characteristics of councils with the lowest fiscal capacity	Predominant geographic characteristics of councils on the minimum grant
	\$pc		
New South Wales	1 057	Rural agricultural and remote	Metropolitan area
Victoria	559	Rural agricultural	Metropolitan area
Queensland	8 668	Remote	Metropolitan area and regional cities
Western Australia	16 899	Rural agricultural and remote	Metropolitan area and large regional cities
South Australia	1 414	Rural agricultural and remote	Metropolitan area
Tasmania	724	Rural agricultural	Metropolitan area and regional cities
Northern Territory	276	Remote	Urban and Rural

Note: Predominant geographic characteristic reflects features in the Australian Local Government Classification (see Attachment C).

Source: Commission calculation using general purpose grants and population data from the then Department of Regional Australia, Local Government, Arts and Sport.

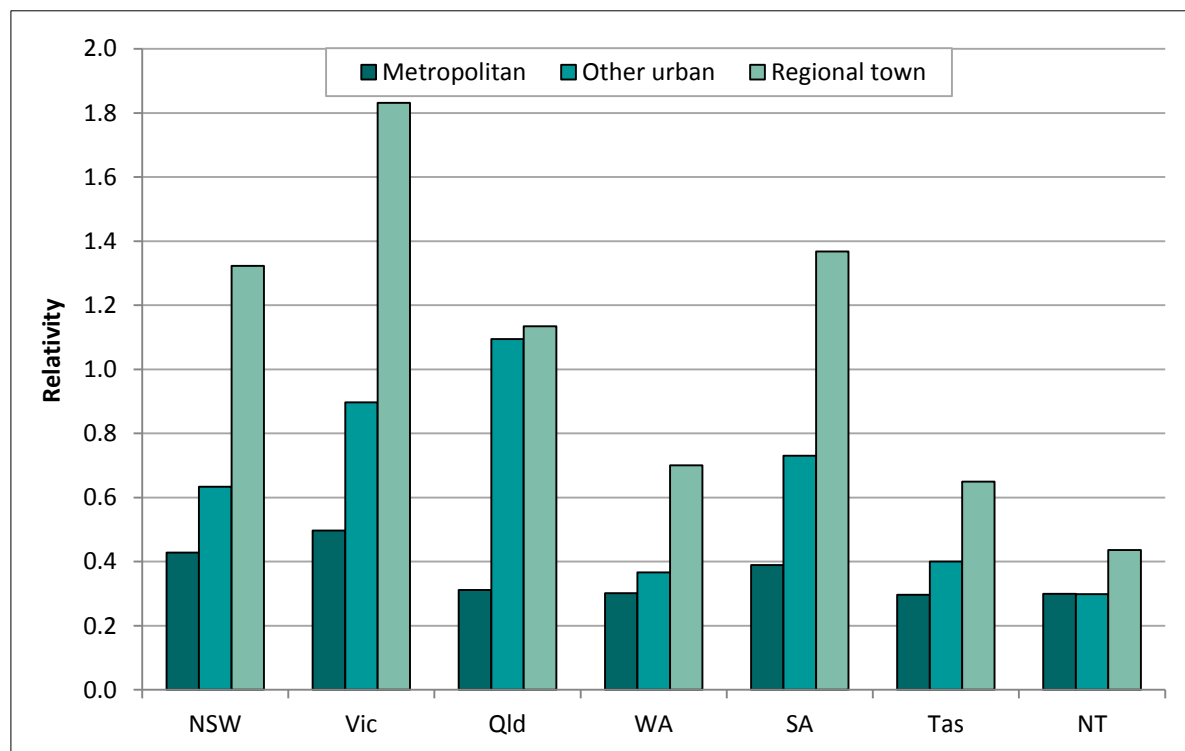
- 19 In the Northern Territory, the largest per capita grants are paid to remote councils which cover 23% of the Territory's population. The largest per capita grants in Queensland and Western Australia are also paid to remote councils, but they cover only 2% and 4% of the State population respectively.
- 20 Figure 6-2 shows the actual grant relativities for different types of rural councils and Figure 6-3 shows the relativities for different types of urban councils. These figures also show grant relativities are larger for rural and remote councils.

Figure 6-2 Actual grant relativities, rural and remote councils, 2011-12



Source: Commission calculation based on data from the then Department of Regional Australia, Local Government, Arts and Sport.

Figure 6-3 Actual grant relativities, urban councils, 2011-12



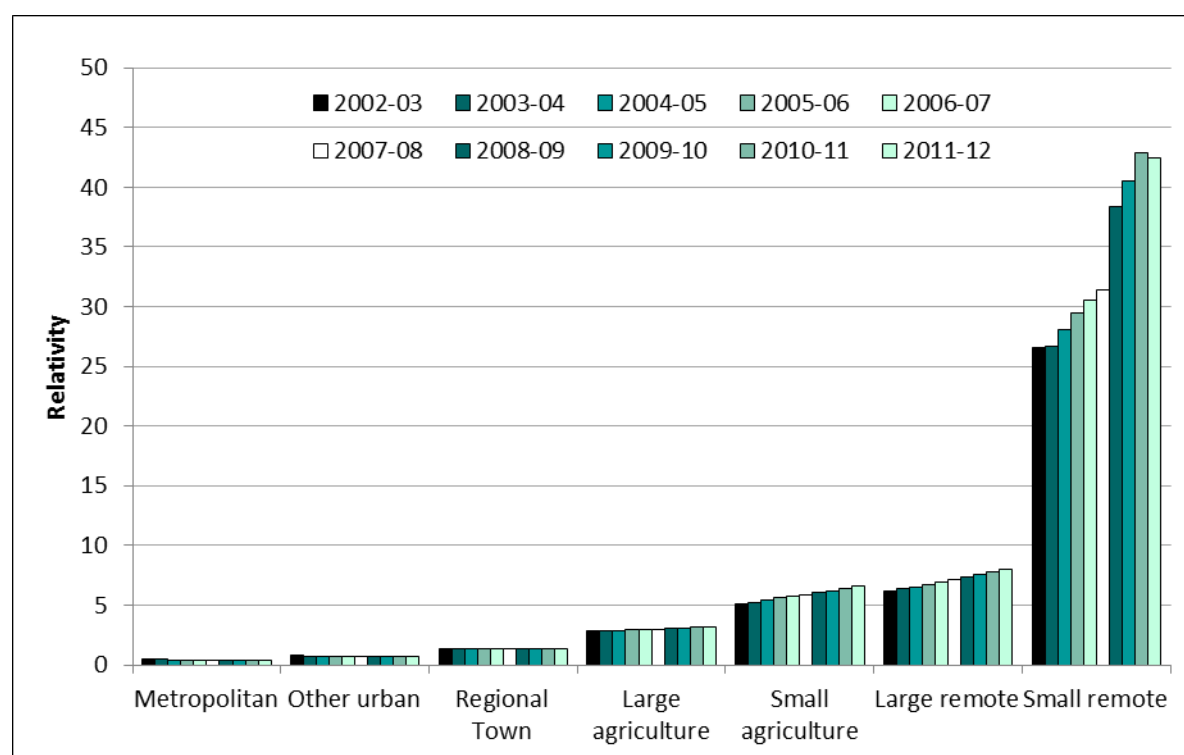
Note: Other urban councils include urban fringe councils.

Source: Commission calculation based on data from the then Department of Regional Australia, Local Government, Arts and Sport.

Changes over time

- 21 The disparities in the fiscal capacities of councils as measured by the LGGCs have increased over time. This can be seen in Figure 6-4 which shows the national actual grant relativity for groups of councils for the period 2002-03 to 2011-12. It shows the per capita grants received by small agricultural and remote councils (and thus their relative needs) have increased relative to the average per capita grants over the last 10 years.

Figure 6-4 Actual grant relativities (a) by geographic classification, 2002-03 to 2011-12

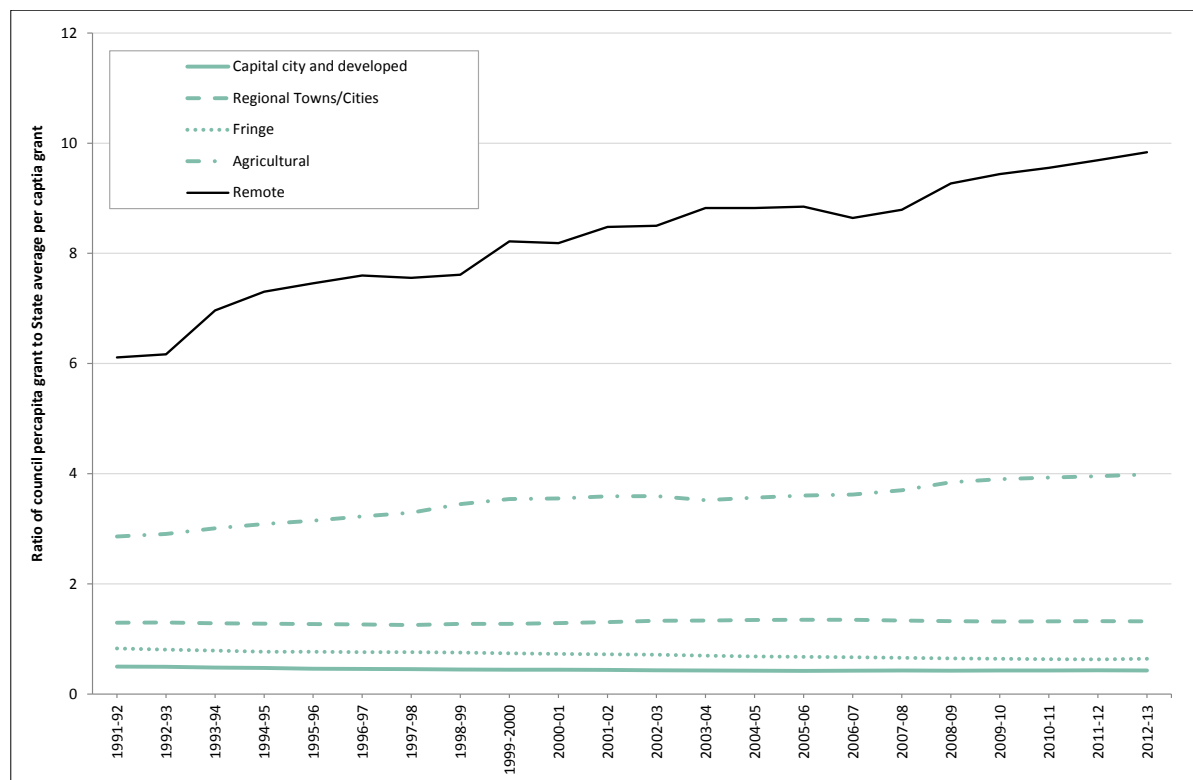


- (a) Calculated as a council's actual grant per capita relative to the average grant per capita. It allows for the effects of the minimum grants and 'factoring back'.

Source: Commission calculation based on data from the then Department of Regional Australia, Local Government, Arts and Sport.

- 22 Figure 6-5 plots the changes in New South Wales over a longer time period. It indicates the relativities of metropolitan area councils, regional town councils and urban fringe councils have remained steady or declined marginally, but those for councils in agricultural areas have risen and those in remote areas have risen even more.

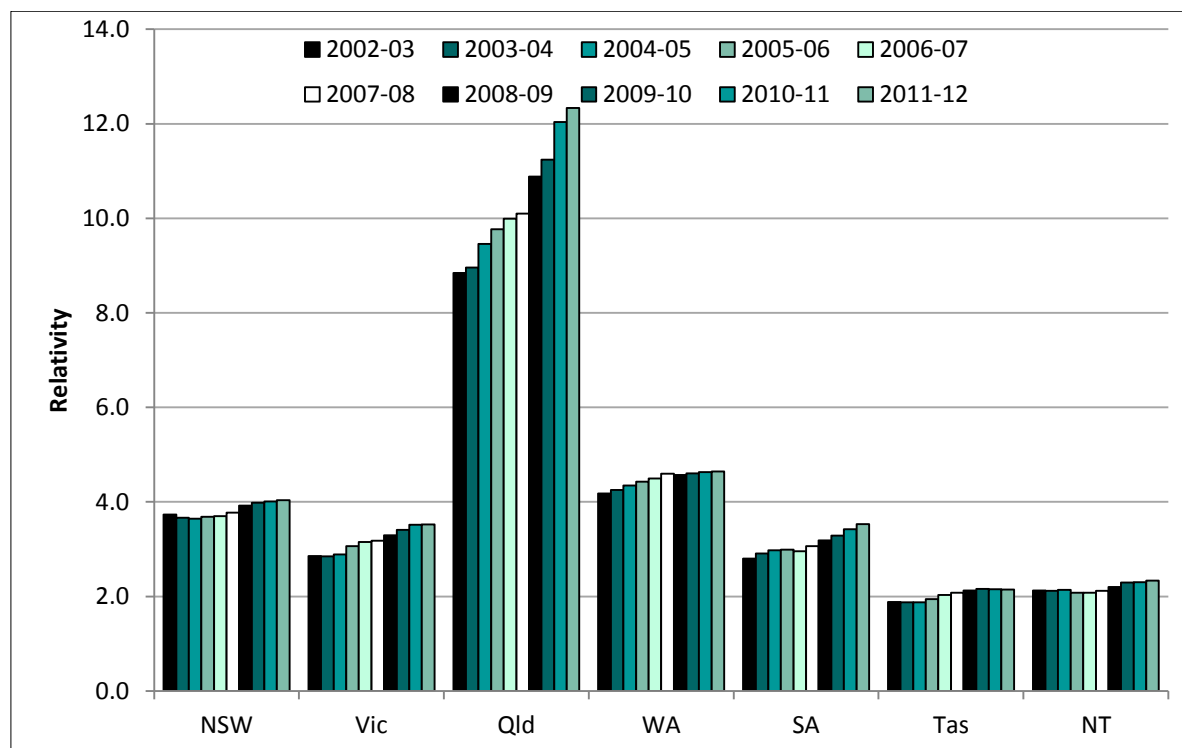
Figure 6-5 Actual grant relativities for all councils in New South Wales, 1991-92 to 2012-13



Source: Commission calculation based on data from the then Department of Regional Australia, Local Government, Arts and Sport.

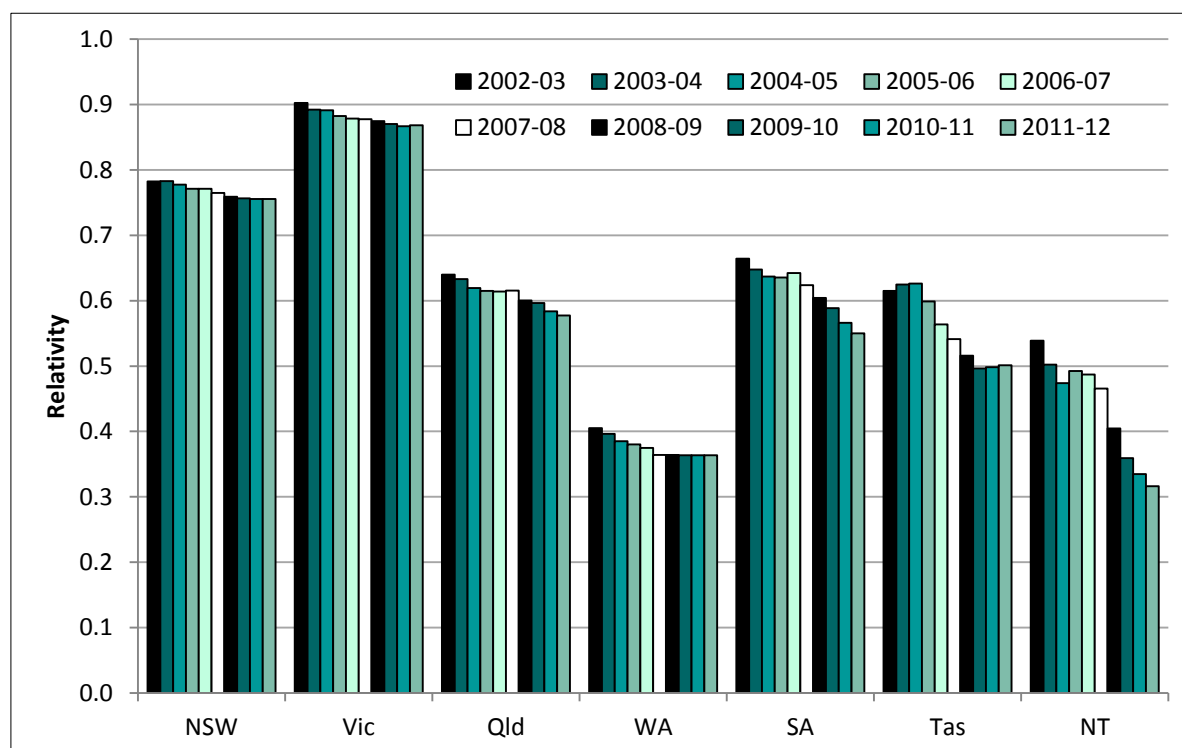
- 23 Figure 6-6 shows the trend of increasing actual grant relativities for rural and remote councils has occurred in all States. Figure 6-7 shows the actual grant relativities for urban councils have declined in each State over the last 10 years. Together they indicate a growing divergence in the fiscal capacities of councils. However, we acknowledge this growing divergence reflects both changes in the underlying circumstances of the councils and in the methods LGGCs use to measure their fiscal capacities. It is not possible to apportion the total change between those two causes.

Figure 6-6 Actual grant relativities, rural councils, 2002-03 to 2011-12



Source: Commission calculation based on data from the then Department of Regional Australia, Local Government, Arts and Sport.

Figure 6-7 Actual grant relativities, urban councils, 2002-03 to 2011-12



Source: Commission calculation based on data from the then Department of Regional Australia, Local Government, Arts and Sport.

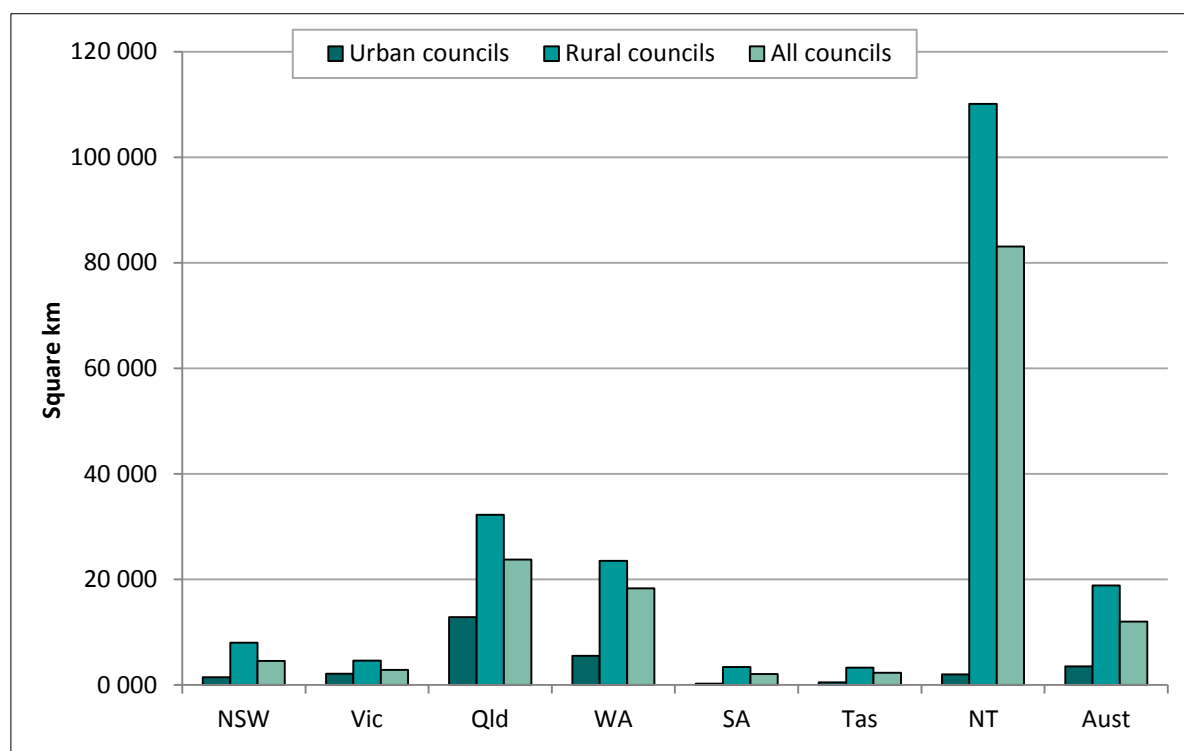
WHAT CAUSES DIFFERENCES IN RELATIVE NEEDS ACROSS COUNCILS?

24 Differences in the relative needs of councils reflect differences in a range of factors affecting the quantity of services they need to provide, the average cost of each service and their capacity to raise revenue. Some of the factors which may affect the relative service provision costs and revenue raising capacity of councils are set out below. However, since the factors impact unevenly on particular services, the extent to which they affect the total relative needs of councils depends on the importance of the affected services in council budgets and the assessment methods of the LGGCs.

- **The population and area of councils** are often affected by State government decisions on the structure of local government. There are considerable differences in local government populations.

There are also big differences in council areas. The average area of rural councils is over six times that of urban ones. Rural councils in Queensland, Western Australia and the Northern Territory are generally larger than those in other States (see Figure 6-8).

Figure 6-8 Average land area, rural and urban councils, 2011-12



Source: Commission calculation based on data from the then Department of Regional Australia, Local Government, Arts and Sport.

Differences in population and area affect the extent to which councils can benefit from economies of scale or face extra costs because staff travel and freight costs are higher. How the population is spread over the council area can

also affect costs, especially if it results in services having to be provided in multiple locations.

- **Socio-demographic and socio-economic characteristics of the population, such as age, Indigeneity and income.** Differences between councils in the proportion of their population with some of these features can affect the relative needs for certain services. For example, inner suburbs of Melbourne have a higher proportion of older people, which leads their councils to spend more on aged services. By contrast, councils in the outer metropolitan areas where a significant proportion of the population is aged under 10 need to spend more on family and community services. Similarly, the level of socio-economic disadvantage and the proportion of Indigenous people can affect spending on welfare, housing and community amenities. It may also affect capacity to raise revenue.

Nationally, there are 31 designated Indigenous councils (out of 565) eligible for general purpose grants. Table 6-3 shows they are generally remote and have high assessed needs. However, these are not all the councils with significant Indigenous populations. For example, Halls Creek is not designated as an Indigenous council even though 80% of its population was identified as Indigenous in the 2011 Census.⁵ Table 6-4 shows the Indigenous proportion of the population in local government areas is very high in remote areas (because most Indigenous councils are in those areas) but it is also significant for councils of regional towns and agricultural areas.

Table 6-3 Indigenous councils

	Number of Indigenous councils	Proportion of State population	Local government classification	Average general purpose grant	Final Relativity
	No.	%		\$pc	
Queensland	16	0.5	Remote and small regional centres	1 350	15.5
Western Australia	1	0.1	Medium remote	2 500	29.2
South Australia	5	0.2	Extremely remote and small regional centres	620	7.3
Northern Territory	9	24.5	Remote	275	3.1

Source: 2009-10 Local Government National Report, Department of Regional Australia, Local Government, Arts and Sport.

- **Road length.** Regional and rural councils tend to have longer road lengths per person (see Figure 6-9). Given the importance of roads in council budgets, this increases the relative needs of those councils, although the effects may be partly offset by relatively lower road use.

⁵ Submission from Shire of Halls Creek, February 2013, p. 1.

Table 6-4 Proportion of population that is Indigenous by council type, 2011-12

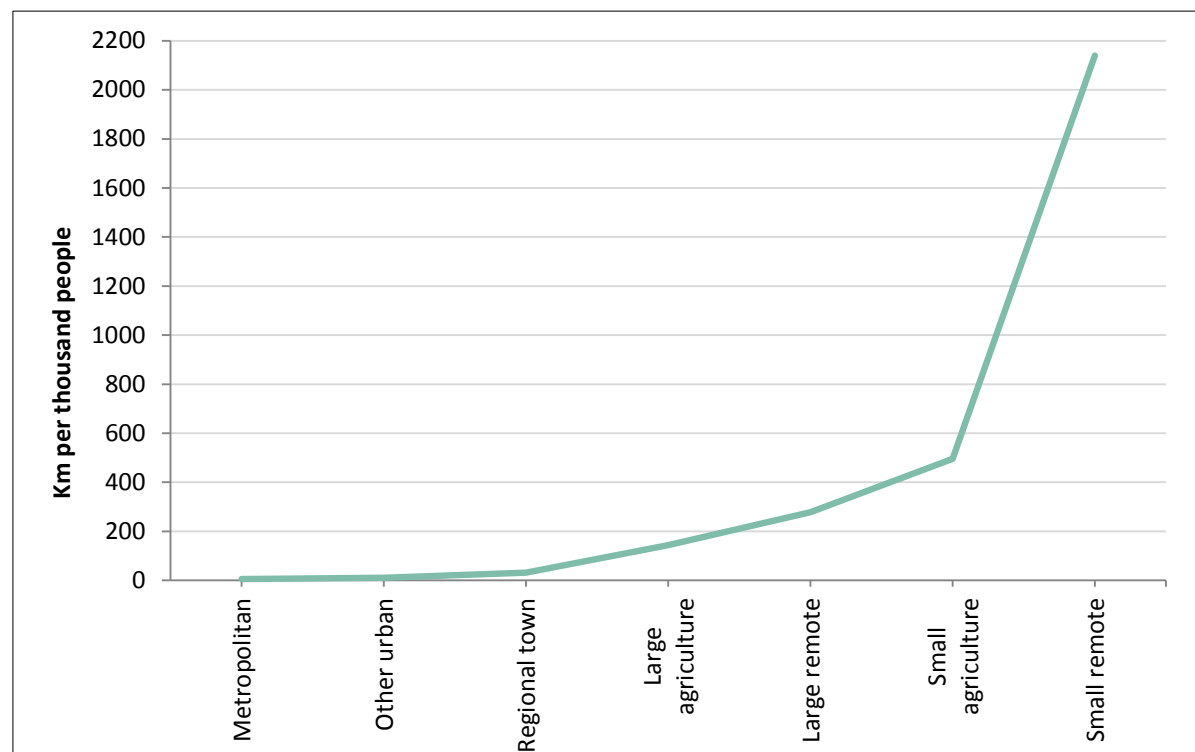
Region	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	%	%	%	%	%	%	%	%
Metropolitan	1.0	0.5	2.1	1.4	1.4	1.5	1.7	9.9
Large urban fringe	2.3	0.8		2.7	2.3			
Small urban fringe	2.7	0.6	3.1	3.0	1.1	3.8		13.0
Regional town	4.6	1.9	6.4	5.8	5.3	5.6		24.1
Large agricultural	7.8	1.2	6.9	3.9	3.0	5.9		8.7
Small agricultural	11.2	0.9	24.2	5.2	4.2	6.0		37.5
Large remote	23.5		53.5	26.8	89.3 (a)			82.9
Small remote	(b)		48.2	34.2	90.8 (c)			
Unincorporated	3.9	0.6			21.1			14.8

(a) Covers the population of Anangu Pitjantjatjara.

(b) The three small remote councils in New South Wales have a total population of about 550. They are included in the unincorporated region in the table.

(c) Covers the population of Maralinga. The population of the other three Indigenous community council areas is included in the unincorporated area in the table.

Source: ABS data on local government area estimated residential population, 2011-12.

Figure 6-9 Average road length per thousand people by council type, 2011-12

Source: Commission calculation based on data from the then Department of Regional Australia, Local Government, Arts and Sport.

- **Revenue capacity.** Rating capacity and the ability to generate revenue through other fees and charges varies noticeably between urban and rural – remote councils.
 - Urban councils tend to have higher land values and concentrations of residential properties, which mean they tend to have bigger rate bases. However, all urban councils are not the same. For example, those in inner city areas appear to have a greater capacity to raise revenue from residents and non-residents through parking fees and other user charges making them less reliant on rate revenue than other metropolitan councils.
 - Most rural and remote councils, particularly remote Indigenous councils have lower revenue capacities. The Northern Territory’s Indigenous councils have limited capacity due to the limited number of rateable properties⁶ and the constraints imposed by conditional rating over pastoral and mining tenements. The State Agreement Acts in Western Australia also limit the revenue raising capacity of some rural – remote councils.
 - Many submissions noted the low revenue raising capacity of regional and remote councils, but none suggested they were not making enough effort to raise revenue. The available evidence suggests the average rating effort of rural councils is higher than their urban counterparts.

- 25 While LGGCs do not generally take it into account, the rate of population change can affect the fiscal capacity of councils. In particular, it can affect the need for council infrastructure. Councils with above average rates of population growth would need to acquire more infrastructure to deliver services if they are to avoid above average crowding of facilities and reductions in service standards. Conversely, councils with declining populations and below average growth would generally have lesser need for extra infrastructure and may be able to spend relatively less on replacing existing infrastructure without reducing service levels.
- 26 While there are exceptions, councils with below average population growth tend to be in rural and remote areas.

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- 27 While LGGCs may use different methods to calculate councils’ relative needs, they produce broadly similar outcomes for similar types of councils. In all States, rural and remote councils are assessed to have the greatest relative need. The differences

⁶ The Commonwealth’s Aboriginal Land Rights (Northern Territory) Act precludes the rating of Aboriginal Land (unless there is leasehold tenure over it). Over 50% of Northern Territory land is Aboriginal land, with most of it located in rural and remote areas.

between the relative needs and fiscal capacities of urban and rural-remote councils as measured by the LGGCs have increased over the last decade and more.

- 28 There are a number of underlying factors that influence the spending requirements and revenue capacity of councils including population, area, road lengths and rating capacity. The relative needs of councils are also influenced by State policies on the structure of local government boundaries and Commonwealth and State policies that limit revenue raising capacity.

CHAPTER 7

IMPROVING THE IMPACT OF FINANCIAL ASSISTANCE GRANTS

- 1 This chapter draws together the key points identified in earlier chapters and, in response to Clause 2 of the terms of reference, identifies tangible measures for improving the impact of financial assistance grants (FAGs) on the effectiveness of local governments and their ability to provide services to their residents.

A COMMONWEALTH GRANT SYSTEM FOR LOCAL GOVERNMENT

Current environment

- 2 Our conclusions are based on an environment where:
 - The States have constitutional responsibility for local government and are the major players in the establishment, governance and the distribution of funding to their local governments. Their decisions in these areas have a major bearing on the effectiveness of local government and their ability to deliver services.
 - Local governments are responsible, and accountable, to their State governments and their residents for effective (and sustainable) service delivery (including the provision of infrastructure) and revenue raising.
 - While the local government sector appears financially sound overall, there is a wide disparity in the fiscal capacities of councils within States. This primarily reflects the different revenue raising capacities and service costs in urban and rural areas. There is evidence that this disparity is widening.

Impact of financial assistance grants on councils

- 3 We have also taken into account the current impact of FAGs on local government. We have found the Commonwealth through the FAGs program provided about 7% of local government sector revenue in 2011-12. It provided an additional 2% through

tied programs. The vast bulk of local government sector spending is financed directly by the sector, with the States contributing about 10%. For many councils, financial assistance grant funding appears marginal, while for some it appears of vital importance.

- 4 Full equalisation of council fiscal capacities cannot be achieved through the general purpose component of the FAGs program, even if the total were allocated on a relative needs basis.
- 5 However, our analysis in earlier chapters suggests the current grant program is largely meeting the Commonwealth's objectives as set out in the Act. The national principles mean all councils receive funding to improve their fiscal capacities and some receive extra funds to reduce the fiscal disparities between councils. These objectives are achieved through the distribution of general purpose and identified local roads grants.
- 6 Local government grants commissions (LGGCs) distribute these funds in accordance with the national principles which are intended to ensure the Commonwealth's purposes and goals for the grants are achieved and that the allocations are done consistently across the States. We have observed variations in how LGGCs interpret these principles. Despite this, rural and remote councils in all States tend to receive the largest general purpose grants and metropolitan councils tend to be on minimum grants.

Characteristics of an ideal scheme

- 7 Our view is the ideal financial assistance grant scheme should:
 - have clear objectives
 - have clear links between objectives and available funds
 - facilitate and permit effective decision making
 - ensure adequate consistency in the distribution process but allow for the diversity of councils in different States
 - ensure appropriate levels of transparency and accountability in the distribution process and the use of funds – reporting requirements which allow residents and the grant provider to assess whether the funds have been used effectively
 - minimise administrative costs for the funding provider, distributor and councils, consistent with maintaining appropriate accountability and transparency, in accordance with the proportionality principle set out in the Commonwealth's Grant Guidelines¹.

¹ This principle requires a grant design which strikes an appropriate balance between complexity of grant process and management of the risk for the Commonwealth and recipient. The goal is to achieve value with public money while putting appropriate accountabilities and transparency in place without overburdening the recipient.

- 8 We also consider a grant scheme should embody the principle of subsidiarity, especially where three tiers of government are involved. Subsidiarity requires powers and responsibilities to be devolved to the lowest level of government practicable so that decisions are made as close as possible to the people affected and at the level best suited to making those decisions. Subsidiarity provides for policies and services to be customised to take account of local knowledge and preferences and thereby improves their effectiveness.

THE WAY FORWARD

How big a change is warranted?

- 9 The current arrangements are complicated, having evolved over time to meet the wide range of objectives set out in the Act. We doubt a financial assistance grants scheme designed from scratch today would look like the current one. For example, since all the funds are untied in the hands of local government, having them allocated in two streams each with its own intrastate allocation procedures suggests scope for simplification.
- 10 We considered if a fundamental change to FAGs was warranted to improve the effectiveness of local government. For example, we considered whether there should be a single pool of funds in each State — see Box 7-1. We concluded such a change could result in large changes in the distribution of funds among individual councils without any certainty as to the impact on the effectiveness of local governments or their ability to deliver services.
- 11 Given the current financial assistance grants program seems to be meeting its diverse objectives and that adjustment costs could be high, we were not convinced a major change to the scheme was warranted. We recognise this means continuing much of the complexity of the scheme.
- 12 However, we consider some modest options for change can be identified which would be practical yet retain a balance between the improvements in effectiveness they can deliver and the ability to still address the objectives the Commonwealth has established for these grants. The changes aim to make the current arrangements a little simpler and promote the effectiveness and ability of councils to deliver services.

Box 7-1 Consideration of the single grant option suggested by South Australia

The South Australian Government suggested we should consider amalgamating the general purpose and identified roads grants for each State so that roads needs are assessed only once. It said few councils understand the overall grant effects of the two existing roads assessments, particularly once the identified road grants are included in the determination of relative needs used to distribute the general purpose grants. It also said combining the grants would result in more funds being available to fiscally weaker councils as stronger councils would receive only the minimum grant (albeit a larger amount because it would be 30% of the combined grants).

Such a change would mean the national principle relating to identified roads would be subsumed into the horizontal equalisation principle, roads needs would be assessed using one method and would cease to be treated differently from the needs for all other local government services.

However, submissions indicated most interested parties regard the separate road funding to be an important and desirable feature of the current arrangements, as it reflects the importance of roads in council budgets. Submissions from a number of LGGCs also indicated amalgamating the two grants would lead to large changes in the allocation of grants to councils in their States.

Tied or untied?

- 13 The terms of reference asked us to evaluate the economic and financial benefits of untied and tied assistance for enhancing the effectiveness of local governments and their ability to ensure effective services for their residents.
- 14 Chapter 4 concluded the principle of subsidiarity and giving councils flexibility to make decisions most consistent with their resident's wishes meant untied grants would lead to more effective local government services. Therefore, we concluded the general purpose grants at least should remain untied.
- 15 We gave special consideration to the option of retying the roads grants, as advocated by the then Department of Infrastructure and Transport, to increase the accountability to the Commonwealth and to make clearer how taxpayer funds were being spent. However, we concluded tying would achieve little as councils generally spend more than their identified road grant on road maintenance.

Improving effectiveness and ability to deliver services

- 16 Next we considered how the effectiveness and ability of councils to deliver services might be improved.
- 17 We concluded the Commonwealth might do this:
 - by better alignment of the existing objectives in the Act with separate pools
 - by including the option of a third general purpose pool to encourage and facilitate structural changes in the operations of local government
 - by giving States some discretion in deciding how much of the existing funding envelope might be allocated to existing and proposed purposes, after taking into account the differences in their local governments

- by improving the equity and consistency with which LGGCs allocate the part of the general purpose pool designed to reduce fiscal disparities by asking LGGCs to reconsider aspects of their methods.
- 18 We see this as a reform agenda driven by State governments in conjunction with their local government sectors. Such an agenda could be supported from the existing funding envelope as a tangible way the Commonwealth could improve effectiveness and still progress its other objectives, such as assisting all councils and reducing the disparity in their fiscal capacities.

Some administrative issues

- 19 Currently, LGGCs advise the State minister responsible for local government on the allocation of both pools of funds to individual councils. The State ministers must in turn seek the Commonwealth minister's approval to the payments for each council. This process appears complex.
- 20 The Act also requires the Commonwealth minister to prepare an annual national report on the operation of the grants program and the actions of councils aimed at improving efficiency and effectiveness and the provision of services to Aboriginal peoples and Torres Strait Islanders. We are not sure of the purpose this serves because current reporting is running some three years in arrears and, because of data and resource limitations, does not provide all the information specified by the Act.
- 21 Some administrative changes could be made to better reflect the subsidiarity principle, to remove any unnecessary duplication and improve accountability and transparency in the distribution and use of the funds. These might include changing the grant approval and reporting arrangements so they meet the proportionality test in the Commonwealth's grant guidelines. For example:
- We see no need for the Commonwealth minister to approve individual council grants. State ministers or auditors-general could provide the Commonwealth with the necessary assurances that the States have passed the funds on to their local governments in accordance with the Act and the national principles.
 - To ensure councils are appropriately accountable to their State governments for the use of FAGs, a conditional requirement could be imposed on the receipt of FAGs, requiring councils to demonstrate that they have appropriate planning, revenue raising and service delivery measures in place and that they operate in accordance with relevant State legislation and financial practices.
 - We do not consider it worthwhile for the Commonwealth to report on the detailed operation of local governing bodies through the National Report unless it is more up to date and provides all the information specified by the Act on a comparable basis. This reporting could be, and is already being, done at State level where comparability of data is likely to be maximised.

A MODIFIED FINANCIAL ASSISTANCE GRANT SCHEME

General revenue grants

- 22 We consider some of the complexity of current arrangements can be addressed through a clearer exposition of objectives and the funds allocated to them. Greater clarity would enable State specific implementation to be more consistent while still recognising State specific circumstances. It would give States greater assurance that they were appropriately addressing the Commonwealth's objectives.
- 23 Direct links between the available funds and the grant objectives are one of the desirable features of a grant program. We, therefore, consider the existing general purpose grants in each State should be divided into three possible pools to better meet the Commonwealth's objectives:
- a common pool which would be used to provide funds to every council on an equal per capita basis
 - a relative needs pool which would be used to reduce differences in the fiscal capacities of councils
 - a reform pool which States could create and use to facilitate greater effectiveness.
- 24 The first two pools make the existing equal per capita and relative needs elements of the grant allocations explicit. The third pool will facilitate changes aimed at making funds available for initiatives which would make local government sectors as a whole more effective as per the terms of reference. This structure of the proposed general purpose pool is set out in Box 7-2.
- 25 **Common pool.** This pool would meet the Commonwealth's objective of ensuring every council receives some general purpose funding, regardless of its financial capacity. Councils with above average financial capacities would receive only the per capita grant while those with below average capacities would receive the per capita grant plus a grant from the proposed relative needs pool.
- 26 This pool would, thus, perform a similar function to the existing provisions requiring each council to receive at least an amount equivalent to its population share of 30% of the general purpose funds received by the State.
- 27 **Relative needs pool.** This pool would meet the equity objective of improving the relative ability of councils to provide services. Consequently, all councils with relative needs (calculated after funding from the common pool is included) would receive funds from this pool.
- 28 To enhance the equity objective, we consider it important that the distribution of funds in this pool conform to appropriate equalisation principles.

- 29 In framing our view of these principles we have carefully reflected on the advice provided to us by LGGCs, local government associations and councils. We are mindful of the complexity of the task faced by LGGCs because of the very disparate natures of local government across States (see Chapter 2) and the fact that the level of funding available is insufficient to achieve full horizontal equalisation. We are also mindful of the data and resourcing issues which constrain what LGGCs can do in practice.
- 30 We consider that, from the perspective of relative needs, a key task is to determine what an equitable level of service and revenue raising would be across councils within a State, given the very different circumstances they face and the different populations they service. We consider that in their work LGGCs should distinguish between the provision of a standard State-wide service and, where more appropriate, a standard service provided by comparable local governing bodies. We note this distinction is already made in some areas. For example, roads needs assessments recognise that some councils require mostly sealed roads and other councils, mainly unsealed roads.
- 31 We consider that, within the constraints of the data available, the equalisation task should be comprehensive, recognising all expenditures, revenues and differences in innate service delivery costs and revenue raising capacities faced by councils. The innate differences would include differences due to the economic, geographic and the socio-demographic characteristics of councils. For example, the relative need assessments should consider what recognition should be given to the operation of regional local governments and their impact on the services that need to be provided to adjoining local governments. They should also ensure they reflect the costs faced in delivering services to Indigenous communities.
- 32 We consider equalisation outcomes would be enhanced if the relative needs assessment process were extended to include, in a simple and practical way, local government infrastructure needs. We think this would better reflect the costs faced by councils experiencing above average population growth.
- 33 Improving the capacity of local governments to provide an equitable level of services is a stated objective of this grants program. We consider this requires the impact of other grant support on that capacity be recognised. Failing to do so means the overall capacity of councils is not as close to an equitable outcome as possible. Consistent with our view that infrastructure needs should be brought within the equalisation process, so too should capital grants received by councils.
- 34 We recognise the practical constraints faced by LGGCs. For that reason we suggest they adopt a materiality guideline which would act to remove some of the smaller factors from their work, letting them, and councils focus on the more significant differences affecting fiscal capacities. We also consider that adopting a separate pool approach would make the task of LGGCs easier and more transparent as would

providing support from the relative needs pool to all councils with below average fiscal capacities.

- 35 We have set out what we consider to be important equalisation principles in Box 7-3 and provide further discussion of equalisation methods in Attachment B.
- 36 **Reform pool.** We see merit in allowing States to use some small part of the general purpose pool to facilitate structural reforms and collaborative action, designed to improve the effectiveness and efficiency of the local government sector overall or of groups of local governments. The reforms to be funded should be tightly defined and relate only:
- to structural reforms, such as amalgamations and collaborative purchasing or service provision arrangements, like those proposed by the Independent Local Government Review Panel in New South Wales² and
 - to collaborative roads or infrastructure projects of benefit to regions rather than specific councils, such as the South Australian Special Local Roads Program.
- 37 The States should decide the need for a reform pool and be responsible for managing it because we consider they are best placed to design (or evaluate) arrangements to improve local government effectiveness which best reflect their circumstances. The resulting arrangements could be quite different in each State.
- 38 Not all councils would derive benefit from this pool each year as its purpose would be to support specific initiatives aimed at improving sector effectiveness. The support would remain general purpose funding and be restricted to a maximum of four years of payments. State auditors-general would play a role in assuring the Commonwealth minister the funds have been allocated according to the Act.
- 39 By providing support to State-based reform initiatives, this pool would complement the operation of the Commonwealth's local government reform fund which is designed to improve the operation of individual councils.³

Size of pools

- 40 Since it is the funding provider, it is a matter for the Commonwealth to set up the broad structure for the proposed three pools and to determine the objectives of the program and each pool. However, because there are substantial differences between the States in the fiscal capacities of their councils, including the proportion of

² Independent Local Government Review Panel, *Future directions for NSW Local Government: Twenty Essential Steps*, April 2013.

³ That fund aims to: support the accelerated implementation of nationally consistent frameworks for local government asset and financial management; encourage collaboration in the local government sector to build capacity; and improve the collection and analysis of nationally consistent data on local government finances.

minimum grant councils and the populations covered, it may not be appropriate for the common pool to be the same size in each State. We consider States should have some flexibility to determine the size of the common pool, given their own circumstances and their judgment on the appropriate trade-off between providing something for all councils and reducing the divergence in the capacity of councils to provide services. If States made different choices, the size of the per capita grant would not be consistent across States.

- 41 We also consider it appropriate for States to make the decision on the extent to which the provision for a reform pool should come from the common pool or the relative needs pool.
- 42 We have concluded that the Commonwealth should, within limits, allow States to decrease the share of general purpose funds allocated equal per capita because:
 - there is evidence needs disparities between councils in each State are getting bigger
 - the sustainability of more needy councils which tend to be those in regional and remote areas, continues to be threatened
 - the contribution which general purpose grants make to council budgets in receipt of only the per capita grant is relatively small
 - per capita grant councils have the capacity to raise more revenue from own sources while more needy councils tend not to be able to do so
 - the extent to which each of these considerations applies in each State varies.
- 43 These factors indicate the share of grants distributed on an equal per capita basis should not be increased and, in some States, may need to be reduced. Within the limits to be set by the Commonwealth, we consider individual States should make the decision on the extent of any changes because they are best placed to assess the circumstances of their councils.
- 44 To ensure the Commonwealth's basic objectives for the grants program are achieved, we consider the Commonwealth should constrain the ability of the States to set the pool sizes. Such constraints might be as follows:
 - the common pool should be between 20 and 30% of a State's funding envelope
 - the relative needs pool should be at least 65%
 - the reform pool should not exceed 5%.

Identified roads grants

- 45 Expenditure on roads is a large part of the budget for many councils, particularly rural and regional councils, and it is a significant contributor to differences in fiscal capacity amongst them. The Commonwealth has supported this expenditure over many years

through the identified local roads grants program and we are not suggesting much change to this program.

- 46 We have concluded that, consistent with the intention of the Act and the strong view in submissions that roads are important to local governments, the Commonwealth should at this time continue to provide untied identified local roads funds.

NATIONAL PRINCIPLES

General purpose grants

- 47 The national principles aim to ensure consistency across all States in the methods used to distribute the grants to councils in each State. We have concluded the national principles are valid, given the circumstances of local government, the purposes set out in the Act and the Commonwealth's intention that progress be made on each. However, we consider they could be better presented. They should be amended to clearly align with the broad objectives of each of the proposed three sub-pools.
- The minimum grant principle should be replaced with a more flexible principle relating to the distribution of the common pool. An equal per capita payment should be made to each council from the common pool, the size of which has been determined by the State as being between 20% and 30% of the State general purpose grant.
 - The horizontal equalisation, effort neutrality and other grant support principles should be replaced by relative needs principles.
 - The amalgamation principle should be broadened with a more general principle aimed at encouraging reform, sustainability and effectiveness.
- 48 A separate Aboriginal peoples and Torres Strait Islanders principle should be retained consistent with the purpose of the Act aimed at improving the provision by local governing bodies of services to Aboriginal and Torres Strait Islander communities. This would allow LGGCs to decide whether the relative needs assessments can be made in the usual way or whether different methods are necessary.
- 49 Box 7-3 sets out the proposed new national principles.

Dealing with roads

- 50 Currently the way LGGCs allocate grants for roads from the general purpose and identified roads grants is complex. However, we consider LGGCs should continue to assess roads needs for the roads grants and the relative needs pool should continue to recognise that a large part of the Commonwealth funding for roads comes from the general purpose funds.

- 51 To simplify the approach and to better understand the interaction between the two grants, we consider the same method should be used to assess roads needs in the distribution of the identified roads and relative needs grants. Different methods are currently used by some LGGCs but those used to distribute the identified roads grants are largely overridden by the relative needs assessment. Attachment B explains why.
- 52 We also consider the assessed allocation of identified road grants should be fully taken into account when assessing relative needs. Otherwise, councils will receive funding for the same factors twice.
- 53 The road expenditure assessment should be comprehensive. In addition to reflecting characteristics such as length, use and asset preservation costs, it should also capture the need for investment in new or improved roads. That could in the first instance be done simply using relative population growth. We consider that not recognising investment needs biases the assessment in favour of councils with large existing networks and disadvantages councils with growing populations and a requirement for new roads. We think it important to recognise all needs if the ability of councils to deliver equitable services is to be improved.
- 54 We suggest the current roads principle be retained, but be modified to reflect the changes suggested above. Box 7-4 proposes an amended principle.

Consistency in interpreting the principles

- 55 Given the Commonwealth's goal of improving the transparency and consistency of LGGC methods and the calls in submissions for improvements in those areas, we suggest the LGGCs be provided with additional guidance on how the principles should be interpreted and implemented. Such guidance is in Attachment B. However, the LGGCs must retain sufficient flexibility to ensure the grant allocations they determine reflect the important drivers of differences in fiscal capacity of councils in their States.

FINDINGS

- 56 Under the changes to the financial assistance grant program we are proposing, the Commonwealth retains responsibility for deciding the level of funding to be allocated to each State, the structure of the grants program and for reaching agreement with the States and representatives of local government on the principles to be followed in allocating the grants within each State.
- 57 We consider FAGs lead to more effective decision making if they continue to be untied in the hands of local government. Tying FAGs would be inconsistent with our view that decision making should be devolved to the level of government responsible for the outcome. States should, within limits, have more flexibility in deciding the

parameters of the program and local government should be responsible for decisions on service provision and revenue raising.

- 58 The States should have greater responsibility for grant allocation decisions within the State because they are responsible for, and closer to, local government. The distribution of the general purpose grants and the identified road grants should be decided by State ministers on the basis of recommendations from the LGGCs. Those recommendations should be prepared on the basis of methodology developed by the LGGC to be consistent with the national principles (and other guidance on their implementation) and to reflect local conditions.
- 59 We have concluded the effectiveness of local government cannot be greatly improved through altering the distribution of general purpose grants, but it can be somewhat improved by:
- dividing the general purpose grants for each State into up to three pools (a common or equal per capita pool, a relative needs pool and a reform pool) to more clearly link the funds with the Commonwealth's purposes in providing the grants and the national principles
 - expanding the amalgamation principle to one that supports a broader range of structural reforms, and giving effect to this principle by setting aside a small proportion of the general purpose grants pool in each State (up to 5%) to facilitate such reforms
 - making councils more accountable to their residents and State government by making FAGs conditional on meeting State legislative requirements and LGGC data requirements.
- 60 We have concluded the capacity of local government to deliver equitable services can be improved by:
- providing additional guidance to LGGCs on aspects of their task which they could consider to improve the equity of their grant allocations and the consistency of those allocations across States
 - allowing States some discretion in deciding the size of the three pools.
- 61 Boxes 7-2, 7-3 and 7-4 provide an overview of the proposed financial assistance grant program and the proposed national principles for allocating the general purpose and identified local roads grants. Attachment B provides guidance on how the national principles might be consistently interpreted.

Box 7-2 Proposed financial assistance grant program design

The Commonwealth provides financial assistance grants to each State and Territory for the purpose of providing financial assistance to local government.

That assistance is provided in two parts:

- a general purpose grant (grants paid under section 9 of the Act)
- an identified local roads grant (grants paid under section 12 of the Act).

The general purpose grants to which each State or Territory is entitled should be sub-divided into three pools for payment to councils as follows:

- A **common pool** which is to comprise between 20% and 30% of the general purpose grants to which each State or Territory is entitled and is to be used to provide each eligible local governing body in the State or Territory with an equal per capita payment to improve their fiscal capacities.
- A **relative needs pool** which is to comprise at least 65% of the general purpose grants to which each State or Territory is entitled and is to be used to narrow relative differences in the ability of councils in the State or Territory to provide average services to their residents.
- A **reform pool** of up to 5% of the general purpose grants to which each State or Territory is entitled to facilitate structural reform and collaborative action aimed at improving the effectiveness of local government in the State.

General purpose grants provided to councils from each of the pools and the identified roads grants can be used by them in accordance with their policies and priorities on service provision.

Transparency and accountability

The Commonwealth minister should ensure that States have appropriate grant administration processes and disclosure and reporting arrangements in place to achieve the objectives of the program in a simple, transparent and reliable way.

The States should assure the Commonwealth minister that the financial assistance grants have been used to achieve the objectives of the Act.

Councils must report to the State minister and their residents on the use of the funds in accordance with the requirements of State legislation and provide the data required by the State and the local government grants commission. States should have the capacity to withhold funds from councils if they do not comply with these requirements.

Box 7-3 Proposed national principles for the distribution of general purpose grants

The State or Territory minister responsible for local government should decide the allocation of general purpose grants for each council in their jurisdiction (other than the ACT). Those decisions should take account of recommendations from the local government grants commission (LGGC) in the jurisdiction which should have regard to the national principles for allocating general purpose grants.

The objective of the national principles is to establish a nationally consistent basis for distributing the grants to local government. The Commonwealth minister responsible for local government should formulate national principles after consulting with jurisdictions and local government.

Common pool

1. This part of the general purpose grants to which the State or Territory is entitled should be allocated to every council on an equal per capita basis.

Relative needs pool

2. This part of the general purpose grants to which the State or Territory is entitled should be allocated among councils on the basis of horizontal equalisation principles to narrow differences in relative need among councils. The grants should ensure each council in the State or Territory with a positive relative need has its fiscal capacity raised towards the average budget outcome of councils in the State or Territory. The relative need calculations should take account of differences between councils in the expenditure required to perform their functions and in their capacity to raise revenue if they operate at average levels.

- To avoid States and LGGCs having to make judgments on what councils should or could do, the average of what councils collectively do should be the benchmark for comparison across councils within States. This will provide guidance on the expenditure and revenue standards, average budget outcomes and the factors to be recognised in LGGC calculations. Factors should recognise that not all councils can, or need to, raise all revenues or provide all services at the same level.
- All local government expenditures and revenues should be included in the equalisation process, including expenditure on roads and the acquisition of infrastructure, consistent with what councils do.
- All material factors, including those relating to the use and cost of providing services to all residents, including Indigenous residents, those affecting roads and innate differences in the ability to raise revenue should be recognised.
- Grants provided by governments, other than from the reform pool, should be taken into account in assessing fiscal capacities if they fund expenditure for which needs are assessed.
- As far as possible, the expenditure and general revenue policies of an individual council should not affect its allocation from the pool.
- LGGC methods should be practical: as simple and transparent as possible while recognising material fiscal differences between councils reliably. A formal materiality guideline should be adopted in each State and also apply to the grants themselves (a council's grant from this pool would need to be above a certain size; for example, \$5 per person).
- Special provision to improve services provided to Indigenous communities may be made.

Reform pool

3. This part of the general purpose grants to which the State or Territory is entitled should be allocated among councils on a basis to be determined by the State. It should be aimed at structural or collaborative reforms which will improve the effectiveness of local government in the State. The reforms should relate:

- to structural reforms, such as amalgamations and collaborative purchasing or service provision arrangements and
- to collaborative roads or infrastructure projects of benefit to regions rather than specific councils.

Box 7-4 Proposed national principle for the identified local roads grants

Identified local roads grants

The identified road grants should be allocated to councils as far as practicable on the basis of the relative needs of each council for roads expenditure, including expenditure required to preserve its existing road assets and to expand or improve its road network.

In assessing road needs, relevant considerations include length, type and usage of roads and population growth in each local government area. The assessment should be the same as that included in the model used to distribute the relative needs pool.

ATTACHMENT A

SUBMISSIONS AND HEARINGS

Submissions

- 1 The commission received submissions from the following interested parties:
 - Alliance of 20 Sydney Metropolitan Councils (March 2013)
 - Australian Local Government Association (March 2013)
 - Department of Infrastructure and Transport (March 2013)
 - Department of Regional Australia, Local Government, Arts and Sport (March 2013)
 - East Gippsland Shire Council (February 2013)
 - Golden Plains Shire Council (February 2013)
 - Government of South Australia (July 2013)
 - Hobart City Council (February 2013)
 - Jeff Roorda and Associates (March 2013)
 - Launceston City Council (March 2013)
 - Local Government Association of the Northern Territory (February 2013)
 - Local Government Association of Queensland (February 2013)
 - Local Government Association of South Australia (March 2013)
 - Local Government New South Wales (March 2013)
 - Nillumbik Shire Council (March 2013)
 - New South Wales Local Government Grants Commission (February 2013)
 - Northern Territory Department of Local Government (April 2013)
 - Northern Territory Grants Commission (February 2013)
 - Queensland Local Government Grants Commission (March 2013)
 - John Comrie (March 2013)

- South Australia Local Government Grants Commission (March 2013)
- Tasmanian Government (March 2013)
- Tweed Shire Council (February 2013)
- Victorian Grants Commission (March 2013)
- Kimberley Group of Councils (March 2013)
- Western Australia Local Government Association (March 2013)
- Western Australia Local Government Grants Commission (February 2013)
- Western Australia Minister for Local Government, Heritage, Citizenship and Multicultural Interests (February 2013)
- Shire of Halls Creek (February 2013)

Supplementary submissions:

- Australian Local Government Association (August 2013)
- NSW Local Government Grants Commission (August 2013)
- Local Government Association of Queensland (August 2013)
- Local Government Association of South Australia (August 2013)
- Northern Territory Grants Commission (August 2013)
- Queensland Local Government Grants Commission (August 2013)
- South Australian Southern & Hills Local Government Association (August 2013)
- Tasmanian Department of Treasury and Finance (August 2013)
- Tasmanian State Grants Commission (August 2013)
- Victorian Grants Commission (August 2013)
- Western Australia Local Government Association (August 2013)
- WA Local Government Grants Commission (August 2013)

- 2 These can be found on the commission's webpage:
<http://www.cgc.gov.au/index.php/other-inquiries/152-2013-inquiry-into-improving-the-impact-of-fags-on-local-government-financial-sustainability>

Hearings

- 3 The commission held hearings on submissions in Canberra on 10 April and 20 June 2013 and in Adelaide on 9 May 2013. The following groups and their representatives discussed their submissions and other matters with the commission.

Table A-1 Hearings

Submission from	Representatives
Alliance of 20 Sydney Metropolitan Councils	Graham Thomas, Manager Sutherland Shire Council Robert Honeyman, Director, Sutherland Shire Council Nigel Stokes, Consultant (Review Today) Dave Walker, General Manager, The Hills Shire Council Sharon Foord, Manager, The Hills
Australian Local Government Association	Adrian Beresford Wiley, Chief Executive Josh Thompson, Researcher
Launceston City Council	Mayor Albert van Zetten Robert Dobrzynski, General Manager Michael Tidey, Director Corporate Services
Local Government Association of Queensland	Roland McMillan, Principal Advisor Alan Morton, Director Morton Consulting
Local Government Association of South Australia	Mayor David O'Loughlin, President David Hitchcock, Director
New South Wales Local Government Grants Commission	Richard Colley, Chair Grahame Gibbs, Deputy Chair Bruce Wright, Executive Officer
Queensland Local Government Grants Commission	Lynette McLaughlin, Chairperson Bill Gilmore, Executive Officer Michael Meehan, Principle Program Officer
South Australia Local Government Grants Commission	Mary Patetsos, Chair Jane Gascoigne, Commissioner Peter Ilee, Executive Officer
Victorian Grants Commission	Colin Morrison, Executive Officer
Western Australia Local Government Grants Commission	Linton Reynolds, Chairman WALGGC Ross Earnshaw, Manager, Reform Implementation, Department of Local Government

- 4 A recording or summary of proceedings is on the commission's webpage:
<http://www.cgc.gov.au/index.php/other-inquiries/152-2013-inquiry-into-improving-the-impact-of-fags-on-local-government-financial-sustainability>

ATTACHMENT B

METHODS OF LOCAL GOVERNMENT GRANTS COMMISSIONS

BACKGROUND

- 1 The commission has not analysed the assessment methods used by individual local government grants commissions (LGGCs) in detail, but based on the understanding of LGGC methods gained through this review has identified some alternate approaches which could improve transparency and equalisation outcomes. The commission is not making specific recommendations on these issues, but presents its observations for consideration by LGGCs.
- 2 The commission recognises the requirements of the Act, the diversity of councils, data deficiencies and resource issues make the task of LGGCs very difficult.
- 3 The very disparate natures of local government across and within States means identifying and measuring all material differences in the fiscal capacities of councils is no easy task. There are large and small councils in terms of both area and population, and population characteristics and economic circumstances differ considerably. This diversity creates methodological and practical problems. Practical issues relating to data availability further complicate the process. The ability of councils to provide data to support complex assessments is limited by their administrative capacity and what is reasonable for them to provide.
- 4 Each LGGC has developed its own approach to allocating general purpose and identified roads grants, to reflect the role and circumstances of local government in its State and its understanding of the main influences affecting councils' fiscal capacity. This is appropriate and differences between States in their methods are inevitable.
- 5 However, the commission expected to find greater consistency in the core features of grant distribution models. As noted in Chapter 7, some essential features of distribution models should be applied by all grants commissions.

- Comprehensiveness is essential to avoid bias in the assessment of fiscal capacities. All expenditures, revenues and innate factors affecting service delivery costs and revenue capacity of councils need to be recognised.
 - Deciding what an equitable level of service and revenue raising would be across councils in a State, given the very different circumstances they face and the different populations they service is a key task.
 - Including all other grant support is essential if the fiscal capacity of councils is to be accurately assessed.
- 6 This attachment covers a range of methodology issues and suggestions for alternate approaches which we believe LGGCs should consider. If adopted, they would:
- make for a simpler distribution process
 - make for better equalisation outcomes
 - make for more consistent outcomes, while allowing State specific circumstances to be appropriately recognised.

METHODOLOGY ISSUES

Practicality

- 7 LGGCs work in an environment prescribed by the Act, the national principles and the current funding envelope. Within that, they have three main tasks:
- to determine relative road needs to allocate identified roads grants
 - to determine which councils have below average fiscal capacities and warrant some relative needs grants and
 - to determine how diverse the fiscal capacities of below average councils are to decide the best way of raising their capacities.
- 8 The methods they develop should deliver these outcomes, consistent with the data available in a simple and practical way. Greater sophistication for example might not improve the ability to discriminate the above and below average capacity councils nor, given the need to factor back, the size of the relative needs grants paid to different councils.
- 9 Adopting a materiality guideline is one way to keep a focus on simplicity and practicality. Method changes which change grant outcomes by only a few cents per person per year are not worth adopting. Each LGGC should set its own guideline consistent with its own circumstances.

Relative needs and the minimum grant guarantee

- 10 The Act requires that as far as practicable general purpose grants should reduce fiscal disparities among councils, but that each council will receive a minimum general purpose grant. The minimum is 30% of what they would have received had all general purpose grants been distributed on an equal per capita basis.
- 11 LGGCs have adopted different ways of implementing these requirements. Most LGGCs initially calculate each council's assessed relative needs grant. If a council's assessed grant is less than the minimum, it is replaced with the minimum. The Tasmanian LGGC uses a two pool approach. It calculates a minimum grant for every council and funds these grants from its general purpose grant pool. It then includes the minimum grant as other grant support when calculating the relative needs grant.
- 12 As noted in Chapter 5, the two approaches achieve different outcomes:
 - the first approach results in relative needs grants only for councils with assessed grants above the minimum grant level
 - the second results in relative needs grants for all councils with below average capacities.
- 13 A feature of the current Act is that, in effect, each council receives the equivalent of the minimum grant and some receive additional relative needs funds. The minimum grant equivalent payment received by all is distributed on a per capita basis and should have no impact on the relative fiscal capacities of councils. A council with a below average capacity before such a grant is distributed will still be below average after its receipt, because while its capacity rises, so does the average. Changing the minimum grant should not affect which councils receive relative needs funds, but with a fixed funding envelope, will affect the degree of factoring back.
- 14 The method adopted by each LGGC should be consistent with this outcome.
- 15 In chapter 7, the commission recommended dividing the general purpose grant pool in each State into three sub-pools to better meet the Commonwealth's objectives:
 - a common pool, which would provide funds to all councils on an equal per capita basis
 - a relative needs pool, which would reduce differences in fiscal capacities
 - a reform pool, which States could create and use to facilitate reforms to local government which improve its effectiveness and efficiency.
- 16 Once the size of the common pool is decided, its allocation is straight forward. Each council will receive the State average per capita amount multiplied by its population.
- 17 The relative needs pool (which would be equal to a State's total general purpose grants funds less its common pool and its reform pool) would be distributed on a basis consistent with equalisation (or relative needs) principles. Including the equal per capita grants as other grant support in determining the relative needs grants is an

element of the recommended approach. While it improves transparency, as set out above including this revenue will not change the assessed relative fiscal capacities of councils.

- 18 If all LGGCs adopted a three pool approach as outlined above:
- there would be a consistent approach to deciding which councils would receive relative needs grants
 - all councils would receive a grant from the common pool and all councils with below average fiscal capacities would receive a grant from the relative needs pool
 - LGGCs would not need to engage in an iterative approach to deciding which councils received only the minimum grant.

The scope of the assessments

- 19 For the equalisation objectives of the Act to be achieved LGGCs need to be able to accurately measure the fiscal capacities of councils, because it is disparities in these capacities that grants seek to reduce.
- 20 This means the methods adopted by LGGCs should capture all the important factors which drive differences in council fiscal capacities. Excluding one would bias the calculations. For example, excluding expenditure on infrastructure would disadvantage fast growing councils as they are likely to have a greater need to acquire new infrastructure.
- 21 Adopting a comprehensive approach which involves giving consideration to all the expenditures and revenues of councils ensures no important driver of differences in fiscal capacities is either inadvertently excluded or given an inappropriate weight in the assessments. However, being comprehensive does not require a differential assessment of all expenditures and revenues. LGGCs could decide, after consideration, that some activities have no impact on relative fiscal capacities and can be assessed equal per capita (EPC). Recording that deliberative decision and its rationale in State methodology reviews, helps ensure consistency in approach across States while allowing each State to develop methods reflecting its circumstances.
- 22 In addition to capturing all major factors, it is important that each be ascribed the right weight in calculating council fiscal capacities. That weight should be based on how important the factor is in the actual day to day operations of councils. This natural weight would come from the relative size of the related expenditure or revenue in the budget of the average council.
- 23 Adopting an approach which assesses a council's relative needs against the actual observed average outcome, be it a surplus or deficit, rather than scaling or constraining expenditures or revenues in an artificial way, is also important in

producing appropriate weights and avoiding bias. Box B-1 provides some further detail.

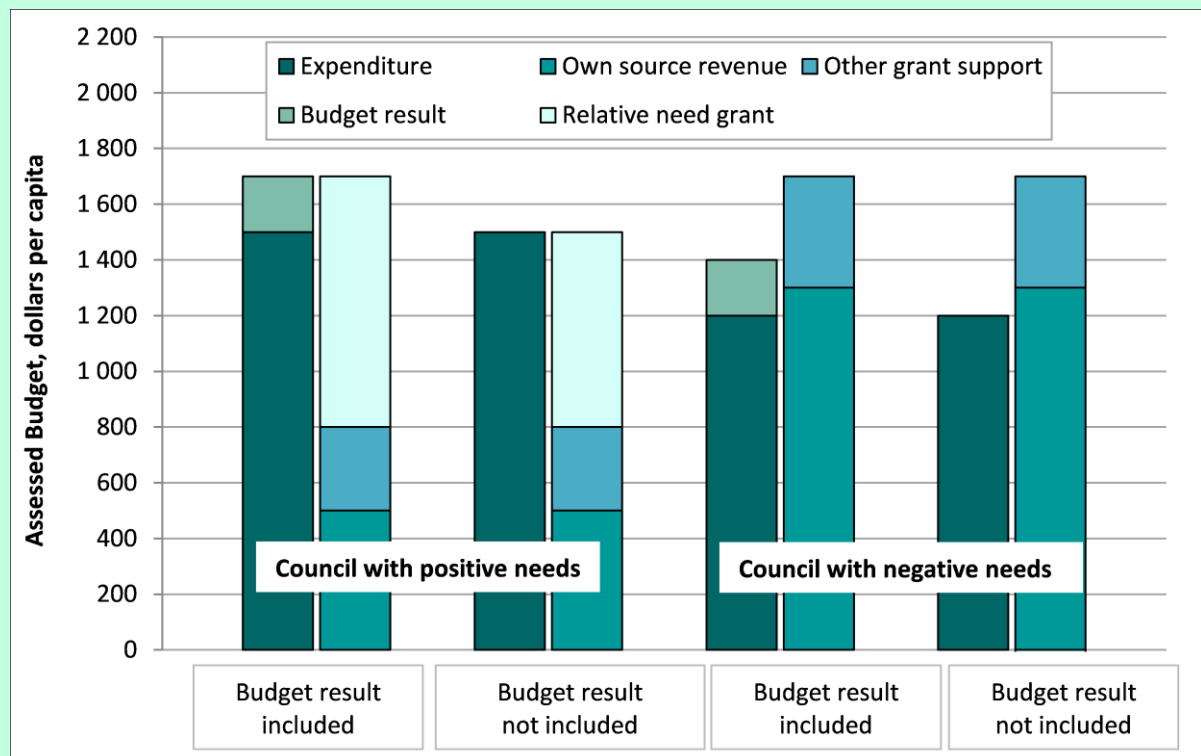
Box B-1 Implications of including the budget result

The first two columns in the graph below illustrate a situation where the local government sector in a State is running a surplus and the council in question is assessed to have a positive relative needs grant (its assessed (or standardised) expenditure plus the average budget outcome exceed its assessed (or standardised) revenue and other grant support). Its relative needs grant fills the shortfall. Were the council to receive all of its assessed relative needs, the expenditure and revenue sides of its assessed budget would balance.

The second pair of columns show omitting the average budget outcome alters the council's assessed relative needs. They use the same assessed expenditure, assessed revenue and other grant support, but the average budget outcome is omitted. In this case, the council's assessed relative needs grant is smaller because it requires less to balance the expenditure and revenue sides of its assessed budget.

The third pair of columns show the situation for a council assessed to have a negative assessed relative needs grant (its assessed expenditure plus the average budget outcome is less than its assessed revenue and other grant support). Its assessed relative needs grant is negative because that is what would theoretically be required to balance the expenditure and revenue sides of its assessed budget. Its negative assessed relative needs grant means it is not eligible to receive a relative needs grant.

The fourth pair of columns show that omitting the average budget outcome alters the council's assessed relative needs grant. In this case, the assessed relative needs grant becomes more negative.



24 **Assessing expenditure.** All LGGCs recognise innate factors which affect council expenditures. New South Wales has the most detailed expenditure approach, with 18 categories of expenditure and 45 cost adjustors, most of which are category specific. Queensland and the Northern Territory have fewer categories of services and include only the main drivers of differences in the cost of delivering those services — socio-demographic composition (including Indigeneity), location and scale diseconomies.

25 Table B-1 summarises the main cost adjustors recognised by each LGGC.

Table B-1 Major cost adjustors

Description	NSW	Vic	Qld	WA	SA	TAS	NT
Population characteristics							
Socio-demographic characteristics (e.g. age)	x	x	x				
Socio-economic disadvantage (e.g. income)	x	x		x	x	x	
Low English proficiency	x	x					
Indigeneity	x	x	x	x	x		x
Location							
Remoteness (or isolation)	x	x	x	x	x	x	x
Higher costs in urban areas	x	x					
Service delivery scale (or population distribution)	x	x		x	x	x	x
Regional centres		x		x	x	x	x
Other cost adjustors							
Economies of scale	x	x	x			x	
Non-resident use	x	x			x	x	
Growth (population growth/decline)	x	x		x		x	
Climate, terrain or environmental risk	x	x		x	x	x	
Off-road drainage maintenance costs	x			x			
Medical facilities and GP services			x		x		
Airports	x			x		x	
Special allowances				x	x	x	

Notes: Cost adjustors are listed if they are applied in more than one jurisdiction.

Source: Information compiled from LGGC documents.

26 LGGCs should include all material factors leading to differences in what councils would need to spend to deliver the average level of service. Those factors should be applied only to the spending they affect.

27 Ideally, the total across all councils of the assessed (or standardised) expenditures for a service should equal the aggregate actual spending on that service (or the sum of all expenditure allowances for the service should be zero). This balancing does not happen in some States; for example, because the LGGC assesses positive allowances but not negative ones. This can overstate the fiscal capacities of some councils.

28 **Regional service centres.** In some cases councils provide services to residents of adjoining councils. This increases the spending of the providing council and reduces what the other councils need to spend. Ideally, these 'cross-border' effects should be captured in assessments, although data to do so accurately might be limited.

- 29 **An infrastructure assessment.** Capital spending has a direct effect on a council's fiscal capacity and its ability to provide services. Since differences in council circumstances cause the need for capital spending to vary from council to council, it affects their relative fiscal capacities.
- 30 Most LGGCs include depreciation expenses in their assessments. However, the commission's proposal that assessments be comprehensive would require capital spending on extra infrastructure to be included in assessing relative fiscal needs. This is particularly so since some of the factors that drive the need for councils to spend on extra infrastructure differ from those that drive recurrent service delivery spending. For example, population and economic growth is an important driver of the need to increase infrastructure stocks.
- 31 The corollary to including capital spending in the assessments is that any capital grants received from the Commonwealth or State governments which help fund that spending must also be included.
- 32 Different assessments would be required for spending on infrastructure replacement, and for spending on extra infrastructure, where differences in population growth rates are important. Each LGGC should consider the approach which best captures the main differences between its councils in a simple and reliable way. Some LGGCs have begun to do so.
- 33 **Roads.** LGGCs have to assess road expenditure both in relation to the distribution of identified local road grants and as part of the overall assessment of council fiscal capacities. LGGCs have adopted different approaches to this task.
- 34 Some States use one assessment to allocate identified local roads grants and to assess roads expenditures in their relative needs calculations. Others use different road assessments for each purpose.
- 35 Some use an asset preservation model. Their models attempt to measure the annual cost of maintaining council roads including the cost of reconstruction at the end of the road's useful life. Others use simple formula approaches (often based on population, road length and surface type) to distribute local roads grants. However, they use more complex formulae for determining assessed road expenditures in their general purpose grant assessments.
- 36 There is no advantage in undertaking two different assessments when the identified local roads grants are treated by inclusion in determining relative needs because their distribution is largely overridden in the general purpose grant assessment. Box B-2 provides an example to make this clearer.

Box B-2 Illustration of implications of treating roads grants by inclusion

Suppose roads are the only function provided by councils.

- The distribution of the roads grants is based on road length and road use.
- The relative needs grant is based on population and roads grants received are included (which means they are subtracted from the assessed deficit).
- Then:
 - each council's relative need grant will be equal to its equal per capita share of the relative need grants less its actual roads grant
 - a council's relative needs grant will be reduced (or increased) if it receives more (or less) than its population share of the roads grants. This adjustment overrides the effect of the roads grant distribution and replaces it with the EPC distribution¹.
 - If not for minimum grants and the factoring back used by LGGCs, the method used to distribute the roads grant would not matter.

- 37 As mentioned above, capital spending on new and improved roads should be part of the assessment process.
- 38 **Assessing revenue.** As with expenditure, ideally all revenue sources should be subject to consideration even if some are assessed equal per capita.
- 39 **Rates.** Most LGGCs recognise different sources of rate revenue (for example, residential, commercial and industrial, rural) and assess each separately using the value of the relevant properties. Some have a more aggregated approach. Ideally, if the intrastate distribution of a particular rate base varies from that of other rate bases it should be separately assessed, rather than aggregated. If feasible a disaggregated approach provides a better measure of fiscal capacity.
- 40 **User charges.** On average, user charges account for 25% of council revenues. Some LGGCs do not assess all user charges. Some deal with user charges by offsetting them against the related expenses. They then assess the net expenditure. This approach is the same as applying the same assessment to both gross expenditure and user charges (a council assessed to need to spend 20% more than average would also be said to be able to collect 20% more in user charges). LGGCs should ensure this is an appropriate assumption before using the net expenditure approach.

Other grant support

- 41 Other grant support comprises grants from the Commonwealth or State governments to councils. These grants are revenue councils can use to finance their operating expenses and their investment in infrastructure.

¹ The council's total grant revenue is equal to its general purpose (GP) grant plus its identified local road (ILR) grant which is equal to ((its EPC share of the GP pool less its actual ILR grant) plus its actual ILR grant); or its EPC share of the GP pool.

42 A current national principle says ‘Other relevant grant support provided to local governing bodies to meet any of the expenditure needs assessed should be taken into account using an inclusion approach.’ LGGCs include some, but not all, other grant support in their assessments.

43 Table B-2 shows the scope of other grant support included by LGGCs.

Table B-2 Scope of other grant revenue

	NSW	Vic	Qld	WA	SA	Tas	NT
	%	%	%	%	%	%	%
Untied local road grants	100	100	50	100	85	100	100
Roads to recovery	100	77	Nil	63	Nil	100	50
Library grant	100	100	Nil	Nil	100	Nil	100
Other grants (a)	No	Yes	Yes	No	No	Yes	No

(a) Tasmania includes heavy vehicle motor tax revenue. Victoria includes a number of other recurrent grants. Queensland includes 20% of its assistance to Indigenous councils.

Source: Information compiled from LGGC documents.

44 Some LGGCs do not include grant support acquired through a competitive application process because they consider doing so is inconsistent with the effort neutrality principle as success in attracting the grant depends on councils’ efforts in applying for it. This interpretation gives the effort neutrality principle priority over achieving equalisation and treats the lack of payments to small councils, which may have neither the expertise nor capacity to engage in a competitive process, as their policy choice. Regardless of the effort required to attract a grant, if it is available to finance usual council operations, it should be recognised as other grant support.

45 The common pool and the identified local roads grants are examples of funding that allows councils to finance normal council operations. Thus, revenues from those grants should be included as other grant support.

46 The proposed reform pool would not relate to individual council operations. Thus, revenues from it would not be included as other grant support.

47 To improve transparency, LGGCs should consider all grants provided to councils and outline their reasons for treating/not treating them as other grant support.

48 **Grants to Indigenous councils.** Some LGGCs treat grants to Indigenous councils differently from grants for other purposes. For example, the Queensland LGGC treats 20% of the State financial aid received by Indigenous councils as a proxy for rate revenue or other grant support in its revenue assessments — the balance is excluded. The Northern Territory treats 50% of the State government operating grant received by Indigenous councils as rate revenue. The omission of the balance of these operating grants may reflect a judgment that: the grants are intended to raise the

standards of service in the communities; or the fiscal capacities of the communities are so low and would not be adequately addressed by the factored back relative needs grants. Such judgments would be consistent with the Aboriginal and Torres Strait Islander purpose and principle.

Policy (or effort) neutrality

- 49 This principle requires that, as far as practicable, the policies or effort of individual councils should not affect the relative needs grants they receive. In practice, this is achieved by calculating grants by reference to the average spending on each service and the average revenues. Those averages encompass the average service provision and revenue collection policies of councils in the State.
- 50 Under this approach every council contributes to the average financial standards and the average policy. While this means more populous councils have a greater influence on averages than smaller councils (and councils with higher land values have more influence than those with lower values), each council has a limited influence. Constructing financial standards so they reflect the average level of local government services provided in a State, or the average level of revenue raised in a State ensures the assessments are based on 'what councils collectively do'.

Dealing with the limited relative needs funds

- 51 In every State, the funds available from the current funding envelope do not allow council fiscal capacities to be equalised (this would require all fiscal capacities to be raised to the standard of the council with the highest capacity). The Act recognises this in asking for equalisation as far as practicable and directing funds to councils with below average fiscal capacities.
- 52 Even then there are insufficient funds to bring all below average councils up to the average.
- 53 LGGCs must ration funds among below average councils by 'factoring back' their equalisation grants to match the funding available. The extent of this 'factoring back' differs across years and across States. In 2012-13, Western Australian non-minimum grant councils had their relative needs reduced to 23% of the assessed amounts. The Northern Territory non-minimum councils had their relative needs reduced to 78% of those assessed. Table B-3 shows each LGGC's factor back ratio.
- 54 While most LGGCs factor back on a proportional basis, there is more than one way to factor back and the choice will affect the grants councils receive.

Table B-3 Factor back ratios for general purpose grants, 2012-13

	NSW	Vic	Qld	WA	SA	Tas	NT
Factor back ratios (%)	49	65	91	23	57	58	78
Relativity range (a)							
Weakest	16.2	8.5	135.3	274.5	14.5	10.1	4.2
Strongest	0.3	0.3	0.3	0.3	0.3	0.3	0.3

(a) A relativity is a council's share of general purpose grants divided by its share of State population.

Source: Commission calculation based on data provided by LGGCs.

55 Some potential factoring back methods are outlined below.

- **A proportional method**

Currently, all LGGCs factor back relative needs using a proportional method (although Queensland only assigns a 50% weighting to this method). Under this approach, the factor back proportion is equal to the available relative needs pool divided by the total relative needs of councils eligible to receive a relative needs grant. Since the factor back proportion is applied to assessed relative needs, it implicitly scales back a council's assessed expenditure, assessed revenue and other grant support by the same proportion.

Each council is factored back by the same proportion regardless of the level of its relative needs. Very disadvantaged councils are factored back by the same proportion as marginally disadvantaged councils.

- **An equalisation ratio method**

This method forms part of the approach used by the Queensland LGGC. It gives each eligible council the capacity to fund the same proportion of its standardised expenditure. It factors back a council's assessed expenditure, but not its assessed revenue or other grant support. Under this approach, the factor-back proportion is the aggregate revenue of eligible councils (assessed revenue, other grant support, common pool grants and relative needs grants) divided by their total assessed expenditures.

The equalisation ratio method is more complex than the proportional method. However, it does not water down eligible councils' revenue capacity. It distributes relatively more grants to councils assessed to have low revenue capacity or who receive a low share of other grant support.

- **A 'fill up from the bottom' method**

This method focuses on the fiscally weakest councils. Under this method, relative needs grants would be allocated to remove the disparity between the fiscally weakest council and the second weakest council. Then, they would be used to remove the disparity between those councils and the third weakest. This process would continue until the available assistance is exhausted.

Under this approach some councils which currently receive a relative needs grant would become minimum grant councils and would receive only their common pool grant. Despite this, they would still have a fiscal capacity that is the same or stronger than councils receiving relative needs grants.

- 56 Each rationing method distributes relative needs grants in a different way. The proportional method is simple to implement; the other methods may provide more equity.
- 57 It is consistent with the subsidiarity principle that States determine the rationing method which best suits their circumstances.
- 58 **Dealing with diversity.** A feature of councils is their diversity in terms of their nature, the type of services they provide and the revenues they collect. Dealing with this diversity where the objective is to, as far as practicable, achieve fiscal equalisation requires careful consideration by LGGCs.
- 59 Equalisation is set out in the Act as:
- a basis that ensures each local governing body in the State or Territory is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in the State or Territory. It takes account of differences in the expenditure required by those local governing bodies in the performance of their functions and in the capacity of those local governing bodies to raise revenue.
- 60 LGGCs generally attempt to measure the standard in terms of an 'all State' average. This approach attempts to give, as far as practical, each council the capacity to provide the 'all State' level of services, adjusted to recognise different needs because of different circumstances, assuming a standard revenue effort.
- 61 Submissions indicated diversity across local governments in terms of the services they provide and their circumstances complicates the LGGC assessments. The submissions also raised issues about the suitability of State-wide averages as measures of average service levels and revenue efforts.
- 62 Some LGGC assessments already recognise that differences among councils mean there will be differences in service levels. For example, in less populous and remote councils road expenditure is more heavily directed towards unsealed roads than in more populous and urban councils.
- 63 LGGCs in considering how to allocate their scarce relative needs funds among councils should consider their diverse nature. There is a choice between either reducing the disparity among comparable councils (ensuring say all very remote councils can provide their average level of services) and some raising of all below average fiscal capacity councils towards the average or a uniform movement of all below average council as at present.

- 64 The outcome for different groups of councils is different and it is a matter of judgment for LGGCs which best satisfies the Act, in the circumstances of their State.

CONCLUSION

- 65 Box B-3 provides a check list of issues to be considered by LGGCs in assessing council relative fiscal capacities.

Box B-3 Issues to be considered by LGGCs

- 1 Have all expenditures and revenues been considered for inclusion in the assessment?
- 2 Have all grants available to fund council activities been included in assessing council fiscal capacities?
- 3 Does the relative needs process ensure the average council has the observed average budget outcome?
- 4 Have all material underlying factors that drive expenditure and revenue been recognised and appropriately calculated? (Or do weighted cost or revenue adjustors sum to one?)
- 5 Do assessed expenditures and revenues across councils sum to the observed total expenditures and revenues? (Or does each expenditure and revenue allowance sum to zero?)
- 6 Does a council's assessed relative need measure the gap between its fiscal capacity and the average observed budget outcome?
- 7 Are all councils with below average fiscal capacities in the group of councils receiving grants in addition to the per capita grant?
- 8 Does the factoring back approach provide the best equalisation outcome consistent with the current funding envelope and the diversity of councils in a State?

ATTACHMENT C

FINANCIAL POSITION OF LOCAL GOVERNMENT IN AUSTRALIA

- 1 This attachment explores the financial position of State local government sectors and different types of councils.¹ Given the diversity of councils, the outcomes for each State sector or group of councils may not reflect the position of individual councils in the State.

FINANCIAL POSITION OF THE LOCAL GOVERNMENT SECTOR

- 2 The financial outcome in a year can be influenced by timing factors, for example, the receipt of grants before they can be expended. We have used the full ABS GFS operating statement with its final outcome being net lending or borrowing rather than the net operating balance. This provides a better indicator of the overall financial position of local governments — the net operating balance can be heavily influenced by the receipt of capital grants which are counted as revenue but are not included in expenses when used to finance investment (the net acquisition of non-financial assets).

Net financial position, 2011-12

- 3 In 2011-12, the local government sector in all States received more revenue than it spent. With the exception of Queensland, the revenues exceeded the total of expenses and investment. As a result, in that year, the net worth of most local government sectors increased.

¹ In interpreting the data in this attachment, it is important to: take account of the differences between States in the responsibilities of local government; and be aware that data have been drawn from different data sources. The main data source used in this attachment is the ABS Government Finance Statistics (GFS), but some data were obtained from the then Department of Regional Australia, Local Government, Arts and Sport and the Commonwealth final budget outcome documents.

- 4 Table C-1 provides details of revenues, expenditures and financial outcomes by State. Table C-2 and Table C-3 indicate the relative importance of different revenue sources and services.

Revenue in 2011-12

- 5 In per capita terms, the local government sectors in Queensland and the Northern Territory received the most revenue in 2011-12 (\$2 146 per capita) and that in South Australia the least (\$1 249 per capita).
- 6 Overall, 82% of all revenue was raised by local governments and 18% was received in the form of grants and subsidies. The proportion of revenue from grants and subsidies varied from a low of 14% in Victoria to a high of 35% in the Northern Territory. The financial assistance grants (FAGs) component varied between 5% in Queensland and 11% in Tasmania.
- 7 Taxation (mainly municipal rates) was the largest revenue source. It was around 36% of all revenue. However, the proportion raised from this source varied across States, from a high of 56% in South Australia to a low of 18% in the Northern Territory. Councils in South Australia raised 19% more than the per capita average and those in the Northern Territory 35% less. The low collections in the Northern Territory were, in part, due to the Commonwealth's Land Rights legislation² which prevents councils in the Northern Territory from imposing rates on Aboriginal land.
- 8 The sale of goods and services was the next largest revenue source (25%). Again, the proportion raised from this source varied across States, from a high of 33% in New South Wales to a low of 16% in South Australia. Local government in New South Wales, Queensland and the Northern Territory raised more than the per capita average reflecting in part its role in providing urban transport and/or water and sewerage services, functions not undertaken by local government in South Australia and other States.

² The Commonwealth's Aboriginal Land Rights (NT) Act precludes the rating of Aboriginal land (unless there is leasehold tenure over it). Over 50% of the Northern Territory is Aboriginal land. In addition, the Northern Territory government has imposed conditional rating arrangements over pastoral leases and mining tenements.

Table C-1 Local government operating statement, 2011-12 (a)

	NSW	Vic	Qld	WA	SA	Tas	NT	Aust	Aust
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	%
GFS Revenue									
Taxation revenue	474	650	645	651	703	619	388	592	35.8
Current grants and subsidies	190	172	172	245	162	207	626	191	11.5
<i>Of which FAGs are</i>	<i>115</i>	<i>112</i>	<i>115</i>	<i>132</i>	<i>110</i>	<i>169</i>	<i>164</i>	<i>118</i>	<i>7.2</i>
Capital grants	54	52	306	47	42	52	115	104	6.3
Sales of goods and services	471	264	592	342	200	277	451	405	24.5
Interest income	50	23	116	58	18	49	55	55	3.3
Other	192	407	315	511	124	284	511	306	18.5
Total	1 432	1 568	2 146	1 853	1 249	1 488	2 146	1 653	100.0
Less									
GFS expenses									
General public services	230	186	428	165	79	217	613	245	17.9
Public order and safety	43	30	27	48	20	14	81	35	2.6
Education	10	14	2	2	0	0	21	7	0.5
Health	11	21	11	23	30	20	21	17	1.2
Social security and welfare	50	157	15	58	69	59	106	73	5.3
Housing and community amenities	355	255	369	205	262	266	422	308	22.5
Recreation and culture	181	211	184	299	237	203	243	207	15.1
Fuel and energy	0	0	2	0	8	0	4	1	0.1
Agriculture, forestry and fishing	0	1	3	0	7	0	0	1	0.1
Mining, manufacturing and construction	29	0	20	13	21	0	0	17	1.2
Transport and communications	257	225	601	322	251	355	175	327	23.9
Other economic affairs	43	63	41	46	35	59	162	49	3.6
Public debt transactions	31	9	61	13	24	8	4	28	2.1
Other	75	37	30	77	56	45	94	55	4.0
Total	1 315	1 209	1 793	1 272	1 100	1 248	1 946	1 370	100.0
Equals									
GFS Net Operating Balance	117	359	353	581	149	240	200	283	
Less									
Net acquisition of non-financial assets (b)	98	265	435	146	123	105	- 128	214	
Equals									
GFS Net Lending(+)/Borrowing(-)	18	94	- 82	435	27	135	328	69	

(a) The ACT is not included because it does not have a separate local government sector.

(b) Net acquisition of non-financial assets is gross fixed capital formation less depreciation. In 2011-12, the Northern Territory's gross fixed capital formation was lower than its depreciation expenses.

Source: Commission analysis of ABS GFS (5512.0) and Australian Demographic Statistics (3101.0).

Table C-2 Local government revenue sources by State, 2011-12

	NSW	Vic	Qld	WA	SA	Tas	NT	Aust
	%	%	%	%	%	%	%	%
Taxation revenue	33.1	41.5	30.1	35.1	56.3	41.6	18.1	35.8
Grants and subsidies (a)	17.1	14.3	22.3	15.7	16.3	17.4	34.5	17.8
Sales of goods and services	32.9	16.9	27.6	18.4	16.0	18.6	21.0	24.5
Other revenue (b)	16.9	27.3	20.0	30.8	11.4	22.4	26.4	21.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(a) Included both current and capital grants, and subsidies from State and Commonwealth governments.

(b) Includes interest income and revenues other than those listed above. Queensland's interest income includes payments from the public non-financial corporations that took over the provision of water services from the councils in the South-east Queensland region.

Source: Commission calculation based on ABS GFS data.

Spending in 2011-12

9 Over time, the range of services provided by local government has expanded. When it was first established, local government was responsible for building roads, wharves, jetties and bridges. Today, it performs a vastly expanded range of services, including:

- building regulation services (inspection, licensing, certification, enforcement)
- commercial services (parking, aerodromes, cemeteries, quarries, abattoirs, sale-yards, markets)
- community services (child care, aged care and accommodation, refuge facilities, meals on wheels, counselling, welfare)
- cultural/educational services (libraries, art galleries, museums)
- engineering services (public works design, construction and maintenance of roads, bridges, footpaths, drainage, cleaning, waste collection and management)
- health services (water and food sampling, immunisation, toilets, noise control, meat inspection, animal control)
- land use planning and development approval
- recreation services (golf courses, swimming pools, sports courts, recreation centres, halls, kiosks, camping grounds and caravan parks)
- transport, and water and sewerage services, but not in all States.

10 In per capita terms, local government in Queensland (\$1 793 per capita) and the Northern Territory (\$1 946 per capita) spent the most in 2011-12. Local government in South Australia spent the least (\$1 100 per capita).

- 11 Table C-3 shows 24% of the sector's spending was on transport and communications (mostly roads) and 23% on housing and community amenities, followed by general public services (18%), and recreation and culture services (15%). Spending on human services (such as education, health, social security and welfare services) was only 7%.
- 12 Table C-3 also shows the variation in spending in different States.
- Transport and communications was the most important function for local governments in Queensland (34%) and Tasmania (29%), but the least important in the Northern Territory (9%). Per capita spending on transport in Queensland was almost twice (\$601) the national average (\$327), reflecting a similarly large difference in average road lengths (2 100 kms compared with the national average of 1 100 kms) and the role of Brisbane City Council in providing urban transit.
 - Housing and community amenities was the most important function in New South Wales (27%) as its non-metropolitan councils provide water and sewage services.
 - Human services were more important functions in Victoria accounting for 16% of spending, compared with the national average of 7%.
 - General public services were the most important function in the Northern Territory. This is partly because governance expenses for Indigenous communities are in this classification.

Table C-3 Local government expenses by purpose, 2011-12

	NSW	Vic	Qld	WA	SA	Tas	NT	Aust
	%	%	%	%	%	%	%	%
General public services	17.5	15.4	23.9	12.9	7.1	17.4	31.5	17.9
Housing and community amenities	27.0	21.1	20.6	16.1	23.8	21.4	21.7	22.5
Recreation and culture	13.8	17.4	10.2	23.5	21.5	16.3	12.5	15.1
Transport and communications	19.5	18.6	33.5	25.3	22.8	28.6	9.0	23.9
Human services (a)	5.4	15.9	1.5	6.6	9.1	6.3	7.7	7.1
Other expenses (b)	16.8	11.6	10.3	15.6	15.6	10.0	17.7	13.6
Total expenses	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(a) Includes spending on education, health, social security and welfare.

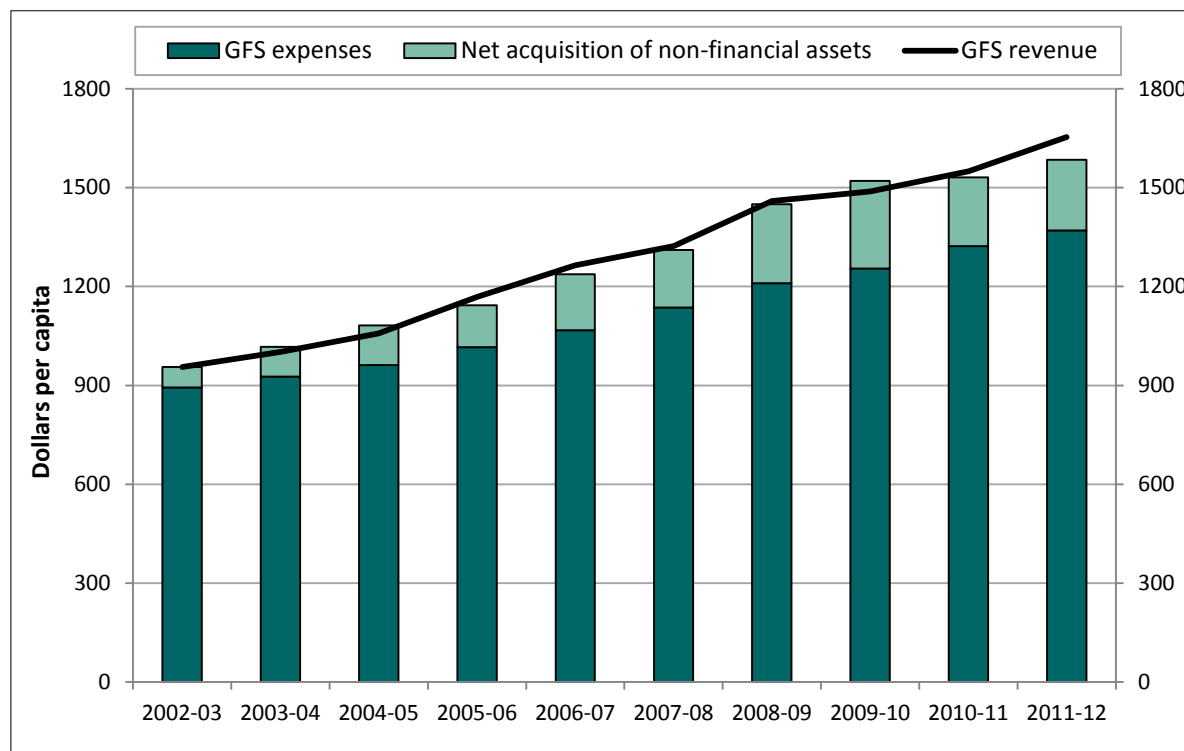
(b) Includes spending on public safety and order, fuel and energy, agriculture, forestry and fishing, other economic affairs, public debt transactions and expenses not included elsewhere.

Source: Commission analysis of ABS GFS data.

Net financial position over the last decade

- 13 Figure C-1 shows that nationally the local government sector had sufficient revenue to fund its expenses and investment over the last decade.³

Figure C-1 Local government sector financial position, all States, 2002-03 to 2011-12



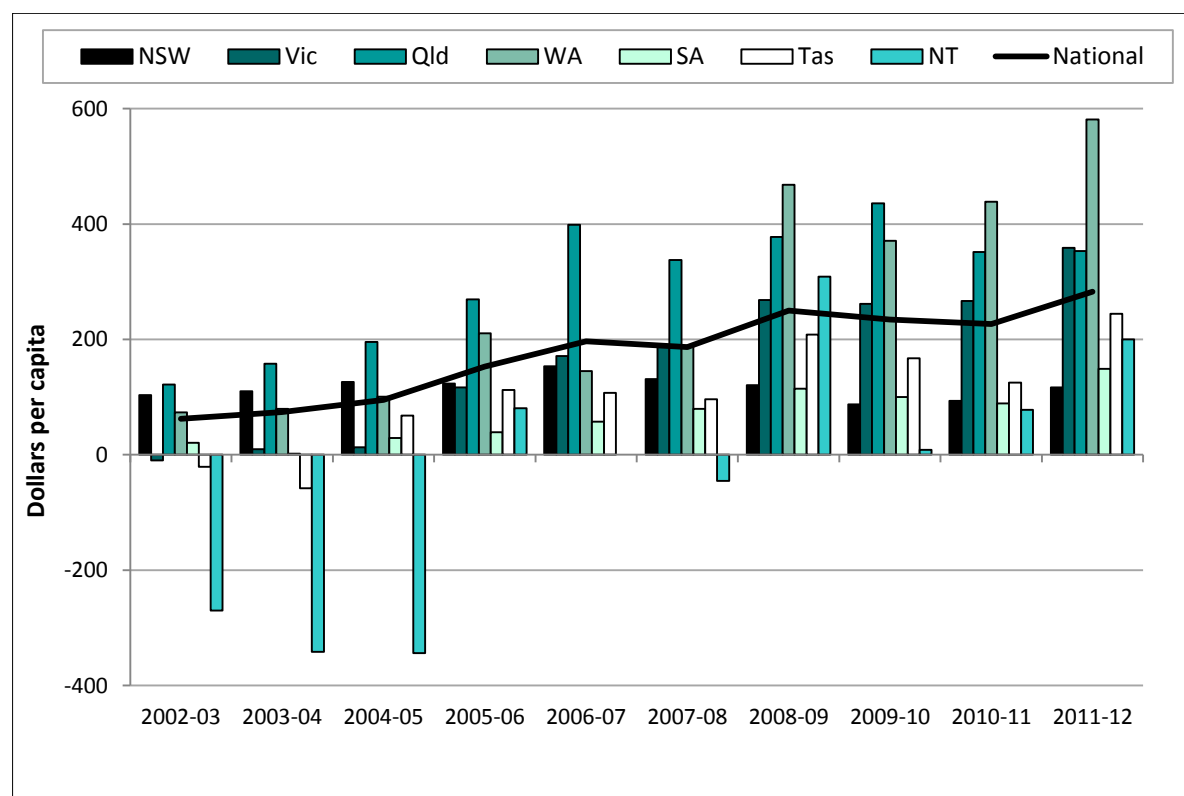
Source: Commission analysis of ABS GFS (5512.0) and Australian Demographic Statistics (3101.0).

- 14 **Net operating balance.** Figure C-2 shows the net operating balance for each State's local government sector for the decade. The sector's revenue exceeded its expenditure for the whole decade. Its surplus increased from \$62 per capita in 2002-03 to \$283 per capita in 2011-12. This improvement was partly due to increases in capital assistance from the Commonwealth and State governments.
- 15 The positions of individual States varied. In 2002-03, the operating surpluses in New South Wales (\$103 per capita), Queensland (\$122 per capita), Western Australia (\$74 per capita) and South Australia (\$21 per capita) outweighed the operating deficits in the other States. Since then the operating position of the sector has improved in all States. The biggest improvement was in Western Australia where the operating surplus rose from \$74 per capita in 2002-03 to \$581 per capita in 2011-12.

³ Since 2008-09, the Commonwealth has prepaid the first quarter (first two quarters in 2011-12) FAGs from the next financial year to assist local government's cash management. This means the grants from the Commonwealth included five quarters of FAGs in 2008-09 and 2011-12. Without the prepayments, the sector would have been in a net borrowing (instead of net lending) position in 2008-09. Its 2011-12 net lending would have been \$44 per capita (not \$69 per capita).

The operating position in the Northern Territory moved from an operating deficit of \$270 per capita in 2002-03 to an operating surplus of \$200 per capita in 2011-12.

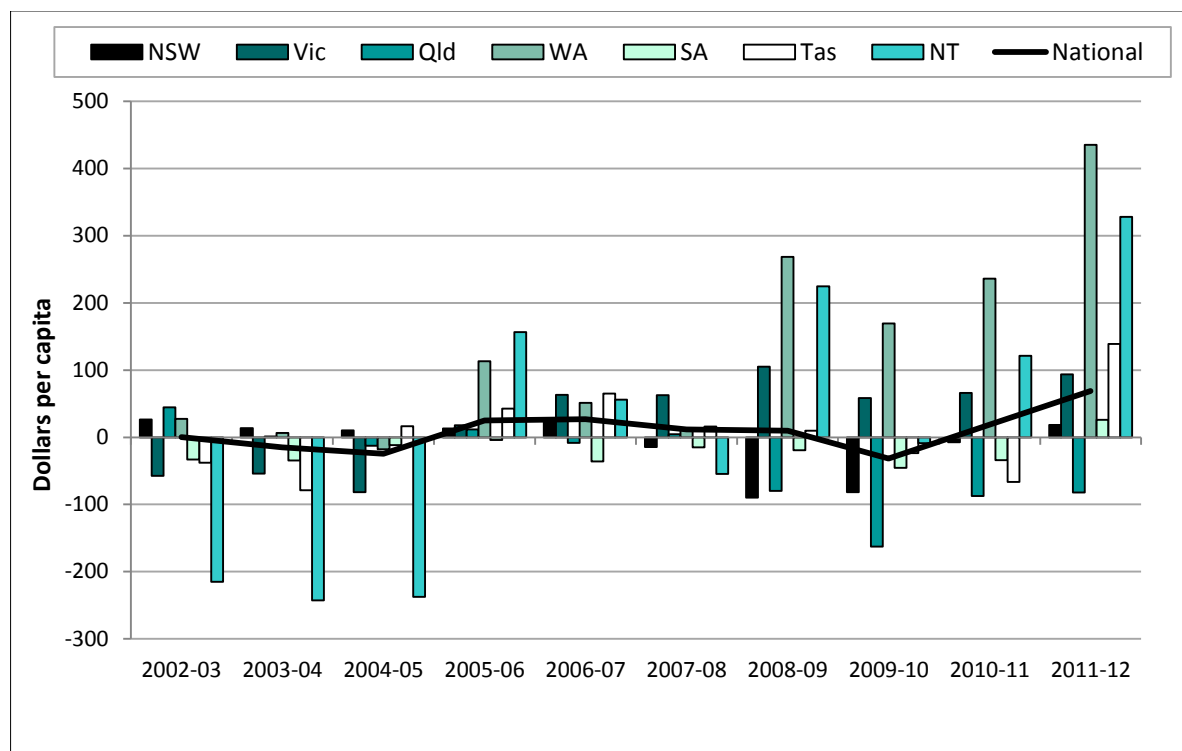
Figure C-2 Local government sector net operating balance, 2002-03 to 2011-12



Source: Commission analysis of ABS GFS (5512.0) and Australian Demographic Statistics (3101.0).

- 16 **Net lending/borrowing position.** Figure C-3 shows the net lending or borrowing position of each State local government sector over the decade. This shows the sector overall moved from having almost no net lending (\$0.30 per capita) in 2002-03 to having net lending of \$69 per capita in 2011-12.
- 17 During 2002-03 to 2004-05, most States were net borrowers — they needed to borrow to fund their annual operating expenses and investment. The Northern Territory had the highest level of borrowing — around \$240 per capita.
- 18 The local government sector in South Australia was a net borrower in nine of the last ten years. New South Wales in 2007-08 to 2010-11, Queensland in 2008-09 to 2011-12 and Tasmania in 2009-10 and 2010-11 also needed to borrow to fund their total outgoings. The Northern Territory borrowed heavily in 2002-03 to 2004-05, but was a net lender for most other years in the decade.

Figure C-3 Local government net lending/borrowing position, 2002-03 to 2011-12



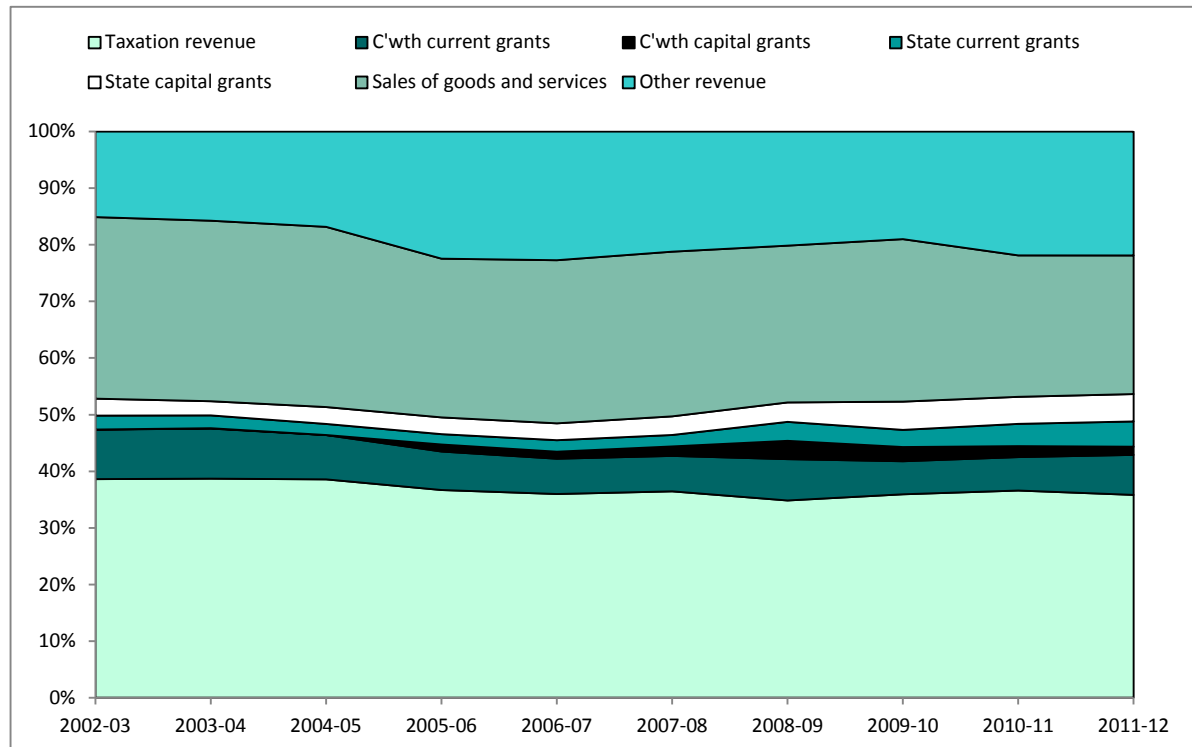
Source: Commission analysis of ABS GFS (5512.0) and Australian Demographic Statistics (3101.0).

Revenue over the last decade

- 19 The composition of local government revenue has been relatively steady since 2002-03.
- 20 Figure C-4 shows the following.
 - Taxation revenue (mainly rate revenue) was the largest source of revenue, but its importance declined from 39% in 2002-03 to 36% in 2011-12.
 - Sales of goods and services (or user charges) declined as a proportion of revenue from 32% in 2002-03 to 24% in 2011-12. It was partly due to the July 2010 transfer of responsibility for water and sewerage services in south-east Queensland to a State government undertaking and the restructuring of water services in Tasmania in 2009-10.
 - Commonwealth assistance (which includes financial assistance and other grants) has remained steady, but its composition has changed. Recurrent grants declined from 9% in 2002-03 to 7% in 2011-12. Capital grants increased from almost 0% in 2002-03 to 2% in 2011-12. Commonwealth assistance peaked in 2008-09 when the Commonwealth prepaid some financial assistance grants and increased capital grants.
 - State assistance was steady at around 6% between 2002-03 and 2007-08, but has increased since reaching almost 10% in 2011-12.

- The biggest change has been in other revenue. This includes revenue from interest earnings, contributions from trading activities and developer contributions. Revenues increased from 15% in 2002-03 to 22% in 2011-12. Councils in south-east Queensland and in Tasmania now receive interest and other revenue from the authorities responsible for water and sewerage services.

Figure C-4 Local government sector revenue by source, all States, 2002-03 to 2011-12



Notes: 1. Other revenue includes revenue from interest earnings, contributions from trading activities and developer contributions.
 2. Commonwealth grants include general government assistance, untied local road funding and direct payments to local government. They have been split between current and capital grants.
 3. This chart excludes the ACT because it does not have a separate local government sector.

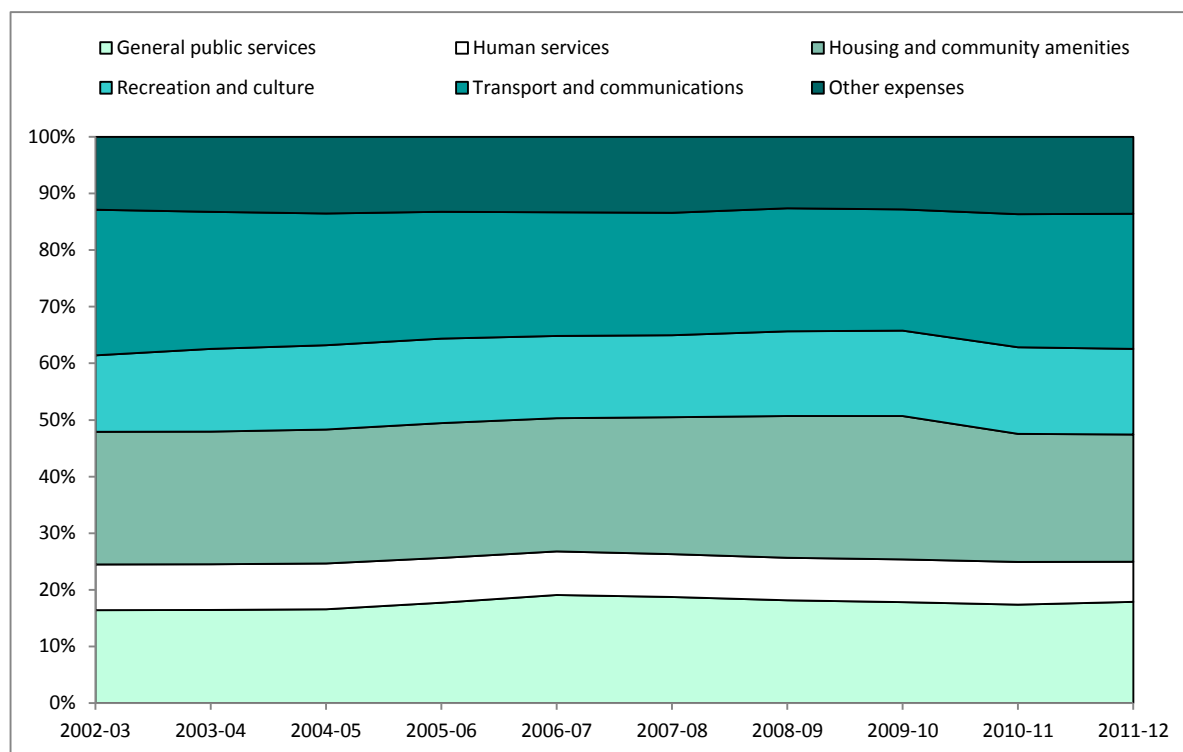
Source: Commission analysis of ABS GFS (5512.0) and Commonwealth Final Budget Outcome.

Spending over the last decade

- 21 The composition of local government spending has changed little since 2002-03. Transport and communications and Housing and community amenities were the most important functions over this period.
- 22 Figure C-5 shows:
 - Transport and communications spending has declined from 26% in 2002-03 to 24% in 2011-12
 - Housing and community amenities spending has declined from 24% in 2002-03 to 23% in 2011-12

- Recreation and culture spending has increased from 13% in 2002-03 to 15% in 2011-12
- Human services spending has declined from 8% in 2002-03 to 7% in 2011-12
- spending on General public services increased from 16% in 2002-03 to 18% in 2011-12
- spending on other services was steady at around 13% of total spending.

Figure C-5 Local government expenses by purpose, all States, 2002-03 to 2011-12



Notes: Other expenses include local government spending on Public order and safety, Fuel and energy, Agriculture, forestry and fishing, Mining, manufacturing and construction, Other economic affairs, Public debt transactions and other expenses.

Source: Commission analysis of ABS GFS (5512.0).

The value of local government infrastructure

- 23 The value of infrastructure at the end of 2011-12.** Collectively, local governments held infrastructure⁴ valued at \$10 372 per capita.
- 24** The value of infrastructure varied significantly across States (see Table C-4) due to differences in local government responsibilities. The local government sector in Queensland had the highest level of infrastructure due to its responsibility for public transport in Brisbane and water and sewerage services outside south-east Queensland. It also had the highest level of borrowing (see Table C-5).

⁴ The ABS refers to this as non-financial produced assets (excluding land) in its GFS publication.

Table C-4 Value of infrastructure stock, 30 June 2012

	NSW	Vic	Qld	WA	SA	Tas	NT	Ave
Value of infrastructure (a) (\$pc)	11 866	7 357	14 134	7 040	8 827	11 603	5 871	10 372
Relative to the average	1.14	0.71	1.36	0.68	0.85	1.12	0.57	1.00

(a) This is the value of non-financial produced assets (excluding land).

Source: Commission analysis of ABS GFS (5512.0) and Australian Demographic Statistics (3101.0).

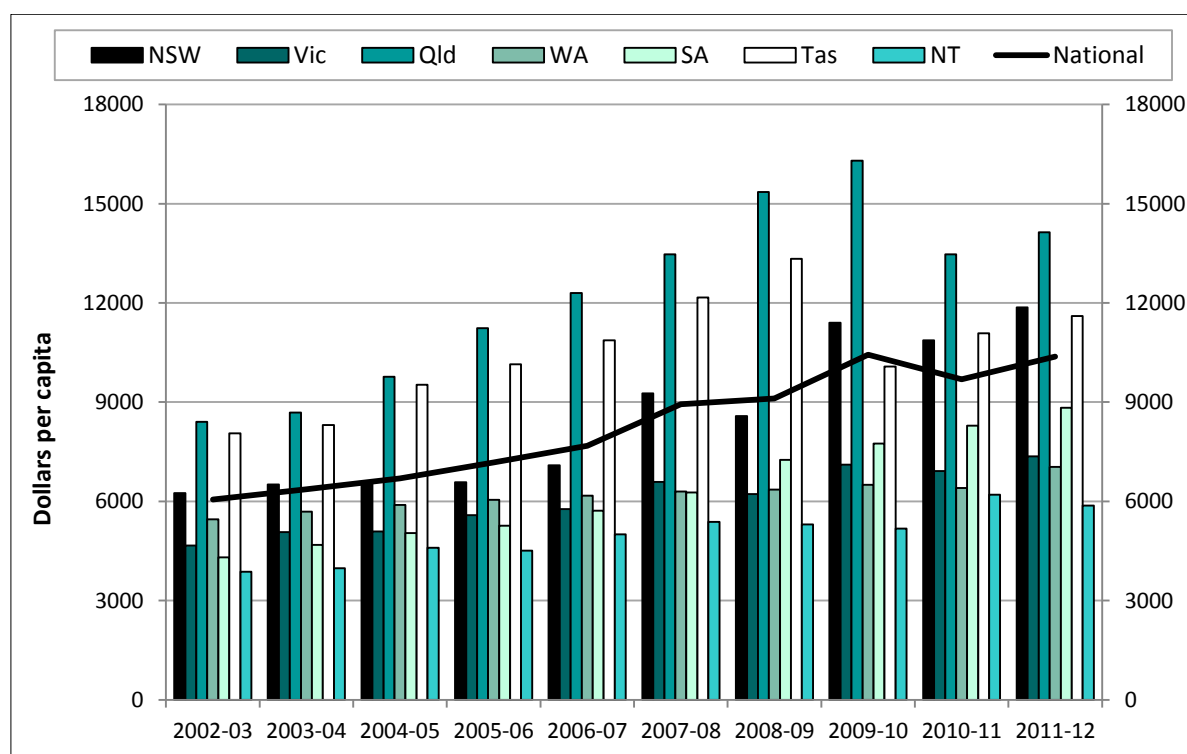
Table C-5 Stock of borrowing, 2011-12

	NSW	Vic	Qld	WA	SA	Tas	NT	Ave
Borrowings (\$pc)	445	142	1 131	248	104	152	55	451
Relative to national average	0.99	0.32	2.51	0.55	0.23	0.34	0.12	1.00

Source: Commission analysis of ABS GFS (5512.0) and Australian Demographic Statistics (3101.0).

- 25 The sectors in New South Wales and Tasmania also had above average levels of infrastructure because they are responsible for water and sewerage services. The sectors in Victoria, Western Australia, South Australia and the Northern Territory had below average levels of infrastructure.
- 26 **The value of infrastructure over the last decade.** The value of local government infrastructure has grown over the last decade. It increased steadily to a peak in 2009-10, declined in 2010-11 but grew again in 2011-12. The decline in 2010-11 was affected by changes in the ownership of water and sewerage assets in south-east Queensland and Tasmania following the restructuring of service delivery responsibilities.
- 27 The interstate pattern of ownership has remained relatively unchanged. Figure C-6 shows:
- The local government sectors in Queensland and Tasmania had above average levels of infrastructure for the decade and the sector in New South Wales had above average levels for most years.
 - The local government sectors in other States had below average levels of infrastructure over the decade.

Figure C-6 Value of infrastructure stock, 2002-03 to 2011-12



Source: Commission analysis of ABS GFS (5512.0) and Australian Demographic Statistics (3101.0).

FINANCIAL POSITION OF GROUPS OF LOCAL GOVERNMENTS

- 28 This section examines the financial position of different types of local governments. It uses the Australian Classification of Local Government (ACLG) developed by the then Department of Regional Australia, Local Government, Arts and Sport to classify local governments. For the analyses, the 22 groups were aggregated into eight groups. Table C-6 shows the ACLG and commission groupings.
- 29 Unpublished GFS data were obtained from the ABS. For confidentiality reasons, the ABS was unable to provide data for a commission group if it contained three or less councils or if one council was more than 75% of the group's total. When this occurred, it added those councils to another group.
- 30 The ABS also said its unpublished data may not match published data at the State level and may not match data published by other agencies because:
- the published ABS data included data from units classified as local governments by the ABS but not classified as local governments by the local government grants commissions (LGGCs). For example, Central Murray County Council is excluded from LGGC data because it was established for the sole purpose of weed control
 - the local government group data provided to the commission have not been balanced against State/Commonwealth data whereas the sector data published

by the ABS have been (for example, grants and subsidies revenue in the published data are sourced from State/Commonwealth data)

- the group data exclude adjustments that might be applied by the ABS in its published data (for example, the published data exclude inter-state transactions whereas the group data do not).

Table C-6 Local government groups

ACLG group		Definition	Population	Commission group
Urban capital city	UCC	Capital city		Metropolitan
Urban development small	UDS	Part of urban centre with more than one million people or population density more than 600/sq km	Up to 30 000	
Urban development medium	UDM		30 001 to 70 000	
Urban development large	UDL		70 001 to 120 000	
Urban development very large	UDV		>120 000	
Urban regional small	URS	Part of urban centre with population less than one million and predominately urban in nature	Up to 30 000	Regional towns
Urban regional medium	URM		30 001 to 70 000	
Urban regional large	URL		70 001 to 120 000	
Urban regional very large	URV		>120 000	
Urban fringe	UFS	A developing local governing body on the margin of a developed or regional urban centre	Up to 30 000	Small urban fringe
Urban fringe medium	UFM		30 001 to 70 000	
Urban fringe large	UFL		70 001 to 120 000	Large urban fringe
Urban fringe very large	UFV		>120 000	
Rural agricultural small	RAS	Agricultural (urban if population is >20 000 or population density >30/sq km or 90% of LGB is urban)	Up to 2 000	Small agricultural
Rural agricultural medium	RAM		2 001 to 5 000	
Rural agricultural large	RAL		5 001 to 10 000	Large agricultural
Rural agricultural very large	RAV		10 001 to 20 000	
Rural significant growth	RSG	Average annual population growth of more than 3%, population is more than 5 000 and not remote		
Rural remote extra small	RTX	Remote (rural if population is <20 000 and population density <30/sq km and <90% of LGB is urban)	Up to 2 000	Small remote
Rural remote small	RTS		2 001 to 5 000	
Rural remote medium	RTM		5 001 to 10 000	Large remote
Rural remote large	RTL		Up to 20 000	

Source: Then Department of Regional Australia, Local Government, Arts and Sport and CGC classification.

- 31 Furthermore, the ABS said Western Australia data for 2011-12 were collected on a basis which differed from that used in previous years and other States. The 2011-12 data were highly aggregated and excluded details on spending by purpose. For the purpose of this analysis, the 2011-12 Western Australian data were dissected using the 2010-11 proportions.
- 32 Finally, the analyses may not align with other analyses published by State departments, LGGCs or other bodies. Local government amalgamations and splits

over the last 10 years⁵ can distort comparisons between local government groups over the period.

33 For all these reasons, the results of the analysis should be used with care.

Net financial position

34 Table C-7 shows that most local government groups had a net operating surplus in 2011-12. The exceptions were the small urban fringe⁶ and small agricultural groups in the Northern Territory, which had a net operating deficit of \$23 per capita and \$584 per capita respectively.

35 Most local government groups were also net lenders. Queensland was the only State in a net borrowing position, because of the borrowings of councils in its metropolitan group. Other council groups in a net borrowing position were:

- the metropolitan and urban fringe groups in Victoria
- the small urban fringe groups in Western Australia and South Australia
- the small agricultural group in the Northern Territory.

⁵ It is possible that a local government might be classified to different groups over the period of the analysis. For example, in 2007-08 several small agricultural/remote councils in the Northern Territory were merged into Victoria Daly council, which means they are now classified as a large remote council.

⁶ The ABS' confidentiality requirements had their biggest impact in the Northern Territory. For example, the small urban fringe group contains metropolitan councils (Darwin) and regional towns (Katherine and Alice Springs). Therefore, the commission's Northern Territory groups are not comparable with similar groups in other States.

Table C-7 Local government financial position by type, 2011-12

	NSW	Vic	Qld	WA	SA	Tas	NT	Total
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
Metropolitan								
Revenue	1 110	1 253	1 597	1 271	1 145	-	-	1 296
Expenses	970	1 087	1 469	1 145	1 032	-	-	1 155
Operating surplus (+)/ deficit (-)	141	166	129	127	112	-	-	141
Net lending (+)/ borrowing (-)	73	-1	-233	36	27	-	-	-35
Regional towns								
Revenue	1 734	1 756	2 697	1 635	1 542	1 424	-	1 990
Expenses	1 613	1 462	2 160	1 416	1 341	1 202	-	1 707
Operating surplus (+)/ deficit (-)	121	293	536	219	201	222	-	283
Net lending (+)/ borrowing (-)	22	34	0	91	10	46	-	21
Large urban fringe								
Revenue	1 103	1 614	-	1 266	-	-	-	1 311
Expenses	986	1 111	-	950	-	-	-	1 013
Operating surplus (+)/ deficit (-)	117	503	-	315	-	-	-	298
Net lending (+)/ borrowing (-)	20	-23	-	62	-	-	-	9
Small urban fringe								
Revenue	1 455	-	-	1 202	1 086	1 414	1 050	1 238
Expenses	1 179	-	-	1 075	954	1 200	1 073	1 082
Operating surplus (+)/ deficit (-)	276	-	-	127	132	214	-23	156
Net lending (+)/ borrowing (-)	42	-	-	-3	-85	121	91	15
Large agricultural								
Revenue	2 755	2 833	4 873	2 536	1 683	1 419	-	2 576
Expenses	2 566	2 240	3 939	1 761	1 455	1 250	-	2 185
Operating surplus (+)/ deficit (-)	189	593	934	775	228	169	-	390
Net lending (+)/ borrowing (-)	120	173	177	457	114	99	-	169
Small agricultural								
Revenue	4 631	-	10 865	4 691	2 831	3 022	829	4 207
Expenses	4 409	-	9 198	3 296	2 336	2 884	1 412	3 514
Operating surplus (+)/ deficit (-)	222	-	1 667	1 395	495	138	-584	693
Net lending (+)/ borrowing (-)	347	-	149	805	392	262	-107	471
Large remote								
Revenue	-	-	13 047	4 577	-	-	5 096	6 099
Expenses	-	-	11 296	2 754	-	-	4 949	4 800
Operating surplus (+)/ deficit (-)	-	-	1 750	1 822	-	-	147	1 300
Net lending (+)/ borrowing (-)	-	-	39	687	-	-	222	441
Small remote								
Revenue	-	-	64 059	18 184	-	-	-	43 306
Expenses	-	-	43 411	13 381	-	-	-	29 826
Operating surplus (+)/ deficit (-)	-	-	20 648	4 804	-	-	-	13 480
Net lending (+)/ borrowing (-)	-	-	13 506	2 911	-	-	-	8 713
Total								
Revenue	1 445	1 505	2 188	1 690	1 250	1 455	2 041	1 629
Expenses	1 306	1 226	1 873	1 348	1 103	1 254	2 072	1 397
Operating surplus (+)/ deficit (-)	139	279	315	342	147	202	-31	232
Net lending (+)/ borrowing (-)	54	11	-131	133	23	96	106	13

Note: 1. Unpublished data. Figures do not reconcile with the published GFS data reported in Table C-1.
2. ' - ' signifies the State did not have local governments in the relevant group or the ABS could not provide data for confidentiality reasons (the data are classified to another group).
3. The ABS supplied only State totals for Western Australia for 2011-12. The data shown were obtained by applying 2010-11 proportions to the 2011-12 data.

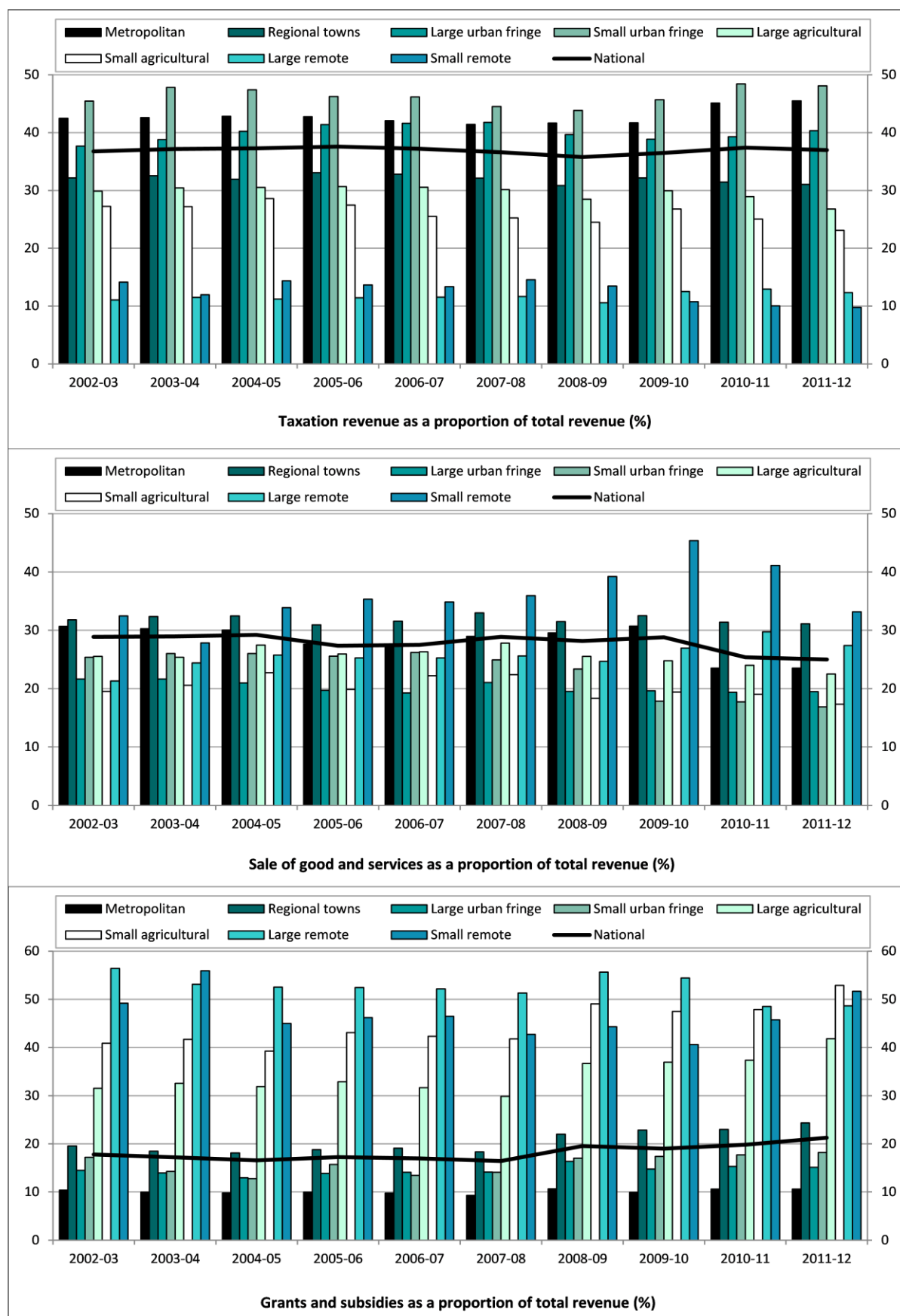
Source: Commission analysis of ABS GFS data.

Revenue

- 36 Figure C-7 shows the main sources of revenue for each local government group for the last decade. These are aggregate numbers; they represent the revenue raised by all councils in that group in all States.
- 37 Income from taxation revenue and sales of goods and services together contributed around 60% of revenue. Grants and subsidies (from Commonwealth and State governments) contributed under 20% of revenue. Other revenue (such as interest earnings and contributions by developers) made up the balance.
- 38 **Taxation revenue.** Urban councils (those in the metropolitan, regional towns, large urban fringe and small urban fringe groups) raise more revenue from rates than rural and remote councils (those in the large agricultural, small agricultural; large remote and small remote groups).
- Councils in the metropolitan and small urban fringe groups raised more than 40% of their revenue from rates. The high concentration of residential properties in urban areas means these councils have large rate bases which contributed to their high level of rate revenue.
 - Councils in the large and small remote groups raised only about 10% of their revenue from rates. Rural and remote councils (particularly remote Indigenous councils) have small rate bases due to a limited number of rateable properties.
- 39 **Sale of goods and services.** Urban councils raise more revenue from user charges than other councils.
- Councils in the metropolitan and regional town groups raised more than 30% of their revenue from sales of goods and services. These councils raised more revenue from commercial services, for example, parking fees and other business charges. Other types of local governments do not have this capacity.
 - Councils in the small agricultural group raised less than 20% of total revenue from this source.
 - Councils in the large and small remote groups raised more than 30% of total revenue from sales of goods and services. This is because these councils often deliver agency services for the State and Commonwealth governments and receive revenue from fees or charges for delivering these services.⁷

⁷ The proportion of user charge revenue for the small remote group increased significantly from 2008-09, reaching a peak of 45% in 2009-10 and declined to 33% in 2011-12. It is possible this increase might be associated with the Commonwealth and State governments' economic stimulus strategies to address the global financial crisis, which increased agency service arrangements over that period.

Figure C-7 Revenue by source, by type of local government over time



- 40 **Grants and subsidies.** Rural and remote councils were more reliant on assistance from the Commonwealth and State governments.
- Grants and subsidies comprised only 10% of revenue for councils in the metropolitan group.
 - Grants and subsidies were 40 to 55% of revenue for rural and remote councils. For councils in the large remote group, they accounted for almost 60% of revenue in some years.
- 41 **Financial assistance grants.** Financial assistance grants were a relatively small proportion of total council revenue. Table C-8 shows financial assistance grants were around 6 to 7% of council revenue during the last decade. Their share of council revenue fell from 7.6% in 2002-13 to 7.2 % in 2011-12. Excluding the brought forward amounts in 2008-09 to 2011-12 the contribution of the grants to council revenue fell from 7.6% in 2002-03 to 5.7% in 2011-12.

Table C-8 Financial assistance grants as proportion of council revenue, 2002-03 to 2011-12

FAGs as proportion of council revenue	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
	%	%	%	%	%	%	%	%	%	%
With brought forward amounts	7.6	7.4	7.1	6.7	6.3	6.3	7.4	6.0	6.0	7.2
Without brought forward amounts	7.6	7.4	7.1	6.7	6.3	6.3	5.9	5.9	6.0	5.7

Source: Commission analysis of ABS GFS (5512.0) and Commonwealth of Australia's Final Budget Outcome.

- 42 The importance of the financial assistance grants to council revenue varies noticeably within States. Table C-9 shows the financial assistance grants are noticeably more important for non-minimum grant councils and for rural and remote councils.

Table C-9 Financial assistance grants as proportion of council revenue, by type of council, 2011-12

	NSW	Vic	Qld	WA	SA	Tas	NT
	%	%	%	%	%	%	%
Minimum grant councils	3.5	2.3	2.6	3.5	3.5	4.7	7.4
Other councils	9.3	9.7	7.8	15.0	14.9	15.8	9.4
Urban councils							
Metropolitan	4.2	3.9	2.7	3.4	4.2	-	-
Regional towns	8.6	12.4	5.1	7.1	9.4	8.7	-
Large urban fringe	5.8	6.3	-	3.1	-	-	-
Small urban fringe	6.5	-	-	5.5	7.4	5.4	6.0
Rural and remote councils							
Large agricultural	17.6	17.7	11.4	10.8	17.4	22.4	-
Small agricultural	20.9	-	16.0	21.8	25.3	23.0	20.8
Large remote	-	-	18.2	13.9	-	-	8.6
Small remote	-	-	11.0	28.4	-	-	-

Source: Commission analysis of ABS GFS (5512.0) and Australian Demographic Statistics (3101.0).

- 43 **Composition of revenue.** At the State level, the composition of revenue by type of council was broadly similar to that shown in Figure C-7 — rates and user charges are a more important revenue source for urban councils, while grants are the more important source for rural and remote councils.
- 44 The composition of revenue also varied by type of council.
- In New South Wales, the importance of rates as a source of revenue has been declining over the decade for councils in the large and small agricultural councils. Grants and subsidies have become a more important revenue source, particularly for councils in the small agricultural group.
 - In Queensland, the proportion of revenue from grants and subsidies for councils in the small agricultural group rose from 39% in 2002-03 to 74% in 2011-12.
 - In Queensland, councils in the small remote group raised more than 40% of their revenue from user charges, as did the metropolitan group prior to 2010-11. User charges were less than 10% of the revenue of councils in the small remote group in Western Australia.
 - In Western Australia, grants and subsidies were less than 20% of urban council revenues, but more than twice that proportion for rural and remote councils.
 - Councils in the metropolitan group in South Australia raised the majority (65%) of their revenue from rates.
 - In Tasmania, grants and subsidies has become a more important source of revenue for urban councils. For example, for most of the decade they were around 10% of the total revenue of regional towns, but this rose to 24% in

2011-12. It has become a less important source of revenue for small agricultural councils, falling from 52% of total revenue in 2002-03 to 37% in 2011-12.

- In the Northern Territory, councils in the urban fringe group raised about 50% of their revenue from rates but only 1% of the revenue of large remote councils came from that source. Grants and subsidies accounted for about 60% of the revenue of the large remote councils.

45 There are State figures at the end of this attachment.

Spending

46 Figure C-8 shows the three biggest areas of spending for each council group for the last decade. These are aggregated numbers; they represent the spending by the councils in the group in all States.

- Housing and community amenities appeared to be a bigger spending priority for urban councils (around 25% of expenses) compared with rural and remote ones (around 15% or less). Urban councils were also twice as likely to spend on recreation and cultural (not shown in the figure) as rural and remote councils.
- The biggest spending priority for rural and remote councils was transport and communications. It was 40 to 50% of expenses, compared to around 20% for urban councils.
- For most groups, spending on human services (not shown in the figure) was relatively small (around 7% of expenses), but there were two exceptions:
 - it was 12% of expenses for large urban fringe councils
 - it was only 3% of expenses for small remote councils.

47 Spending priorities also varied by type of council within States.

- In New South Wales, urban and town councils spent more on housing and community amenities, and less on roads compared to rural and remote councils. There was a similar pattern in Queensland, Western Australia, South Australia and Tasmania.
- Expenses of urban and rural councils in Victoria and the Northern Territory did not show the similar distinctive patterns as in other States.
 - Housing and community amenities was responsible for the highest proportion of expenses by large urban fringe councils in Victoria while roads accounted for the highest proportion of spending of large agricultural councils.
 - Urban and large remote councils in the Northern Territory had higher proportion of housing and community amenities spending than small agricultural councils (there are only three types of councils in the Northern Territory), while small agricultural councils had a higher proportion of roads spending than the other two council types.

48 There are State figures at the end of this attachment.

Figure C-8 Expenses by function, by type of local government over time

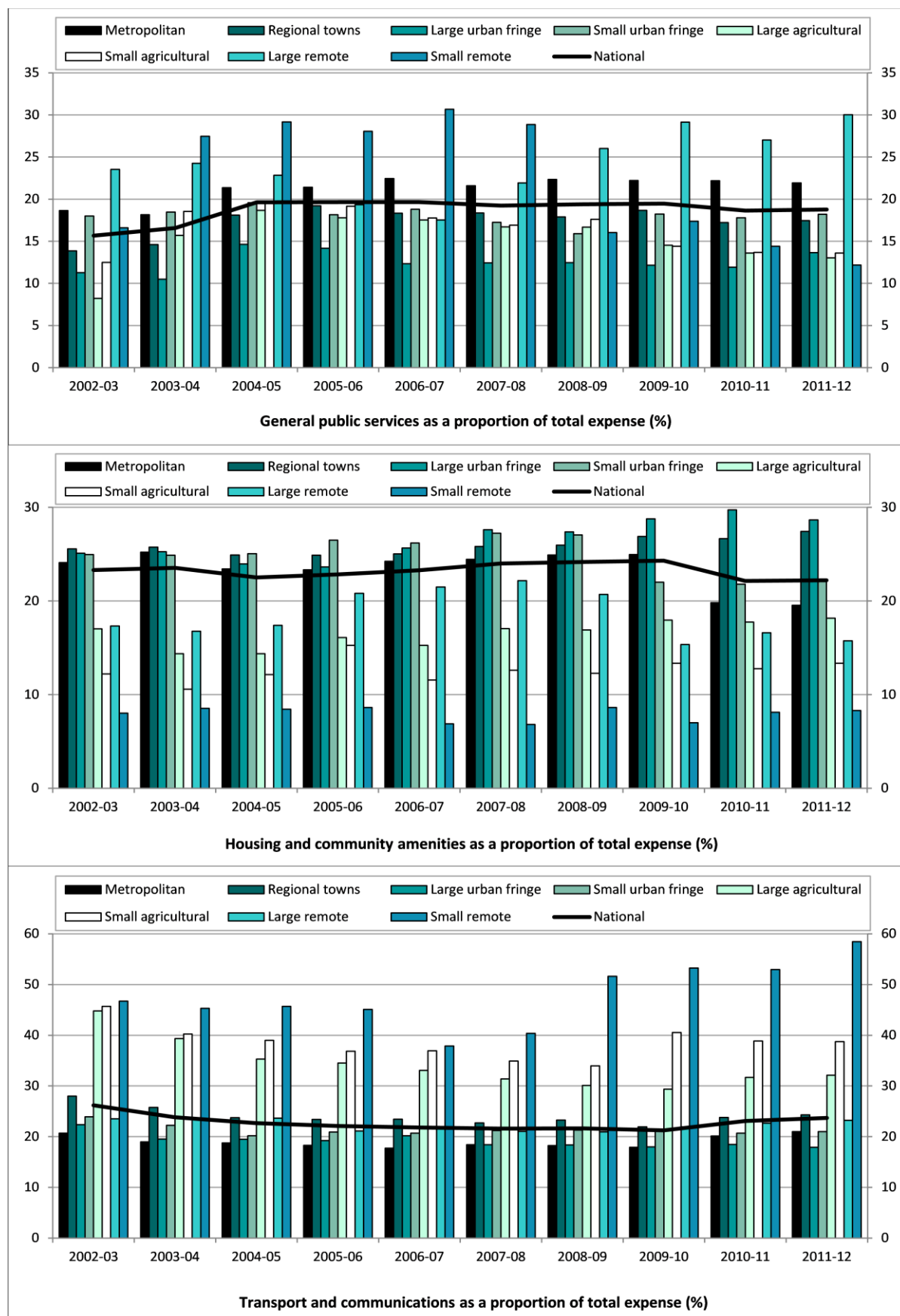


Figure C-9 Revenue by source, by type of council over time, New South Wales

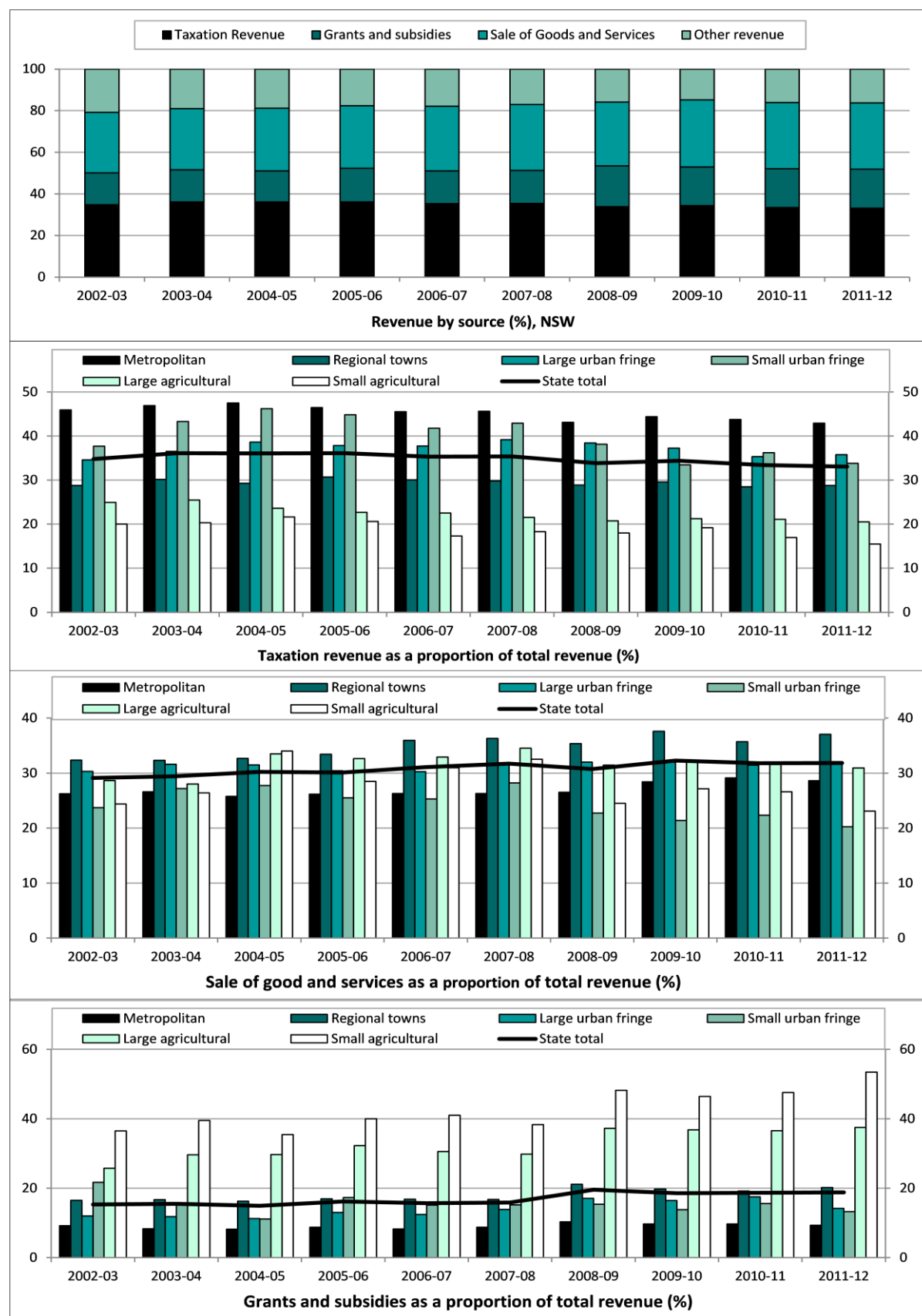


Figure C-10 Revenue by source, by type of council over time, Victoria

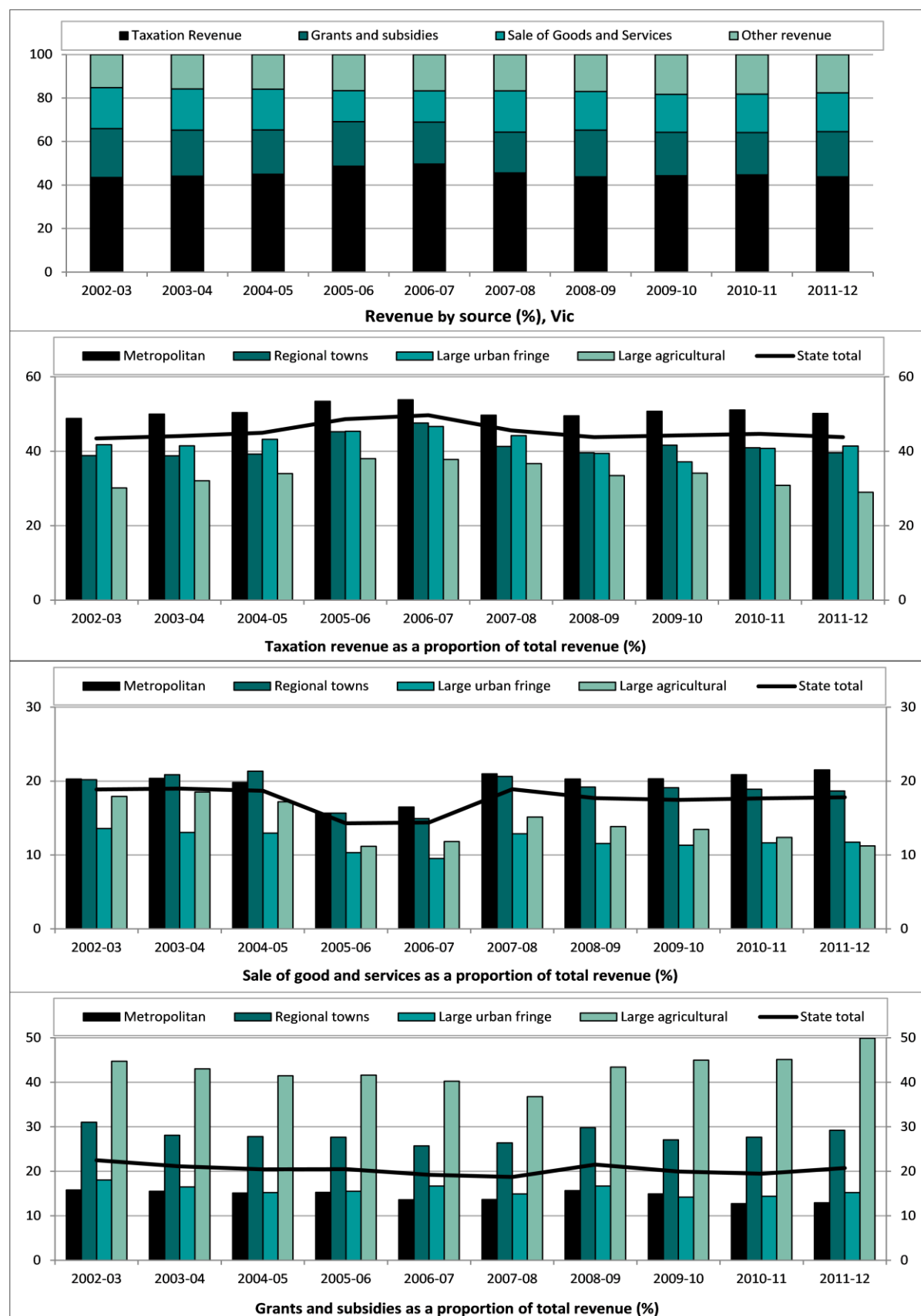


Figure C-11 Revenue by source, by type of council over time, Queensland

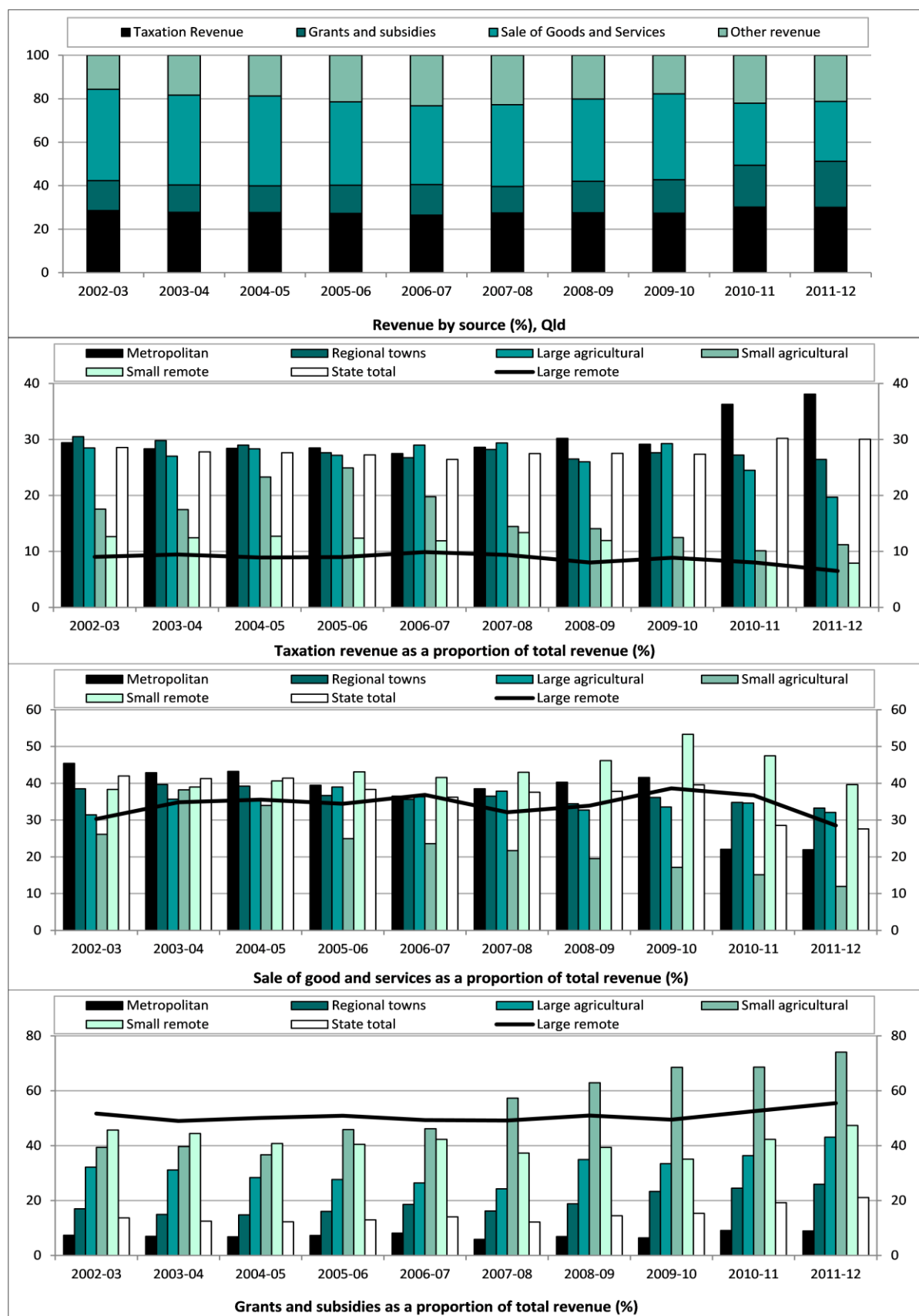


Figure C-12 Revenue by source, by type of council over time, Western Australia

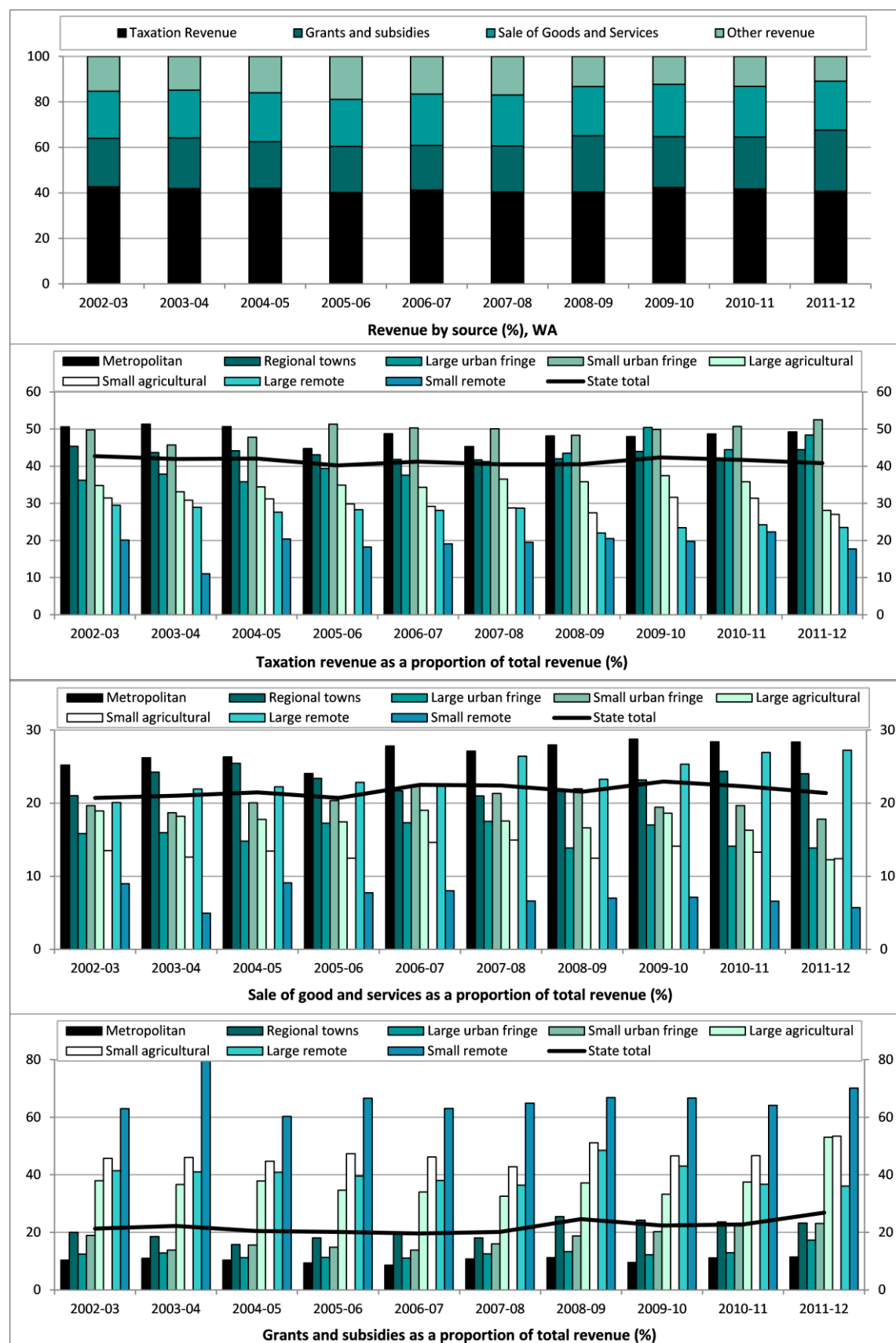


Figure C-13 Revenue by source, by type of council over time, South Australia

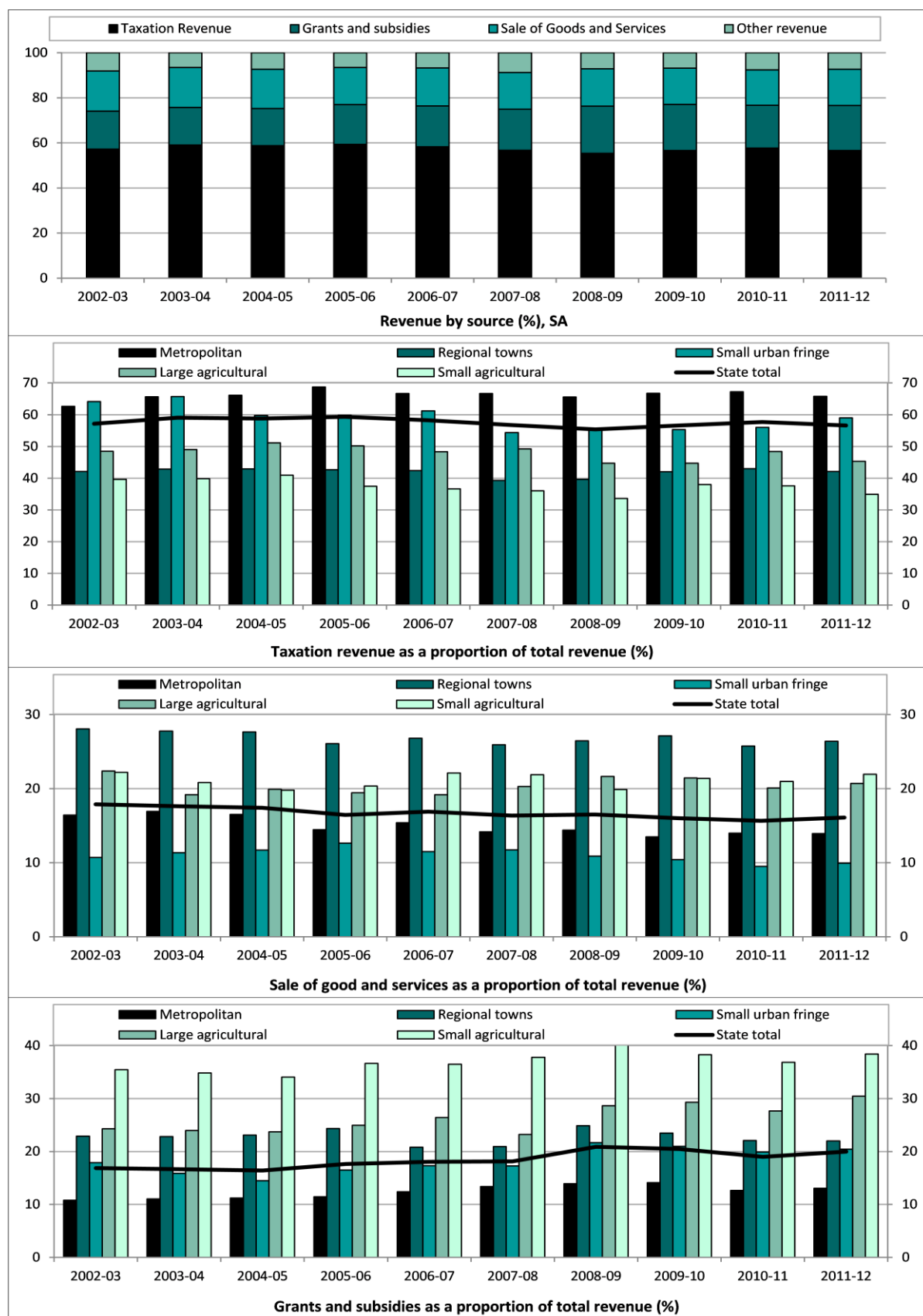


Figure C-14 Revenue by source, by type of council over time, Tasmania

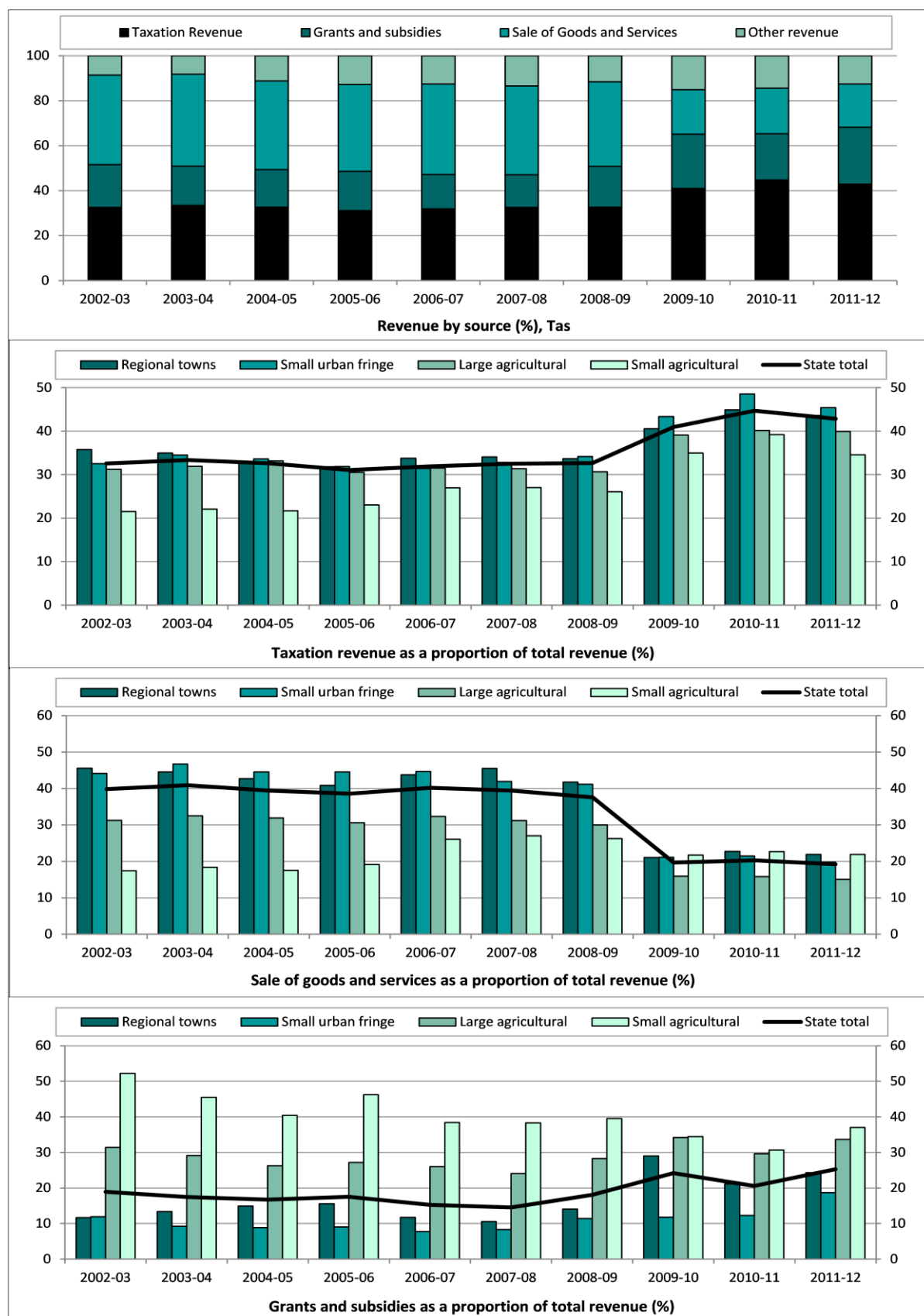


Figure C-15 Revenue by source, by type of council over time, Northern Territory

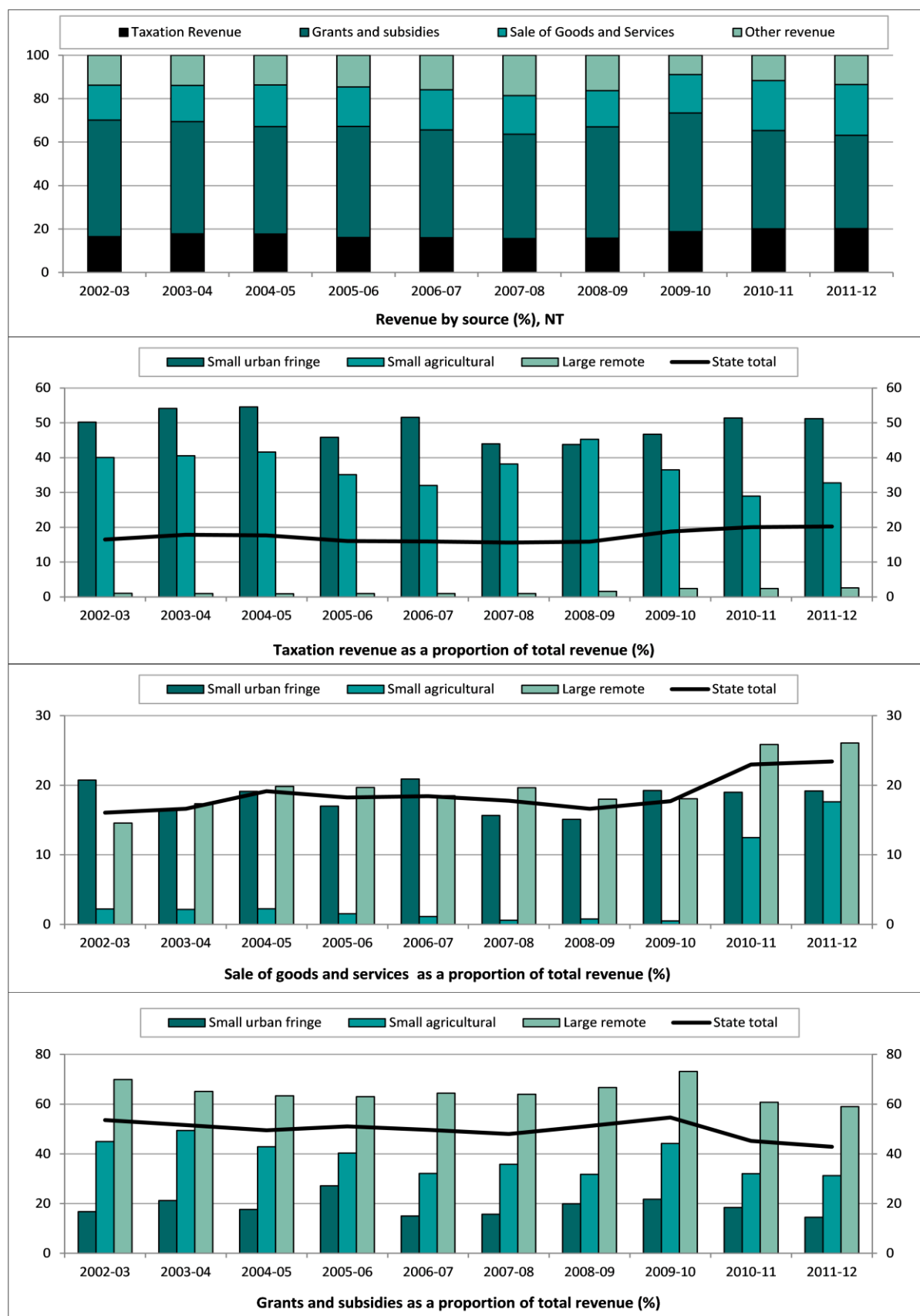


Figure C-16 Expense by function, by type of council over time, New South Wales

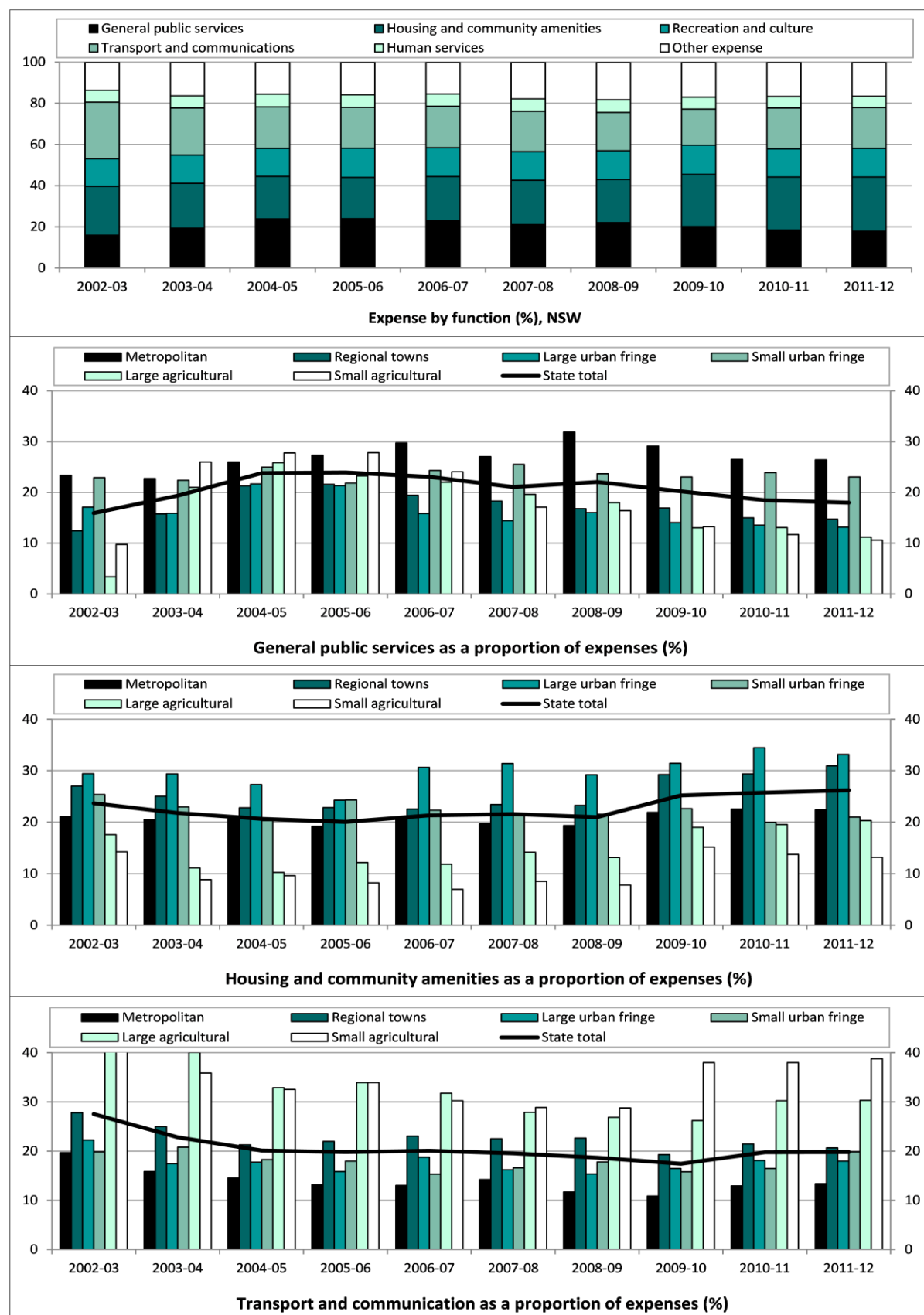


Figure C-17 Expense by function, by type of council over time, Victoria

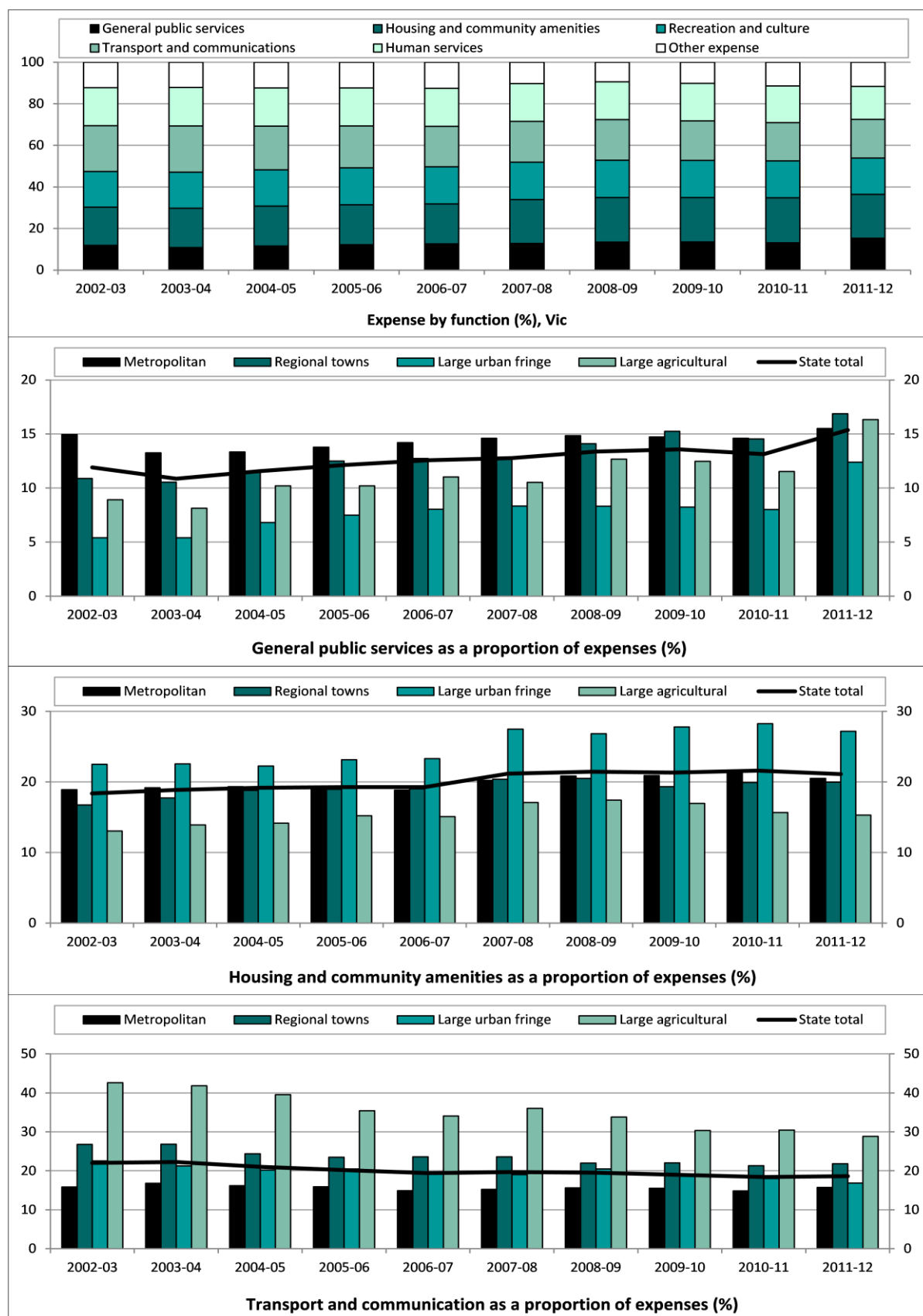


Figure C-18 Expense by function, by type of council over time, Queensland

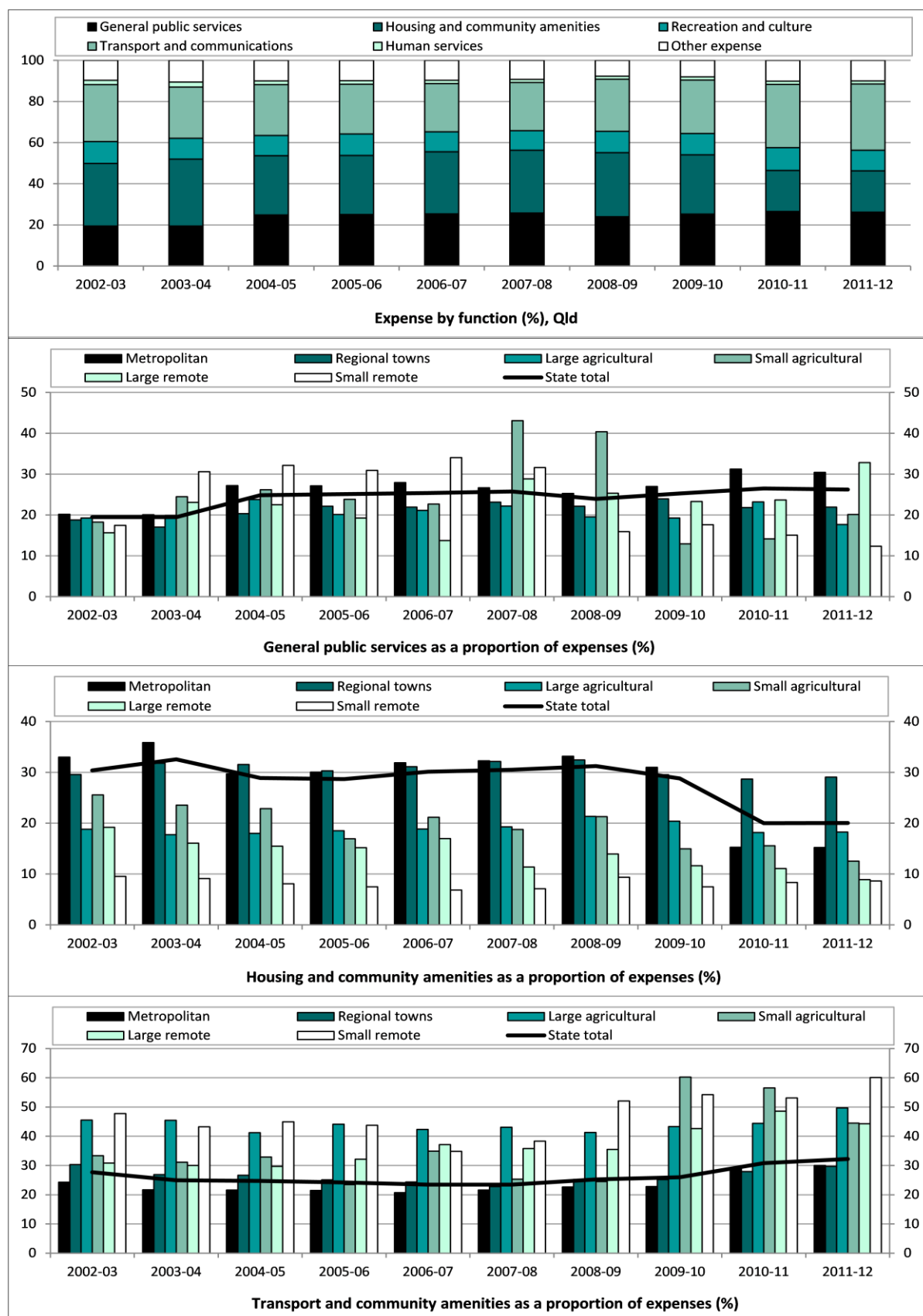


Figure C-19 Expense by function, by type of council over time, Western Australia

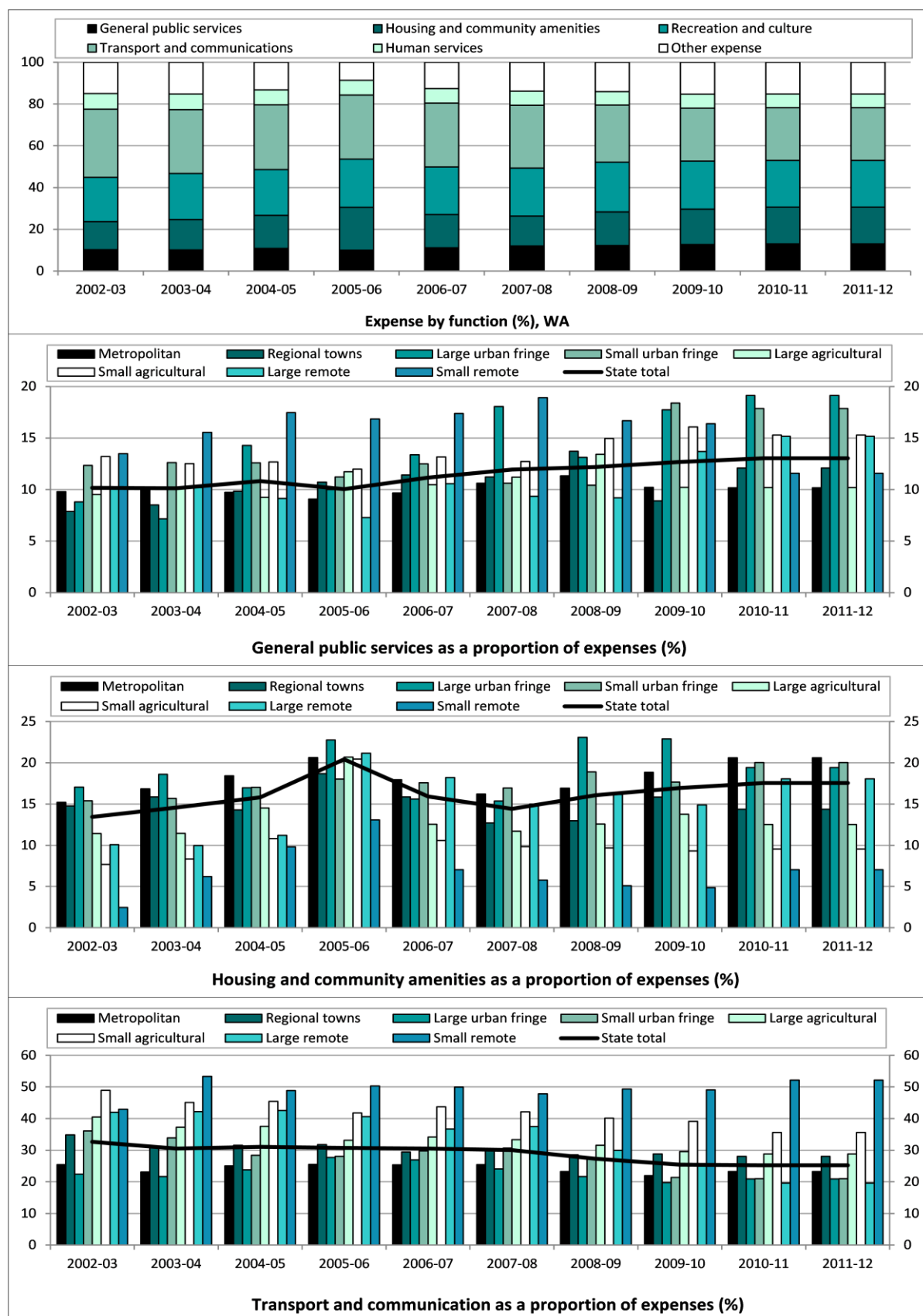


Figure C-20 Expense by function, by type of council over time, South Australia

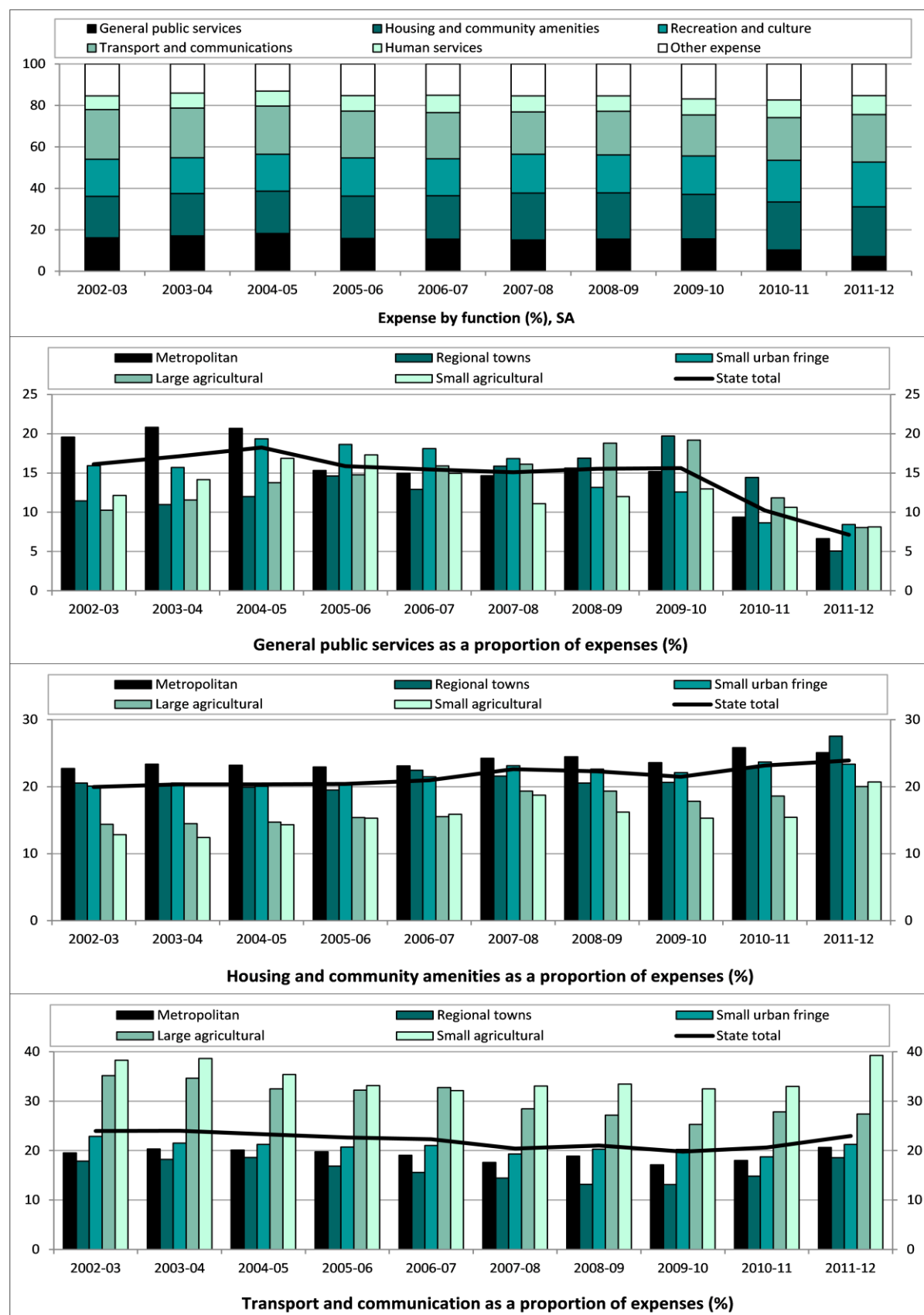


Figure C-21 Expense by function, by type of council over time, Tasmania

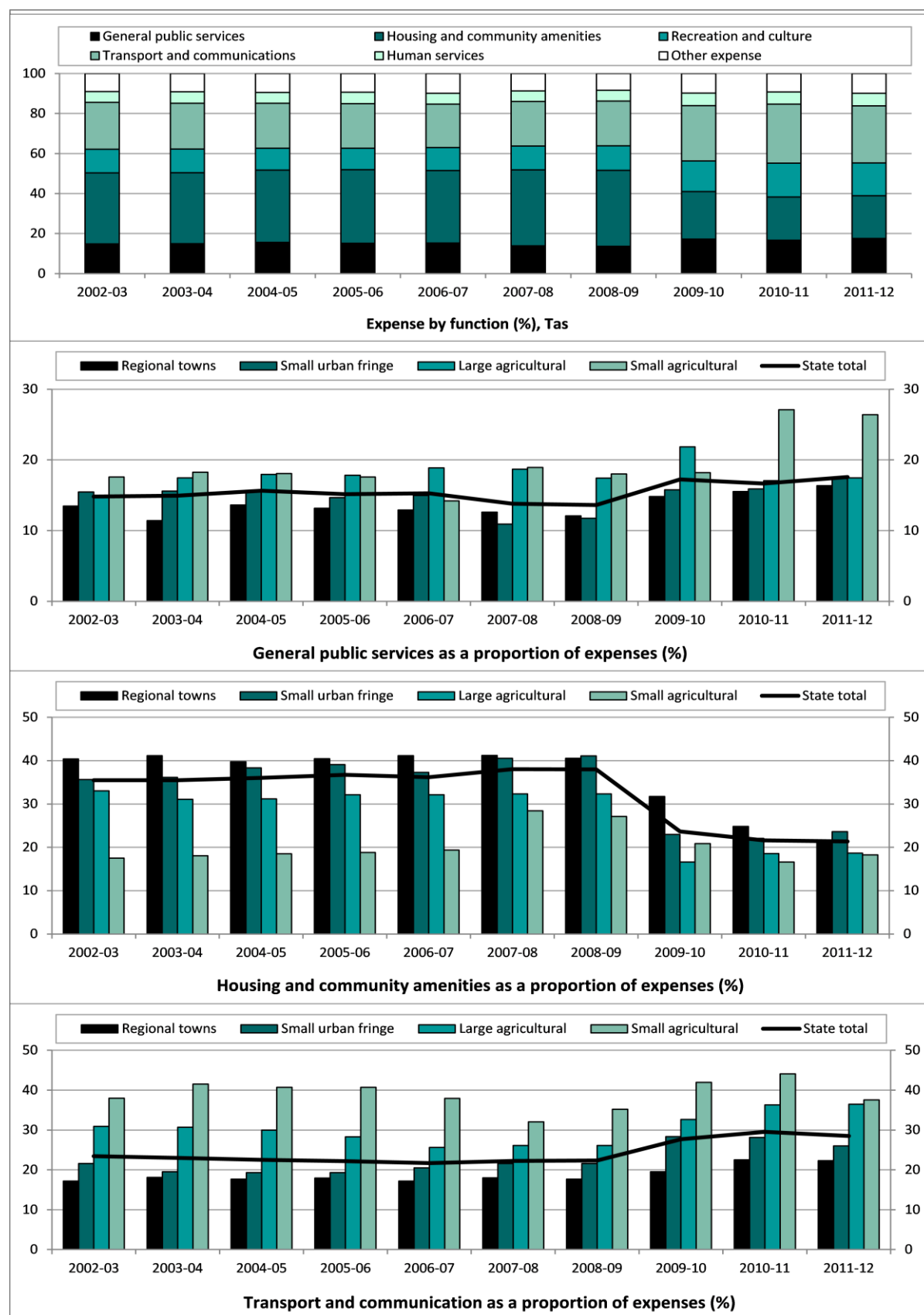
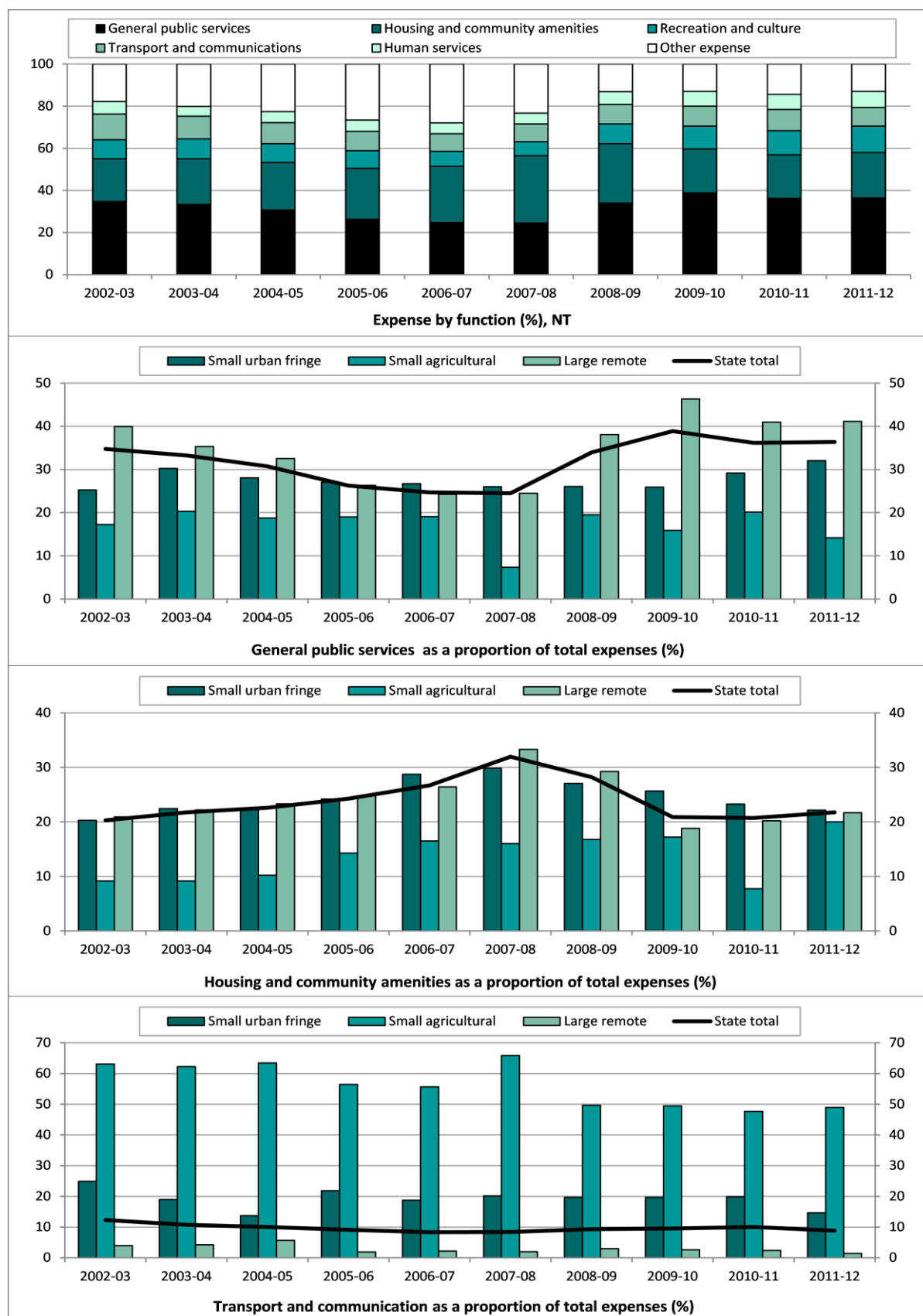


Figure C-22 Expense by function, by type of council over time, Northern Territory



TERMINOLOGY

Term	Meaning
Ability (of councils) to deliver services	The ability or capacity of councils within each State to deliver equal or comparable services.
Assessed budget outcome	The budget outcome (deficit or surplus) a council would have if it provided the average level of services to its residents and made the average effort to raise revenue from its revenue base.
Assessed expenditure or spending (or standardised expenditure or spending)	The expenditure a council would incur if it provided the average level of services to its residents and taking account of its circumstances.
Assessed revenue (or standardised revenue)	The revenue a council would collect if it made the average effort to raise revenue from its revenue base.
Average effort to raise revenue	The State-wide average of council policies relating to revenue raising, including the range of taxes and charges imposed, the scope of the revenue base for each tax or charge and the tax rates imposed.
Conditional grants	Grants where eligibility to receive the funds depends on the recipient meeting specified conditions not directly related to a particular function.
Current funding envelope	The total Commonwealth financial assistance (general purpose and identified local roads grants) paid under the Act to each State for local government, but excluding the supplementary funding paid to South Australia for local roads.
Effectiveness (of councils)	How well the services councils deliver are aligned to the services residents seek, having regard to the cost of the services and the revenues residents are prepared to contribute, other available revenues and the degree to which objectives are efficiently achieved and targeted problems resolved.

Term	Meaning
Equalisation requirement	The assistance a council would require to raise its fiscal capacity to the average capacity for its State. It is equal to the council's relative needs.
Financial (or fiscal) capacity	The financial ability of a council to provide services to its residents given the differences between the costs of providing the services in its circumstances and the average costs and its ability to raise revenue under average revenue policies.
Horizontal equalisation	A basis for distributing grants in a way which aims to equalise the financial capacities of the recipients to provide services. The grant for each recipient takes account of aspects of its circumstances which affect its costs of providing services and its ability to raise its own revenue, provided those factors are not directly affected by the recipient's own actions.
Minimum grant council	A council whose general purpose grant is equal to its population share of 30% of the general purpose grants received by the State, which is the minimum grant guaranteed by section 9 of the Act.
Relative level of service provision	How the level of service provided by a council compares with the average level of service provided by councils in the State. It is calculated as the council's actual spending divided by the spending it would make if it followed the average service delivery policies in its circumstances (that is, delivered the average level of services to its residents).
Relative needs	The difference between: the budget outcome the local government grants commission assesses a council would have if it provided the average level of services and made the average effort to raise revenue from its revenue base (its assessed budget outcome); and the average budget outcome for all councils in the State. It is the same as the council's equalisation requirement.
Relative revenue effort (or relative revenue raising effort)	A council's actual revenue divided by the revenue it would collect if it followed the average revenue raising policies and imposed the average tax rates on its revenue bases. It shows how the council's efforts to raise its own revenue compare with the average effort of all councils in the State.

Term	Meaning
Standard expenditure	Average per capita expenditure on a particular service (or group of services) by councils in a State. It is calculated as the expenditure by all councils in the State on the service divided by the population of all councils in the State.
Standard revenue	Average per capita revenue raised from a tax or charge (or group of taxes and charges) by councils in a State. It is calculated as the revenue collected by all councils in the State from a nominated tax or charge divided by the population of all councils in the State.
Tangible measures	Changes to how funds are allocated to councils in each State or changes in how the funds may be used to improve the effectiveness and service delivery of the local government sector in each State.
Tied grants	Grants the recipients must use for the purpose nominated by the funding provider or in accordance with other conditions the provider sets.
Untied grants	Grants the recipients can use for any purpose and in any manner they deem appropriate. The recipients are not required to report to the funding provider on the use of the funds.