CHAPTER 13

A WORKED EXAMPLE

1. This chapter provides a worked example of how the proposals in the Commission's draft report might operate. It uses 10 fictitious LGBs and assumes:

- 2 expenditure categories (Roads and Other);
- 3 revenue categories (Municipal Rates, User Charges and Other); and
- 4 forms of Commonwealth assistance (Per Capita grants, Local Roads grants, Relative Needs grants and Other grants).

2. The example is provided in both a Balanced Budget and a Direct Assessment format. It is used as the basis for a discussion of Horizontal Equalisation and Relative Needs, and demonstrates that, if correctly specified, the two models produce the same result.

BALANCED BUDGET MODEL

3. Chapter 10 set out the **Balanced Budget Model.** It is based around the standardisation of expenditure, revenues and SPPs for each LGB and can be expressed as[1]:

Grant required	*equals*	Standardised expenditure
	less	Standardised revenue capacity
	less	Actual receipt of SPPs
	plus	The standard budget result

4. The model as implemented by LGGCs has a missing term (the standard budget result). This chapter sets out an example of this model. The standard budget term is included.

[1] Unless otherwise stated, the figures in the worked example are expressed in millions of dollars.

Population

5. Table 13-1 sets out the assumed population for each of the ten LGBs.

Table 13-1 ASSUMED POPULATION

Local Governing Body										Total
1	2	3	4	5	6	7	8	9	10	population
250	750	9 000	18 000	20 000	37 000	65 000	80 000	120 000	150 000	500 000

Standard Budget

6. Table 13-2 sets out total expenditure and revenue by function. It shows that expenditures exceed revenues by $5 million, so that the LGBs are in overall deficit[2].

Table 13-2 ASSUMED STANDARD BUDGET

Function	Amount spent/raised/received	
	$m	$pc
Expenditure		
Road expenditure	30.0	60.00
Other expenditure	300.0	600.00
Total expenditure	**330.0**	**660.00**
Revenue		
Municipal Rates	150.0	300.00
User Charges	10.0	20.00
Other Revenue	50.0	100.00
Total revenue	**210.0**	**420.00**
Other Grants (SPPs)		
Relative Needs grants	60.0	120.00
Per Capita grants	20.0	40.00
Local Roads grants	30.0	60.00
Other grants (SPPs)	5.0	10.00
Total SPPs	**115.0**	**230.00**
Budget result	**-5.0**	**-10.00**

[2] This imbalance is the standard budget result.

Assumed Factors

7. The per capita figures in Table 13-2 form the category standards to which assumed disability factors and revenue capacity ratios are applied to calculate standardised expenditures and revenues. The assumed factors are given in Table 13-3. They have been calculated in accordance with normal Commonwealth Grants Commission (CGC) practice — the average factor for the LGBs as a whole is 1.0000. A factor of one for each LGB implies an equal per capita assessment (EPC). The Other Grants (SPPs) factor is based on each LGB's actual receipt of other grants and is, therefore, an actual per capita (APC) assessment.

8. For expenditure functions, a factor above one signals disadvantage — the LGB has above average costs of service provision. For revenue functions (including SPPs) a factor below one signals disadvantage — the LGB has a below average revenue capacity.

9. In the example, one assessment method has been used both to distribute the Local Roads grants and to assess road needs in the Relative Needs calculation.

Table 13-3 ASSUMED FACTORS FOR THE RELATIVE NEEDS CALCULATION

	Local Governing Body									
Function	1	2	3	4	5	6	7	8	9	10
Road expenditure	4.98728	4.48855	2.99237	1.99491	1.49618	1.19695	0.94758	0.84784	0.84784	0.84784
Other expenditure	4.63951	1.85580	1.85580	1.39185	1.85580	0.74232	0.83511	1.39185	0.83511	0.83511
Municipal Rates	0.79761	0.79761	0.79761	0.89731	0.89731	0.89731	0.89731	1.04686	1.04686	1.04686
User Charges	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
Other Revenue	0.00000	0.00000	0.09940	0.29821	0.39761	0.59642	0.69583	0.79523	1.09344	1.49105
Per Capita grants	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
Local Roads grants	4.98728	4.48855	2.99237	1.99491	1.49618	1.19695	0.94758	0.84784	0.84784	0.84784
Other grants (SPPs)	4.00000	5.33333	0.55556	0.55556	1.00000	1.08108	0.76923	0.87500	0.83333	1.33333
Budget result	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000

10. Table 13-4 sets out the standardised expenditures and revenues (in millions of dollars). These were calculated by multiplying the factors in Table 13-3, the per capita standards in Table 13-2 and the populations in Table 13-1. For each function, the sum of standardised expenditures (revenues) is equal to the total expenditure (revenue) shown in Table 13-2. This result occurs because the average factor for each function is 1.00000.

11. In accordance with CGC processes, the total deficit (standard budget result) is distributed between LGBs on an EPC basis (factors of 1.00000).

Table 13-4 ASSESSED STANDARDISED EXPENDITURES AND REVENUES

	Local Governing Body										
Function	1	2	3	4	5	6	7	8	9	10	Total
	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m
Road expenditure	0.1	0.2	1.6	2.2	1.8	2.7	3.7	4.1	6.1	7.6	30.0
Other expenditure	0.7	0.8	10.0	15.0	22.3	16.5	32.6	66.8	60.1	75.2	300.0
Standardised expenditure	**0.8**	**1.0**	**11.6**	**17.2**	**24.1**	**19.1**	**36.3**	**70.9**	**66.2**	**82.8**	**330.0**
Municipal Rates	0.1	0.2	2.2	4.8	5.4	10.0	17.5	25.1	37.7	47.1	150.0
User Charges	0.0	0.0	0.2	0.4	0.4	0.7	1.3	1.6	2.4	3.0	10.0
Other Revenue	0.0	0.0	0.1	0.5	0.8	2.2	4.5	6.4	13.1	22.4	50.0
Standardised revenue	**0.1**	**0.2**	**2.4**	**5.7**	**6.6**	**12.9**	**23.3**	**33.1**	**53.2**	**72.5**	**210.0**
Per Capita grants	0.0	0.0	0.4	0.7	0.8	1.5	2.6	3.2	4.8	6.0	20.0
Local Roads grants	0.1	0.2	1.6	2.2	1.8	2.7	3.7	4.1	6.1	7.6	30.0
Other grants (SPPs)	0.0	0.0	0.1	0.1	0.2	0.4	0.5	0.7	1.0	2.0	5.0
Other grants received	**0.1**	**0.3**	**2.0**	**3.0**	**2.8**	**4.5**	**6.8**	**8.0**	**11.9**	**15.6**	**55.0**
Budget result	**0.0**	**0.0**	**-0.1**	**-0.2**	**-0.2**	**-0.4**	**-0.7**	**-0.8**	**-1.2**	**-1.5**	**-5.0**
Relative Needs grants required	**0.6**	**0.6**	**7.1**	**8.3**	**14.5**	**1.3**	**5.5**	**29.0**	**-0.1**	**-6.8**	**60.0**

12. For two LGBs (numbers 9 and 10), the assessment of grants required is negative. In horizontal equalisation terms, they are already overequalised because of their high revenue capacities and low relative expenditure needs. If they were to be placed on a 'full' horizontal equalisation footing, an amount of money equal to their negative assessment would need to be taken away from them and redistributed amongst the other LGBs. In the Australian local government context, this is not a practical option — all that can be done is that they receive no Relative Needs grant. However, because they do not contribute funds to the pool for redistribution, these LGBs will remain overequalised. The extent of their overequalisation differs depending on the assessments that have been made.

13. Correspondingly, in the absence of such a redistribution from the 'No Relative Needs Grant' LGBs, it is not possible to place the other LGBs on a 'full' horizontal equalisation footing. They must remain underequalised.

How Should the Available Grants be Rationed?

14. In the example, the amount of grants required by the underequalised LGBs is $66.9 million but only $60.0 million is available. The available assistance has to be

rationed[3] amongst the underequalised LGBs. There are two ways that this could be done. The process could:

(i) ration the available grants according to grants required — the method used by most LGGCs; or

(ii) ration the available grants so that all the underequalised LGBs are underequalised to the same degree.

15. Under option 1, the Relative Needs grant to each underequalised LGB is reduced by the same proportion, irrespective of differences in capacity to raise revenues from all sources. Under option 2, the Relative Needs grant to each LGB is reduced according to its overall capacity to suffer the loss, that is, taking into account its capacity to raise revenues from all sources.

16. The first option is easiest to implement. Table 13-5 shows how it would be implemented.

Table 13-5 DISTRIBUTION OF RELATIVE NEEDS GRANTS, OPTION 1

		Local Governing Body									
Function		1	2	3	4	5	6	7	8	9	10
Grants required[(a)]	$m	0.6	0.6	7.1	8.3	14.5	1.3	5.5	29.0	0.0	0.0
Percentage share[(b)]	%	0.91	0.84	10.61	12.39	21.66	1.98	8.22	43.39	0.00	0.00
Grants allocated[(c)]	$m	0.5	0.5	6.4	7.4	13.0	1.2	4.9	26.0	0.0	0.0

(a) Negative 'Grants Required' figures are set to zero.
(b) Calculated as percentage share of 'Grants Required'.
(c) Calculated by applying percentage share to total available assistance.

17. The second option requires the introduction of a new concept — the Equalisation Ratio, calculated as:

$$\text{Equalisation Ratio}_i = \frac{\text{Grants required}_i + \text{Standardised revenue}_i + \text{SPPs received}_i}{\text{Standardised expenditure}_i + \text{Budget result}_s}$$

18. The appendix to this chapter explains the derivation of the Equalisation Ratio. It defines the numerator as the LGB's overall assessed revenue capacity and the denominator as its overall expenditure requirement. The Equalisation Ratio relates the revenue resources available to a LGB to its expenditure requirements.

19. The purpose of the Equalisation Ratio is to determine whether a LGB is equalised, overequalised or underequalised:

- if the ratio equals one, the LGB is equalised;

[3] Some LGGCs refer to this process as factoring back.

- if the ratio is greater than one, the LGB is overequalised; and
- if the ratio is less than one, the LGB is underequalised.

20. Full horizontal equalisation means that, after Relative Needs grants are distributed, all LGBs would have an equalisation ratio of one. The appendix explains why the uneven pattern of own source revenues prevents this outcome.

21. The equalisation ratio can also be used to choose between the two rationing options. If the purpose of rationing is to distribute Relative Needs grants so that all the underequalised LGBs are underequalised to the same degree — that is, after distributing the Relative Needs grants, their equalisation ratios are the same — then Table 13-6 shows the first rationing option does not achieve that outcome.

Table 13-6 CALCULATION OF EQUALISATION RATIO, OPTION 1

	Local Governing Body										
Function	1	2	3	4	5	6	7	8	9	10	Total
	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m
Grants allocated	0.5	0.5	6.4	7.4	13.0	1.2	4.9	26.0	0.0	0.0	60.0
Standardised revenue	0.1	0.2	2.4	5.7	6.6	12.9	23.3	33.1	53.2	72.5	210.0
SPPs received	0.1	0.3	2.0	3.0	2.8	4.5	6.8	8.0	11.9	15.6	55.0
Overall assessed capacity	**0.7**	**1.0**	**10.8**	**16.2**	**22.4**	**18.6**	**35.0**	**67.1**	**65.1**	**88.1**	**325.0**
Standardised expenditure	0.8	1.0	11.6	17.2	24.1	19.1	36.3	70.9	66.2	82.8	330.0
Budget result	0.0	0.0	-0.1	-0.2	-0.2	-0.4	-0.7	-0.8	-1.2	-1.5	-5.0
Overall expenditure requirement	**0.8**	**1.0**	**11.5**	**17.0**	**23.9**	**18.8**	**35.6**	**70.1**	**65.0**	**81.3**	**325.0**
Equalisation ratio	**0.91835**	**0.94363**	**0.93664**	**0.94976**	**0.93742**	**0.99274**	**0.98409**	**0.95732**	**1.00123**	**1.08383**	**1.00000**

22. Table 13-6 shows:

- two LGBs are overequalised (their overall assessed capacity exceeds their overall assessed outlays) — an equalisation ratio above one;
- eight LGBs are underequalised (their overall assessed capacity falls short of their overall assessed outlays) — an equalisation ratio below one; and
- the eight LGBs are underequalised to a different degree — their equalisation ratios are different.

23. It is the last point that indicates this method of rationing is unfair[4].

24. The second method of rationing requires an adjustment be made to the grants required figures for the underequalised LGBs. The issues are:

- the size of the adjustment; and
- its distribution amongst the underequalised LGBs.

25. In aggregate, the grants of the underequalised LGBs have to be reduced by the extent of the shortfall in grants (grants required less grants available) — $6.9 million in the example.

26. Its distribution should be in accordance with the LGBs' overall assessed revenue capacities. The steps involved are:

(i) calculate the level of grants that would be required to fully equalise all the underequalised LGBs[5];

(ii) calculate the difference between this level of grants and the grants available — the shortfall;

(iii) calculate an adjustment for each underequalised LGB by distributing the shortfall in accordance with each LGB's share of the Overall Assessed Capacity for all underequalised LGBs; and

(iv) deduct each LGB's adjustment from its grant assessed in step (i).

27. Table 13-7 shows how each LGB's adjustment would be calculated.

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4 Fairness is a relative concept. The definition of fairness used in this chapter is couched in terms of equalisation outcomes. A fair outcome is one which allows a LGB to meet the same proportion of its expenditure requirements as other LGBs.

5 The 'Grants Required' figures are the grants which would fully equalise these LGBs. Therefore, these numbers are used rather than the 'Grants Allocated' figures.

Table 13-7 CALCULATION OF ADJUSTMENT, OPTION 2

	Local Governing Body										
Function	1	2	3	4	5	6	7	8	9	10	Total
	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m
Grants required	0.6	0.6	7.1	8.3	14.5	1.3	5.5	29.0	-0.1	-6.8	60.0
Standardised revenue	0.1	0.2	2.4	5.7	6.6	12.9	23.3	33.1	53.2	72.5	210.0
SPPs received	0.1	0.3	2.0	3.0	2.8	4.5	6.8	8.0	11.9	15.6	55.0
Overall assessed capacity	**0.8**	**1.0**	**11.5**	**17.0**	**23.9**	**18.8**	**35.6**	**70.1**	**65.0**	**81.3**	**325.0**
Percentage share[(a)]	0.43	0.58	6.46	9.52	13.36	10.50	19.93	39.22	0.00	0.00	100.00
Adjustment	0.0	0.0	-0.4	-0.7	-0.9	-0.7	-1.4	-2.7	0.0	0.0	-6.9

(a) For each underequalised LGB, this is calculated as its percentage share of the aggregate overall assessed capacity for all underequalised LGBs. For overequalised LGBs, the figure is set to zero.

28. Table 13-8 calculates the distribution of the Relative Needs grants under the second rationing option.

Table 13-8 DISTRIBUTION OF RELATIVE NEEDS GRANTS, OPTION 2

		Local Governing Body									
Function		1	2	3	4	5	6	7	8	9	10
Grants required	$m	0.6	0.6	7.1	8.3	14.5	1.3	5.5	29.0	-0.1	-6.8
Adjustment	$m	0.0	0.0	-0.4	-0.7	-0.9	-0.7	-1.4	-2.7	0.0	0.0
Grants allocated[(a)]	$m	0.6	0.5	6.7	7.6	13.6	0.6	4.1	26.3	0.0	0.0

(a) Overequalised LGBs do not require grants, so their figures are set to zero.

29. Table 13-9 confirms that this approach distributes Relative Needs grants in a way that equalises the underequalised LGBs to the same degree — that is, after distributing the relative needs grants, their equalisation ratios are the same.

Table 13-9 CALCULATION OF EQUALISATION RATIO, OPTION 2

	Local Governing Body										
Function	1	2	3	4	5	6	7	8	9	10	Total
	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m
Grants allocated	0.6	0.5	6.7	7.6	13.6	0.6	4.1	26.3	0.0	0.0	60.0
Standardised revenue	0.1	0.2	2.4	5.7	6.6	12.9	23.3	33.1	53.2	72.5	210.0
SPPs received	0.1	0.3	2.0	3.0	2.8	4.5	6.8	8.0	11.9	15.6	55.0
Overall assessed capacity	**0.7**	**1.0**	**11.1**	**16.4**	**22.9**	**18.0**	**34.2**	**67.4**	**65.1**	**88.1**	**325.0**
Standardised expenditure	0.8	1.0	11.6	17.2	24.1	19.1	36.3	70.9	66.2	82.8	330.0
Budget result	0.0	0.0	-0.1	-0.2	-0.2	-0.4	-0.7	-0.8	-1.2	-1.5	-5.0
Overall assessed outlays	**0.8**	**1.0**	**11.5**	**17.0**	**23.9**	**18.8**	**35.6**	**70.1**	**65.0**	**81.3**	**325.0**
Equalisation ratio	**0.96141**	**0.96141**	**0.96141**	**0.96141**	**0.96141**	**0.96141**	**0.96141**	**0.96141**	**1.00123**	**1.08383**	**1.00000**

30. The second option, though more complex, produces a 'fairer' outcome. It places those LGBs that receive Relative Needs assistance in the same position. They are able to finance the same proportion of their standardised expenditures.

31. Table 13-10 shows the total grants received by each LGB under the preferred rationing method. It demonstrates that:

- LGBs receive four separate forms of Commonwealth assistance (Relative Needs grants, Per Capita grants, Local Roads grants and SPPs);
- the Relative Needs assessment takes into account the LGB's receipt of other assistance;
- a LGB's share of Per Capita and Local Roads grants does not depend on its Relative Needs — LGBs assessed to have a negative Relative Needs grant requirement still receive a Per Capita and a Local Roads grant; and
- a LGB's total receipt of Commonwealth assistance is the sum of its Relative Needs, Per Capita, Local Roads and SPP grants.

Table 13-10 DISTRIBUTION OF TOTAL COMMONWEALTH ASSISTANCE, OPTION 2

Local Governing Body	Relative Needs Grant	Per Capita Grant	Local Roads Grant	Other Grants (SPPs)	Total Grants
	$m	$m	$m	$m	$m
Local Governing Body 1	0.6	0.0	0.1	0.0	0.7
Local Governing Body 2	0.5	0.0	0.2	0.0	0.8
Local Governing Body 3	6.7	0.4	1.6	0.1	8.7
Local Governing Body 4	7.6	0.7	2.2	0.1	10.6
Local Governing Body 5	13.6	0.8	1.8	0.2	16.4
Local Governing Body 6	0.6	1.5	2.7	0.4	5.1
Local Governing Body 7	4.1	2.6	3.7	0.5	10.9
Local Governing Body 8	26.3	3.2	4.1	0.7	34.3
Local Governing Body 9	0.0	4.8	6.1	1.0	11.9
Local Governing Body 10	0.0	6.0	7.6	2.0	15.6
Total	**60.0**	**20.0**	**30.0**	**5.0**	**115.0**

DIRECT ASSESSMENT MODEL

32. This section shows how the model works in terms of the **Direct Assessment Model.** Chapter 10 said that this model is based on assessing needs rather than standardised expenditures, revenues and SPPs. It can be expressed as:

Grant required	*equals*	An equal per capita share of available assistance
	plus	Expenditure needs
	plus	Revenue needs
	plus	SPP needs

33. As discussed in Chapter 10, the Direct Assessment Model as implemented by LGGCs has a missing term (the EPC share of available assistance). In this section the missing term is included. Expenditure, revenue and SPP needs for each LGB are calculated using the formulae[6]:

Expenditure needs	*equals*	LGB's assessed standardised expenditure
	less	LGB's share of standard expenditure[7]
Revenue needs	*equals*	LGB's share of standard revenue
	less	LGB's assessed standardised revenue
SPP needs	*equals*	LGB's share of standard SPPs
	less	LGB's actual receipt of SPPs

34. Table 13-11 sets out the expenditure, revenue and SPP needs. These were calculated by:

- subtracting a LGB's population share of total expenditure from its assessed standardised expenditure in Table 13-4;
- subtracting a LGB's assessed standardised revenue in Table 13-4 from its population share of total revenue; and
- subtracting a LGB's actual receipt of SPPs in Table 13-4 from its population share of total SPPs.

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6 This is similar to the New South Wales and South Australian approach to calculating expenditure and revenue allowances. The only difference is that category standards are calculated using population rather than numbers of properties or road lengths.

7 CGC practice is to calculate standard expenditure (revenue or SPPs) in per capita terms, by dividing total expenditure (revenue or SPPs) by total population. However, this worked example is expressed in millions of dollars rather than in per capita terms. For each LGB, its standard revenue is obtained by multiplying the per capita standard revenue by its population. The result is identical to its population share of total revenue.

Table 13-11 ASSESSED EXPENDITURE, REVENUES AND SPP NEEDS ($m)

	Local Governing Body										
Function	1	2	3	4	5	6	7	8	9	10	Total
	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m
Share of assistance	**0.0**	**0.1**	**1.1**	**2.2**	**2.4**	**4.4**	**7.8**	**9.6**	**14.4**	**18.0**	**60.0**
Road expenditure	0.1	0.2	1.1	1.1	0.6	0.4	-0.2	-0.7	-1.1	-1.4	0.0
Other expenditure	0.5	0.4	4.6	4.2	10.3	-5.7	-6.4	18.8	-11.9	-14.8	0.0
Expenditure needs	**0.6**	**0.5**	**5.7**	**5.3**	**10.9**	**-5.3**	**-6.6**	**18.1**	**-13.0**	**-16.2**	**0.0**
Municipal Rates	0.0	0.0	0.5	0.6	0.6	1.1	2.0	-1.1	-1.7	-2.1	0.0
User Charges	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue	0.0	0.1	0.8	1.3	1.2	1.5	2.0	1.6	-1.1	-7.4	0.0
Revenue needs	**0.0**	**0.1**	**1.4**	**1.8**	**1.8**	**2.6**	**4.0**	**0.5**	**-2.8**	**-9.5**	**0.0**
Per Capita grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local Roads grants	-0.1	-0.2	-1.1	-1.1	-0.6	-0.4	0.2	0.7	1.1	1.4	0.0
Other grants (SPPs)	0.0	0.0	0.0	0.1	0.0	0.0	0.2	0.1	0.2	-0.5	0.0
SPP needs	**-0.1**	**-0.2**	**-1.0**	**-1.0**	**-0.6**	**-0.5**	**0.4**	**0.8**	**1.3**	**0.9**	**0.0**
Grants required	**0.6**	**0.6**	**7.1**	**8.3**	**14.5**	**1.3**	**5.5**	**29.0**	**-0.1**	**-6.8**	**60.0**

35. The grant required figures are identical to those calculated in Table 13-4 (under the Balanced Budget Model). This confirms that, if correctly specified, the Balanced Budget and Direct Assessment Models produce identical results.

36. As was the case under the Balanced Budget model, LGBs 9 and 10 have a negative grant requirement. This means that they are ineligible for Relative Needs assistance because they are overequalised and (relative to other LGBs) do not require additional assistance.

37. The grants required to equalise the other LGBs total $66.9 million, but there is only $60.0 million available. Again, the issue is how to ration the available assistance amongst the eligible LGBs. There are two rationing options:

(i) ration the available grants according to grants required — the method used by most LGGCs; or

(ii) ration the available grants so that all the underequalised LGBs are underequalised to the same degree.

38. The first option is easy to implement. The numbers are unchanged from those shown in Table 13-5.

39. As discussed earlier, the second option requires an adjustment to be made to the grants required figures. The adjustment subtracts the shortfall in the grants ($6.9 million) from the underequalised LGBs. It is distributed in accordance with an underequalised LGB's share of their combined Overall Assessed Capacity.

40. Overall revenue capacity is calculated as:

$$\text{Overall Assessed Capacity}_i = \text{Grants required}_i + \text{Standardised revenue}_i + \text{SPPs received}_i$$

41. It is a slightly more difficult to calculate Overall Assessed Capacity in the Direct Assessment Model, because not all the variables are calculated in that model. Standardised revenue is not assessed but revenue needs are. Standardised revenue can be calculated by subtracting a LGB's revenue needs from its share of standard revenue. As defined earlier, a LGB's share of standard revenue is calculated as:

$$\text{LGB's share of standard revenue} = \frac{\text{Total Revenue}}{\text{Total Population}} * \text{LGB's Population}$$

$$\equiv \text{LGB's population share of total revenue}$$

42. Table 13-12 shows how the adjustment would be calculated in the Direct Assessment Model.

Table 13-12 CALCULATION OF ADJUSTMENT, DIRECT ASSESSMENT MODEL

		Local Governing Body										
Function		1	2	3	4	5	6	7	8	9	10	Total
Population		250	750	9000	18000	20000	37000	65000	80000	120000	150000	500000
Share of population	%	0.05	0.15	1.80	3.60	4.00	7.40	13.00	16.00	24.00	30.00	100.00
Share of standard revenue[(a)]	$m	0.1	0.3	3.8	7.6	8.4	15.5	27.3	33.6	50.4	63.0	210.0
Grants required	$m	0.6	0.6	7.1	8.3	14.5	1.3	5.5	29.0	-0.1	-6.8	60.0
Share of standard revenue	$m	0.1	0.3	3.8	7.6	8.4	15.5	27.3	33.6	50.4	63.0	210.0
Revenue needs	$m	0.0	0.1	1.4	1.8	1.8	2.6	4.0	0.5	-2.8	-9.5	0.0
SPPs received	$m	0.1	0.3	2.0	3.0	2.8	4.5	6.8	8.0	11.9	15.6	55.0
Overall assessed capacity[(b)]	**$m**	**0.8**	**1.0**	**11.5**	**17.0**	**23.9**	**18.8**	**35.6**	**70.1**	**65.0**	**81.3**	**325.0**
Percentage share[(c)]	%	0.43	0.58	6.46	9.52	13.36	10.50	19.93	39.22	0.00	0.00	100.00
Adjustment	$m	0.0	0.0	-0.4	-0.7	-0.9	-0.7	-1.4	-2.7	0.0	0.0	-6.9

(a) Calculated by applying a LGB's population share to the total revenue collected by all LGBs.

(b) Calculated as 'Grants Received' plus 'Share of Standardised Revenue' less 'Revenue Needs' plus 'SPPs Received'.

(c) For each underequalised LGB, this is calculated as its percentage share of the aggregate overall assessed capacity for all underequalised LGBs. For overequalised LGBs, the figure is set to zero.

43. The adjustment is identical to that calculated for option 2 under the Balanced Budget Model. Again reinforcing that the two models produce identical results if correctly specified.

44. Since both models produce identical results, it can be concluded that the second rationing option, though more complex, produces a 'fairer' outcome. It places those LGBs that receive Relative Needs assistance in the same position. They are all able to finance the same proportion of their standardised expenditures.

45. Because the numbers are identical, earlier tables are not replicated:

- the calculation of the Equalisation Ratios under each option are in Table 13-6 and Table 13-9; and
- the distribution of total Commonwealth assistance is in Table 13-10.

THE DIFFERENCE BETWEEN EQUALISATION AND RELATIVE NEEDS

46. In Volume 1 of this Report, the Commission concluded that Horizontal Equalisation is not a relevant or appropriate concept in the current local government funding context. It suggested that the concept of Horizontal Equalisation should be replaced by the related concept of relative needs. It proposed this change mainly to introduce new language — language that would present the Commonwealth's equity purpose as an attainable objective.

47. The example in this chapter shows one way of implementing the relative needs concept. It demonstrates that the change is indeed one of language. The main thrust of the change is to highlight that the available grants have to be rationed amongst the LGBs on the basis of need. Rationing inevitably leaves some LGBs underequalised and others overequalised.

48. Under this form of implementation, th e difference between equalisation and relative needs is in the grant distribution model used. Chapter 10 set out the equalisation models employed by the LGGCs. The aim of those models is to aggregate the expenditure and revenue assessments. The relative needs concept presented in this chapter adds to this a process for rationing the assistance when it is less than the amount required.

49. The relative needs concept can, on the other hand, be more than this. The example calculated category standards based on what LGBs do (internal standards). Under the relative needs concept, LGGCs are not limited to using internal standards. They could use external standards (for example LGB best practice standards or international best practice standards). The relative needs concept requires only that LGBs expenditures and revenues are compared against 'a standard', and that the assessment of disabilities is consistent with the standard used.

TECHNICAL APPENDIX

1. This appendix presents a simplified version of the LGGC's distribution models and highlights some useful relationships.

2. In this chapter, the Balanced Budget Model was set out as:

Grant required	*equals*	Standardised expenditure
	less	Standardised revenue capacity
	less	Actual receipt of SPPs
	plus	The standard budget result

3. It also set out the CGC's definition of standardised expenditure, standardised revenue and standardised SPPs as:

LGB's assessed standardised expenditure	*equals*	LGB's share of standard expenditure[8]
	plus	Expenditure needs
LGB's assessed standardised revenue	*equals*	LGB's share of standard revenue
	less	Revenue needs
LGB's actual receipt of SPPs	*equals*	LGB's share of standard SPPs
	less	SPP needs

4. The following notation is used[9].

s	=	subscript that denotes a standard
i	=	subscript that denotes an individual LGB
E_s	=	standard expenditure[10]
EN_i	=	expenditure needs
$(E_s + EN_i)$	=	standardised expenditure[11]

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8 CGC practice is to calculate standard expenditure (revenue or SPPs) in per capita terms, by dividing total expenditure (revenue or SPPs) by total population. However, this worked example is expressed in millions of dollars rather than in per capita terms. For each LGB, its share of standard expenditure (revenue or SPPs) is obtained by multiplying the per capita standard expenditure (revenue or SPPs) by its population. The result is identical to its population share of total expenditure (revenue or SPPs).

9 Unless otherwise stated, all figures are in per capita terms. This means we do not have to introduce a population variable.

10 This is the CGC's definition of a standard. It equals total financial transactions (expenditure, revenue or other grants) divided by total population.

R_S	=	standard revenue
RN_i	=	revenue needs
$(R_S - RN_i)$	=	standardised revenue [12]
O_S	=	standard Other Grants (SPPs)
ON_i	=	Other Grants (SPP) needs
$(O_S - ON_i)$	=	actual Other Grants (SPPs) received [13]
G_S	=	grants available
G_i	=	grants required
B_S	=	budget result

5. The budget result term (Bs) is not a term familiar to most LGGCs. In the CGC's model, the budget result term is equal to:

$$B_S = G_S + R_S + O_S - E_S \qquad \text{A-1}$$

6. If positive (negative) it implies a surplus (deficit) of revenue over expenditure. In a local government context, it would be the surplus (or deficit) for all of the LGBs as a whole. The budget result recognises that budgets are not in balance and that LGBs should be given the capacity to fund the average imbalance.

7. Under the Balanced Budget Model, grants required by an individual LGB is defined as:

$$G_i = (E_S + EN_i) + B_S - (R_S - RN_i) - (O_S - ON_i) \qquad \text{A-2}$$

Equalisation, Overequalisation and Underequalisation

8. If a LGB receives Relative Needs assistance equal to its assessed grants required, it is equalised. If it receives less than this level of assistance it is underequalised. If it receives no Relative Needs assistance because its combined own source revenue

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[11] A positive needs figure implies disadvantage. A positive expenditure needs figure means that the relevant LGB faces higher costs of service provision (other things equal, it costs more than the average to provide the service). Its standardised expenditure would therefore exceed its standard expenditure, thus expenditure needs are added to expenditure standards.

[12] A positive needs figure implies disadvantage. A positive revenue needs figure means that the relevant LGB has a low revenue capacity (other things equal, it would raise less than the average). Its standardised revenue would therefore fall short of its standard revenue, thus revenue needs are subtracted from revenue standards.

[13] A positive needs figure implies disadvantage. A positive SPP needs figure means that the relevant LGB receives a less than the average share of the SPP. Its standardised SPP (or actual SPP) falls short of the average level of SPP, thus SPP needs are subtracted from SPP standards. SPPs include Per Capita grants and Local Roads grants.

capacity, Per Capita grant, Local Roads Grant and SPPs are more than its expenditure requirements) it is overequalised. The nature of this distribution model is such that it produces an equalisation level of grants for a given level of:

- Relative Needs grants (G_s);
- own source revenue (R_s);
- SPP payments (O_s);
- own source expenditure (E_s);
- assessed expenditure needs (EN_i); and
- assessed revenue needs (RN_i).

9. Equation A-2 can be reorganised by moving all the revenue terms to the one side.

$$G_i + (R_s - RN_i) + (O_s - ON_i) = (E_s + EN_i) + B_S \qquad \text{A-3}$$

10. The revenue terms on the left hand side of this equation calculate an individual LGB's Overall Assessed Capacity. That is, its assessed capacity from all sources (Relative Needs grants, own source revenue, Per Capita grants, Local Roads grants and SPPs).

11. The terms on the right hand side of Equation A-3 calculate the LGB's Overall Expenditure Requirement. That is, what it would need to spend to provide the average level of services (standardised expenditure) and to finance the average budget imbalance (the budget result).

12. This equation can be used to determine whether a LGB is equalised, overequalised or underequalised:

- if its Overall Assessed Capacity equals its assessed Overall Expenditure Requirement, the LGB is equalised;
- if its Overall Assessed Capacity is greater than its assessed Overall Expenditure Requirement, the LGB is overequalised; and
- if its Overall Assessed Capacity is less than its assessed Overall Expenditure Requirement, the LGB is underequalised.

13. Overequalisation and underequalisat ion occur because the pattern of own source revenue capacity[14] (and possibly SPPs) is so uneven that some LGBs can more than finance their Overall Expenditure Requirement. In this sense, they are overequalised and do not require Relative Needs grants.

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[14] This can be occur if revenue capacity is not assessed correctly.

14. Collectively, all the other LGBs are underequalised and will remain so after the Relative Needs grants have been distributed.

Equalisation Ratio

15. Equation A-3 can be respecified to calculate an Equalisation Ratio.

$$\text{Equalisation Ratio}_i = \frac{\text{Overall Assessed Capacity}_i}{\text{Overall Expenditure Requirement}_i} = \frac{G_i + \left(R_s - RN_i\right) + \left(O_s - ON_i\right)}{\left(E_s + EN_i\right) + B_s}$$

or $$\text{Equalisation Ratio}_i = \frac{\text{Grants required}_i + \text{Standardised revenue}_i + \text{SPPs received}_i}{\text{Standardised expenditure}_i + \text{Budget result}_s} \qquad \text{A-4}$$

16. The Equation Ratio can also be used to determine whether a LGB is equalised, overequalised or underequalised:

- if the ratio equals one (that its overall capacity equals its assessed overall outlays) the LGB is equalised;
- if the ratio is greater than one, the LGB is overequalised; and
- if the ratio is less than one, the LGB is underequalised.

17. This ratio can be used to:

(i) determine whether a particular LGB is equalised, overequalised or underequalised; and

(ii) choose a method of rationing the available assistance so that all the underequalised LGBs are underequalised to the same degree. That is, after the grants are distributed, their Equalisation Ratios are the same.

Calculating Overall Revenue Capacity

18. In the chapter, the method of rationing was to distribute the shortfall in available assistance amongst the underequalised LGBs on the basis of their Overall Assessed Capacity. Equation A-4 set out that Overall Assessed Capacity can be assessed as:

$$\text{Overall Assessed Capacity} = G_i + \left(R_s - RN_i\right) + \left(O_s - ON_i\right)$$

19. These terms are readily a vailable under the Balanced Budget Model. Under that model, the Overall Assessed Capacity would be calculated as:

Overall Assessed Capacity	*equals*	Grants required (G_i)
	plus	Standardised revenue ($R_s - RN_i$)
	plus	Actual receipt of SPPs ($O_s - ON_i$)

20. It is a slightly more difficult to calculate Overall Assessed Capacity in the Direct Assessment Model, because not all the variables are calculated in that model. Standardised revenue is not assessed but revenue needs are. Standardised revenue can be calculated by subtracting a LGB's revenue needs from its share of standard revenue. As defined earlier, a LGB's share of standard revenue is calculated as:

$$\text{LGB's share of standard revenue} = \frac{\text{Total Revenue}}{\text{Total Population}} * \text{LGB's Population}$$

$$\equiv \text{LGB's population share of total revenue}$$

21. This calculation of standard revenue is not used in the production of the grants required figures. It is only used if an adjustment has to be made because some LGBs are overequalised, forcing others to be underequalised. An adjustment is required to the grants required figures of the underequalised LGBs — they are all reduced in a fashion that leaves all underequalised LGBs with the same Equalisation Ratio.

CHAPTER 14

LOCAL GOVERNMENT FINANCE

1. The terms of reference required the Commission to examine:

   (i) the impact of the Act on the raising of revenue by LGBs;

   (ii) the impact of the Act on the assistance provided by the States to LGBs; and

   (iii) the implications of any changes in the functions or responsibilities of LGBs.

2. In supporting the Commission's response to this part of the terms of reference, this chapter provides an overview of local government finances in Australia.

WHAT'S HAPPENED TO LOCAL GOVERNMENT?

3. The Commission has interpreted the terms of reference broadly — to refer to assistance provided under the series of Acts which cumulate in the *Local Government (Financial Assistance) Act 1995* — rather than a narrow reference to the 1995 Act alone.

4. This section provides analyses of local government revenue and expenditure for the period 1961–92 to 1997–98[1]. It has been complicated because Commonwealth assistance under this Act (and its predecessors) was provided to local government through the States and, as a result, the data series shows this assistance as State grants to local government. To date, it has been possible to accurately identify and reclassify these data as Commonwealth grants from 1974–75, but not for earlier years. The intention is to identify and reclassify data for earlier years for the final report. In order not to draw incorrect conclusions, some of the revenue analyses have had to be restricted to the period 1974–75 to 1997–98.

[1] The analysis is based on unpublished Government Finance Statistics (GFS) data for the general government sector compiled by the Australian Bureau of Statistics (ABS). Data for 1998–99 are not included in the analysis because they are prepared on an accrual basis and are not comparable with earlier years. The data have been converted to constant prices using an ABS Gross Domestic Product price deflator.

5. Two important aspects of the analysis are:

- whether there have been big changes in revenue and the expenditure patterns over this period; and
- whether the introduction of local government Financial Assistance Grants (FAGs) in 1974–75 or the introduction of the 1995 Act had any influence on these changes.

6. Chapter 15 provides State by State analysis. Because of the particular interest in the Commonwealth's financial assistance grants, 1974–75 has been used as a base point for many of the State comparisons.

7. As part of its consultation process, the Commission held meetings with representatives of local government in each State. A number of participants to those hearings said that:

- local government was more important today than it has ever been;
- local government is increasingly being 'drawn into' new areas of service provision, often without funding;
- Commonwealth and State assistance has not been sufficient to enable it to finance its expanding services; and
- local government has responded by increasing rates and user charges, contracting out for private works, greater efficiencies, cutting back on other services, spending less on roads and increasing borrowings.

8. This section provides support for some of these views.

Vertical Fiscal Imbalance

9. There are three levels of governments in Australia: Commonwealth; State; and local government. Each has its own revenue raising powers and expenditure responsibilities. Figure 14-1 shows the growth in real terms (in 1997–98 prices) in own-source revenue[2] and own-purpose outlays[3] of each level of government over the period 1961–62 to 1997–98. It confirms that:

- the Commonwealth has the largest own-source revenues and own-purpose outlays, and local government the smallest;
- the Commonwealth's own-source revenue exceeds its own-purpose outlays; and

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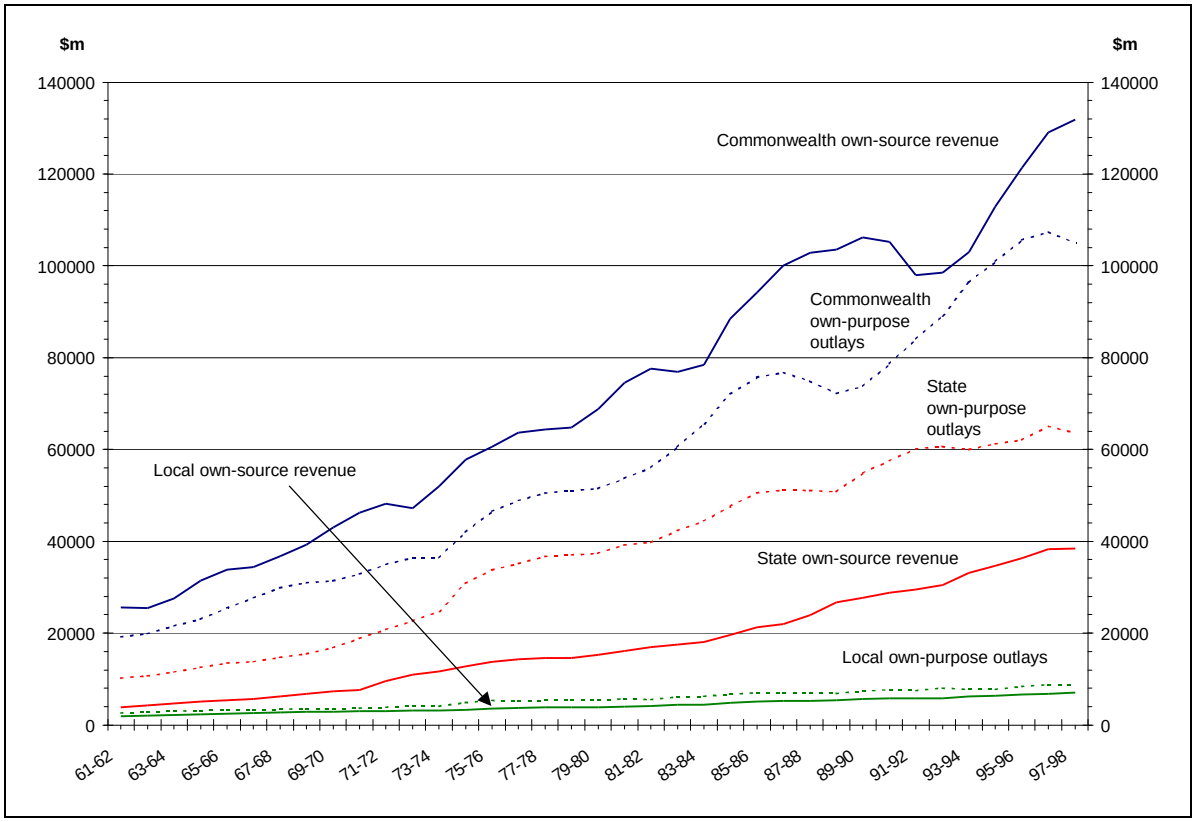
2 Own-source revenue excludes transfers from other levels of government.

3 Own-purpose outlays includes transfers to other levels of government.

- the State and local governments' own-purpose outlays exceed their own-source revenue.

10. The degree of imbalance between the revenue raising and expenditure responsibilities of different levels of government is known as Vertical Fiscal Imbalance (VFI). The existence of VFI means that some of the Commonwealth's revenue has to be distributed to State and local government if they are to have the capacity to provide the services they do[4]. Table 14-1 shows that between 1961–62 and 1997–98, the degree of VFI[5] declined — implying that States and local government are financing a greater proportion of their own-purpose outlays from their own revenue sources.

Figure 14-1 OWN-SOURCE REVENUE AND OWN-PURPOSE OUTLAYS AT 1997–98 PRICES



11. Table 14-1 also shows that while the three levels of government have expanded over the period 1961–62 to 1997–98, the pace of growth has been different for each. State own-purpose outlays have experienced average annual rates of growth of

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4 In 1998–99, the Commonwealth provided $16.8 billion of general revenue grants and $14.4 billion of specific purpose payments to the States. It provided $1.2 billion as financial assistance grants and $0.2 billion in specific purpose payments to local government.

5 The degree of VFI is calculated as a sphere's percentage of national own-source revenues divided by its percentage of national own-purpose outlays.

5.2 per cent and their own-source revenues has grown at 6.6 per cent[6]. Commonwealth own-purpose outlays have grown at an average annual rate of about 4.7 per cent, as has its own-source revenues. Local government own-purpose outlays and own-source revenues have both grown at about 3.5 per cent per annum.

12. These trends imply that, in relative terms, the size of the State sector has grown while the size of the local government sector has declined. The major determinant for the differing performance of the spheres over this period appears to be the growth in their own-source revenue. That is, the growth in own-purpose outlays appears to be limited by the growth in own-source revenue. Local government had the slowest growing revenues, so it had the slowest growing expenditures.

13. To overcome its VFI, local government receives transfers from both Commonwealth and the State. Grant transfers are another source of revenue for local government. It is possible that increased transfers (from the spheres that had the faster growing revenues) could partially offset the effect of its own slow growing revenues.

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[6] One reason for the increase in State revenue over this period was the transfer of Payroll Taxation from the Commonwealth to the States in 1970–71.

Table 14-1 OWN-SOURCE REVENUE AND OWN-PURPOSE OUTLAYS AT 1997–98 PRICES, AND THE DEGREE OF VERTICAL FISCAL IMBALANCE

	Commonwealth	State	Local
	$m	$m	$m
A. Own-source Revenue			
1961–62	25 542	3 876	1 924
1973–74	51 905	11 679	3 091
1974–75	57 788	12 802	3 325
1997–98	131 855	38 423	6 986
Average annual growth (%)			
1961–62 to 1973–74[(a)]	6.1	9.6	4.0
1974–75 to 1997–98[(b)]	3.7	4.9	3.3
1961–62 to 1997–98	4.7	6.6	3.7
B. Own-purpose Outlays			
1961–62	19 192	10 231	2 593
1973–74	36 405	24 762	4 094
1974–75	42 045	30 812	4 852
1997–98	104 952	63 543	8 781
Average annual growth (%)			
1961–62 to 1973–74[(a)]	5.5	7.6	3.9
1974–75 to 1997–98[(b)]	4.1	3.2	2.6
1961–62 to 1997–98	4.8	5.2	3.5
C. Degree of VFI (=A / B)			
1961–62	1.33	0.38	0.74
1973–74	1.43	0.47	0.76
1974–75	1.37	0.42	0.69
1997–98	1.26	0.60	0.80

(a) Before the introduction of financial assistance grants to local government.
(b) After the introduction of financial assistance grants to local government.

14. Figures 14-2 and 14-3 show each sphere's percentage share of the national own-source revenue and own-purpose outlays for 1961–62 to 1997–98. Both charts confirm:

- the increase in the relative size of the State sector; and
- the decrease in the relative size of the local government sector.

Figure 14-2 COMPOSITION OF GOVERNMENT OWN-SOURCE REVENUE

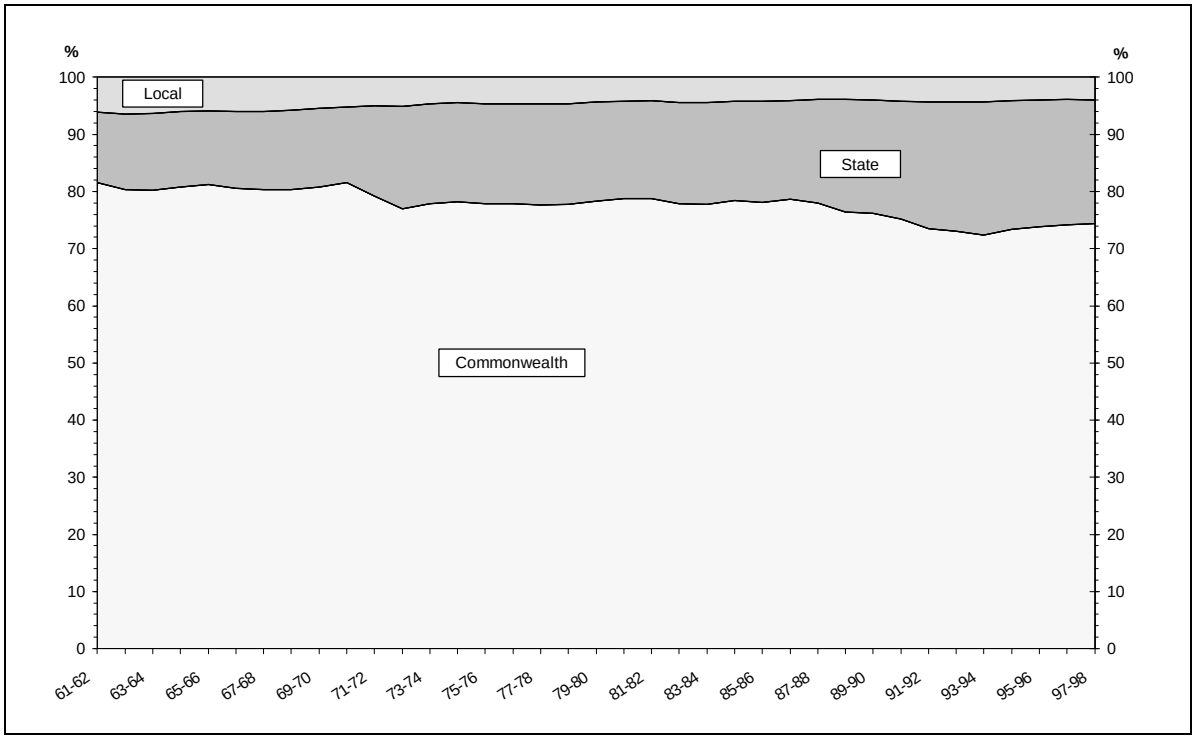
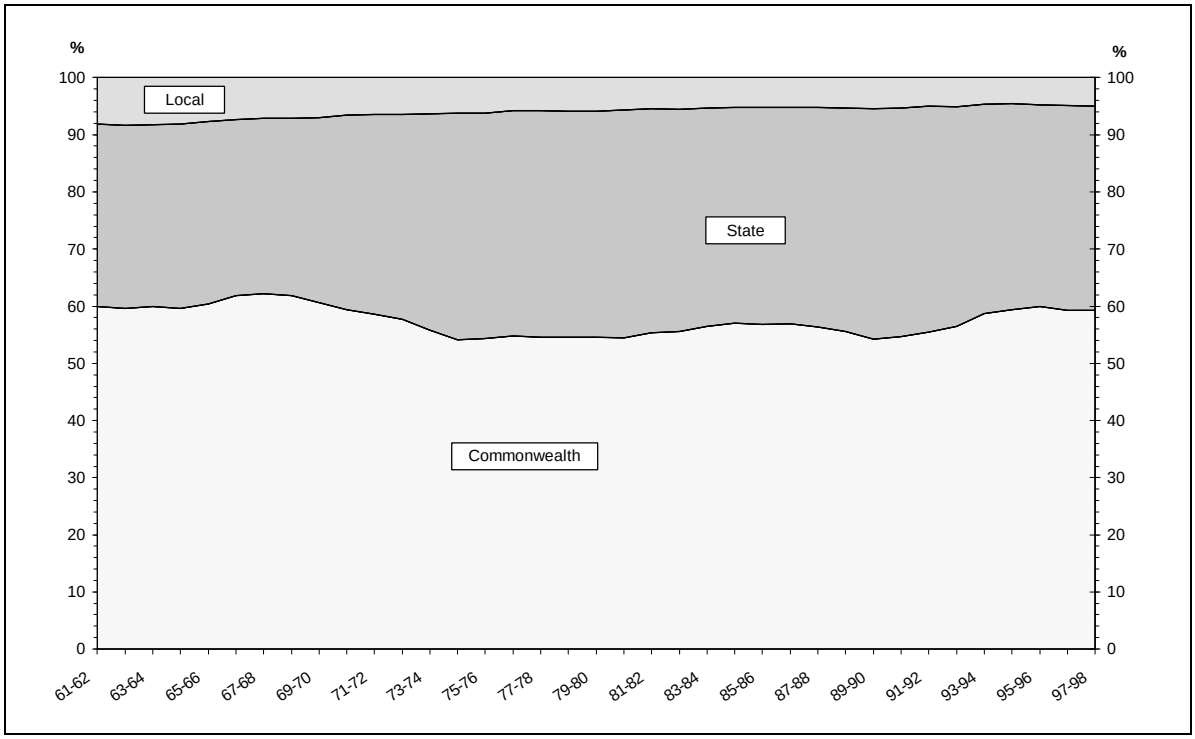


Figure 14-3 COMPOSITION OF GOVERNMENT OWN-PURPOSE OUTLAYS



Local Government Revenue

15. Figure 14-4 shows the contribution of the different revenues and transfers to total local government revenue. It shows that, over the period:

- own-source revenues[7] have become a slightly bigger proportion of total revenue;
- Commonwealth transfers have become a larger proportion;
- State transfers[8] are now a smaller proportion;
- Municipal rates are now a smaller proportion; and
- User charges have become a larger proportion.

16. Figure 14-4 confirms municipal rates to be a revenue source that has grown slowly. Local government's reliance on this revenue source has declined steadily over the period. Its share of total revenue has declined from 54 per cent to 47 per cent. Local government has increasingly turned to user charges as a means of financing its own-purpose outlays.

17. Total Commonwealth and State transfers to local government have not increased greatly in importance. They comprise a smaller proportion of total local government revenue (19 per cent) than they did at the start of the period (25 per cent). Although the amount of State assistance has increased in real terms since 1974–75, its rate of increase (0.4 per cent per annum) is about one-tenth of the rate of increase of local government own-source revenue (4 per cent per annum). Its overall importance has declined. This decline is almost exactly matched by the increase in importance of Commonwealth transfers.

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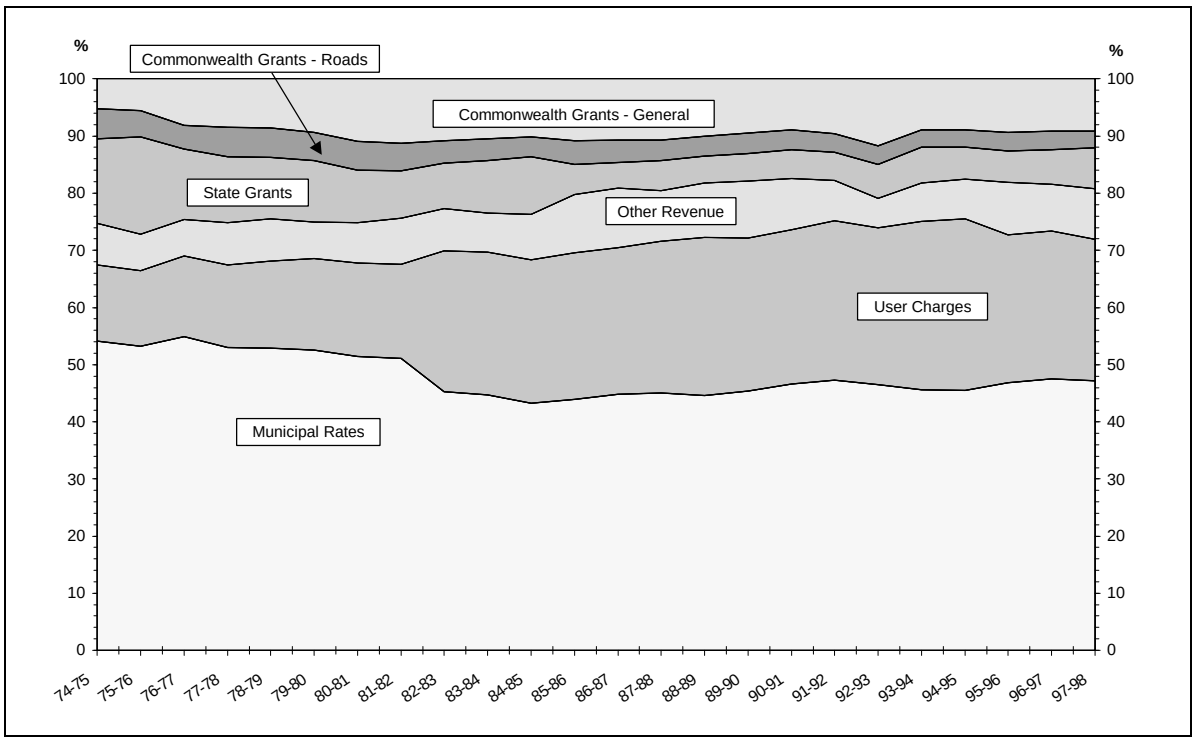
7 Total of municipal rates, user charges and other revenue.

8 Includes Commonwealth payments through the States to local government.

Figure 14-4 LOCAL GOVERNMENT REVENUE SOURCES, 1974–75 TO 1997–98



Notes: State Grants include all Commonwealth payments through the States to local government except for the local government General Purpose grants and Local Roads grants. Commonwealth Grants include local government financial assistance grants and specific purpose payments paid directly to local government.

Source: Unpublished ABS Government Finance Statistics data.

Table 14-2 LOCAL GOVERNMENT REVENUE SOURCES AT 1997–98 PRICES

		Own-source Revenue			Transfers		
Year		Municipal Rates	User Charges	Other Revenue	Common-wealth	State	Total Revenue
1974–75	($m)	2 842	703	381	550	779	5 256
1997–98	($m)	5 620	2 947	1 052	1 443	848	11 911
Share of total revenue							
1974–75	(%)	54.1	13.4	7.2	10.5	14.8	100.0
1997–98	(%)	47.2	24.7	8.8	12.1	7.1	100.0
Average Annual growth							
1974–75 to 1997–98	(%)	3.0	6.4	4.5	4.3	0.4	3.6

18. Local government's relative revenue raising effort has risen since the introduction of FAGs in 1974–75. Municipal rates remains the sector's primary revenue source but its slow rate of growth has been a major constraint on the sector's development. The rate of growth of municipal rates has slowed slightly since the introduction of FAGs.

User charges have become an increasingly important source of revenue and are the sector's growth revenue, this trend is unrelated to the introduction of FAGs. The slow growth in municipal rates since the introduction of FAGs has been offset by the fast growth in user charges.

19. The relative contribution of Commonwealth support has increased slightly (from more than 10 per cent in 1974–75 to 12 per cent in 1997–98). The introduction of FAGs in 1974–75 marked a major shift in Commonwealth support.

20. While State assistance to local government has increased in line with inflation, it has not grown as quickly as Commonwealth assistance to local government. This has led to a marked change in the pattern of local government funding since the introduction of FAGs. Since 1974–75, State assistance has grown at about one-tenth of the rate of local government own-source revenue. The contribution of State assistance to total local government revenue has declined in importance since 1974–75.

Local Government Expenditure

21. Figure 14-5 shows the pattern of local government expenditure since 1961–62. For ease of analysis, expenditure has been classified to seven categories. The figure shows that, over the period:

- the pattern of expenditure has changed markedly;
- the importance of Roads (Transport and Communications) has declined steadily;
- the importance of General Public Services has declined; and
- the importance of people services (Education, Health, Welfare and Public Safety and Recreation and Culture) has increased steadily.

22. This evidence supports the views that were put to the Commission during its consultation process. It does suggest that local government is increasingly being drawn into new areas of service provision. It also suggests that local government is funding these expanding areas by spending proportionally less on its traditional areas of service provision — roads.

23. Table 14-3 shows that while expenditure on roads has doubled over the last 37 years, expenditure on the people services has grown tenfold. The introduction of FAGs in 1974–75 has changed this trend only slightly.

Figure 14-5 LOCAL GOVERNMENT EXPENDITURE COMPOSITION

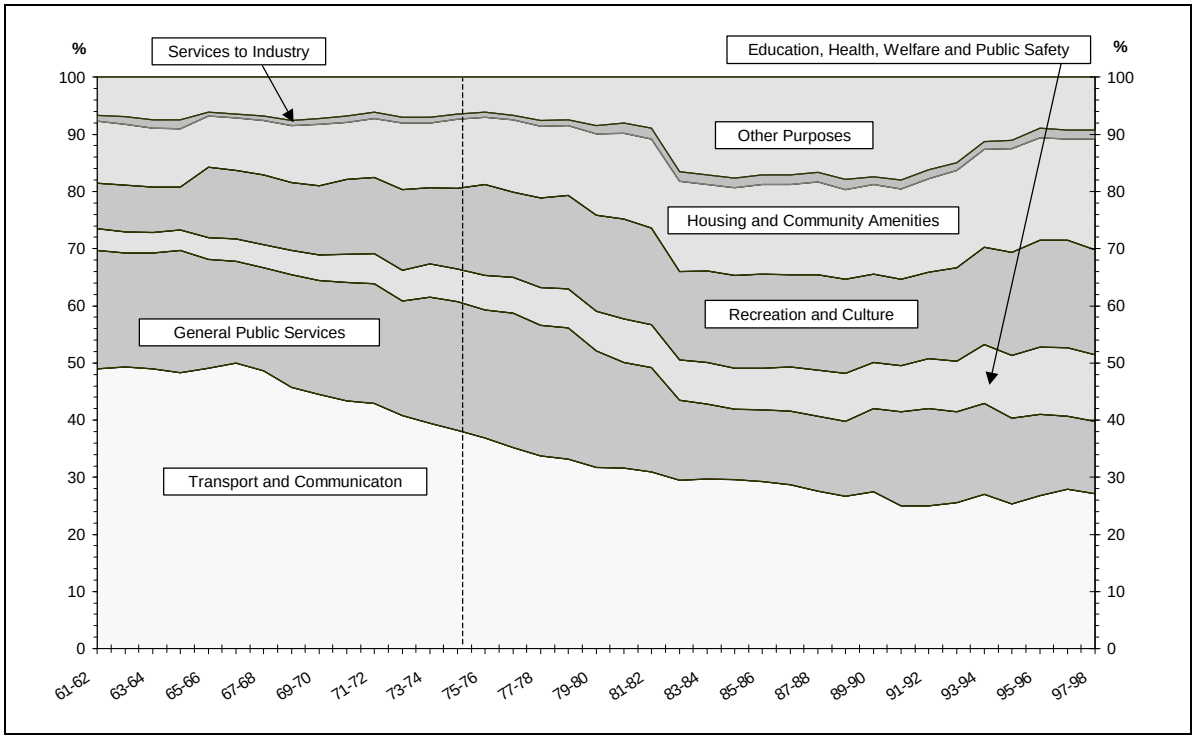


Table 14-3 LOCAL GOVERNMENT EXPENDITURE AT 1997–98 PRICES

Year	Transport	General Public Services	Education Health, Welfare and Public Safety	Recreation and Culture	Housing and Community Amenities	Services to Industry	Other Purpose	Total
	$m	$m	$m	$m	$m	$m	$m	$m
1961–62	1 534	651	120	248	341	30	210	3 133
1973–74	1 899	1 060	281	639	545	49	338	4 810
1974–75	2 132	1 258	318	790	673	52	358	5 582
1997–98	3 275	1 539	1 403	2 217	2 348	188	1 121	12 090
Share of total outlays (%)								
1961–62	48.9	20.8	3.8	7.9	10.9	1.0	6.7	100.0
1973–74	39.5	22.0	5.8	13.3	11.3	1.0	7.0	100.0
1974–75	38.2	22.5	5.7	14.2	12.1	0.9	6.4	100.0
1997–98	27.1	12.7	11.6	18.3	19.4	1.6	9.3	100.0
Average annual growth (%)								
1961–62 to 1973–74	1.8	4.2	7.4	8.2	4.0	4.2	4.1	3.6
1974–75 to 1997–98	1.9	0.9	6.7	4.6	5.6	5.8	5.1	3.4
1961–62 to 1997–98	2.1	2.4	7.1	6.3	5.5	5.2	4.8	3.8

24. Local government's pattern of expenditure has changed markedly over the period. The move away from property services into people services has continued since the introduction of FAGs in 1974–75.

25. Roads remain the sector's largest expenditure function but its level of importance has declined from about half of all expenditure in 1961–62 to a little more than a quarter of all expenditure in 1997–98.

26. Recreation and Culture, and Housing and Community Amenities are now very large areas of local government expenditure — each is a little less than 20 per cent of total expenditure.

27. Education, Health, Welfare and Public Safety has been the fastest growing area of local government expenditure. Since 1961–62, it has grown from about 4 per cent of all expenditure to about 12 per cent of all expenditure.

Conclusion

28. Local government has changed since the early 1960s. While it has expanded over that period, its rate of growth has been slower than that experienced by the Commonwealth and the States so that its relative size has declined.

29. Local government is increasingly being drawn into new areas of service provision. It has responded by increasing rates and user charges and spending proportionally less on roads. It has been constrained in what it can do because its primary revenue source (municipal rates) is a slow growth tax.

30. Local government revenue raising has decreased slightly over the period but it has remained unchanged since the introduction of FAGs in 1974–75.

31. The level of assistance from the Commonwealth and State has declined slightly over the period. The introduction of FAGs, signalled a passing of the baton and it is now the Commonwealth rather than the State which provides the greater share of transfers to local government.

CHAPTER 15

LOCAL GOVERNMENT FINANCE — STATE ANALYSES

1. This chapter examines local government finance by State for the period 1961–62 to 1997–98 to determine whether the national trends (discussed in Chapter 14) are evident at the State level.

2. Because of the difficulty of identifying and reclassifying Commonwealth assistance prior to 1974–75, some of the revenue analyses have been restricted to the period 1974–75 to 1997–98.

3. In this chapter, the analysis for each State focuses on three issues:

(i) the apparent impact of the introduction of Commonwealth financial assistance grants on local government own-source revenue;

(ii) the apparent impact of the introduction of Commonwealth financial assistance grants on State assistance to local government; and

(iii) changes in functions or responsibilities of local government implied by changes in the composition of expenditure since 1961–62.

4. To examine these issues, the composition of local government revenue and expenditure from 1961–62 to 1997–98 for each State has been plotted.

5. Before looking at the charts for each State, this chapter first examines the growth of total revenue and total expenditure by State.

GROWTH IN LOCAL GOVERNMENT REVENUE AND EXPENDITURE

6. All figures in this section show the movements in the Consumer Price Index for comparison purposes. To allow growth comparisons, each series[1] has also been rebased so that the value equals 100 in 1974–75, the year the Commonwealth started providing financial assistance grants to local government.

[1] Local government data for the Northern Territory is available only from 1978–79 — after it gained self-government.

7. Figure 15-1 shows the growth of total local government revenue by State. The chart shows that:

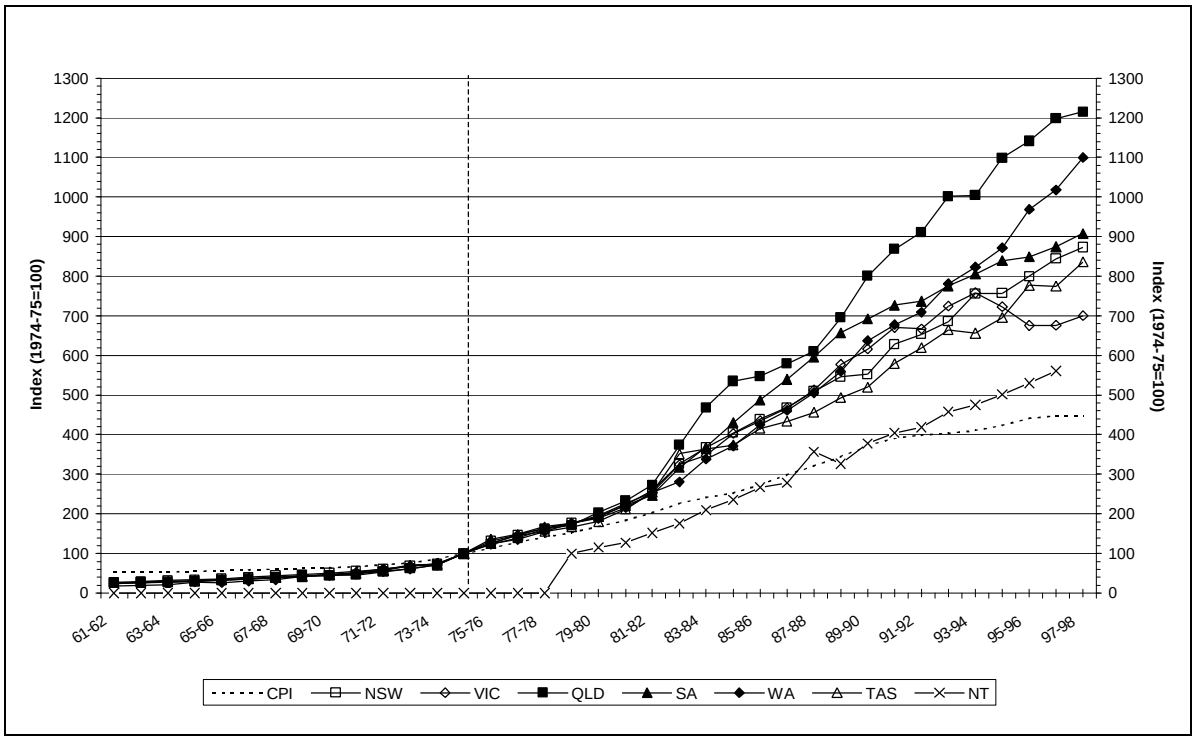
(i) over the period, total local government revenue has grown at a rate faster than CPI in all States;

(ii) there are different rates of growth of total revenue between the States, with Queensland growing the fastest followed by Western Australia — their higher growth rates may be influenced by population growth;

(iii) New South Wales, which has had rate pegging legislated by the State Government since the late 1970s, has still had several States below it in terms of rates of growth; and

(iv) Victoria — with a State government-mandated 20 per cent rate cuts in 1995–96 — had the second slowest rate of growth.

Figure 15-1 GROWTH IN TOTAL REVENUE BY STATE, 1961–62 TO 1997–98

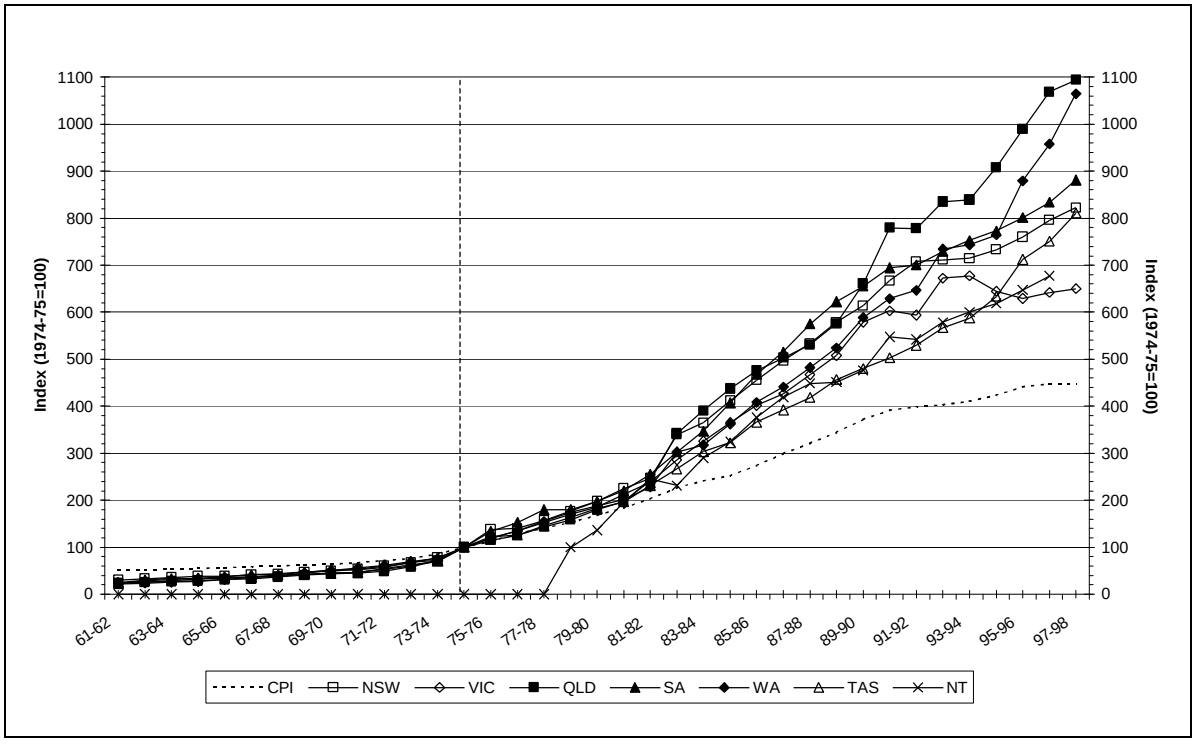


Notes: All series (except the NT series) have been rebased so that their value in 1974–75 equals 100. For the NT, the value in 1978–79 equals 100. Also for the NT, the 1997–98 figure is not included because the ABS includes the figures for all types of LGBs for the first time in that year. In other years, ABS uses only the figures for municipalities. CPI is the ABS Consumer Price Index: All Groups Index Numbers – Annual Indexes.

Source: Unpublished ABS Government Finance Statistics data.

8. Figure 15-2 plots the growth of total expenditure for local government by State. As expected, the results are similar to those for Figure 15-1.

Figure 15-2 GROWTH IN TOTAL EXPENDITURE BY STATE, 1961–62 TO 1997–98



Notes: All series (except the NT series) have been rebased so that their value in 1974–75 equals 100. For the NT, the value in 1978–79 equals 100. Also for the NT, the 1997–98 figure is not included because the ABS includes the figures for all types of LGBs for the first time in that year. In other years, ABS uses only the figures for municipalities. CPI is the ABS Consumer Price Index: All Groups Index Numbers – Annual Indexes.

Source: Unpublished ABS Government Finance Statistics data.

NEW SOUTH WALES

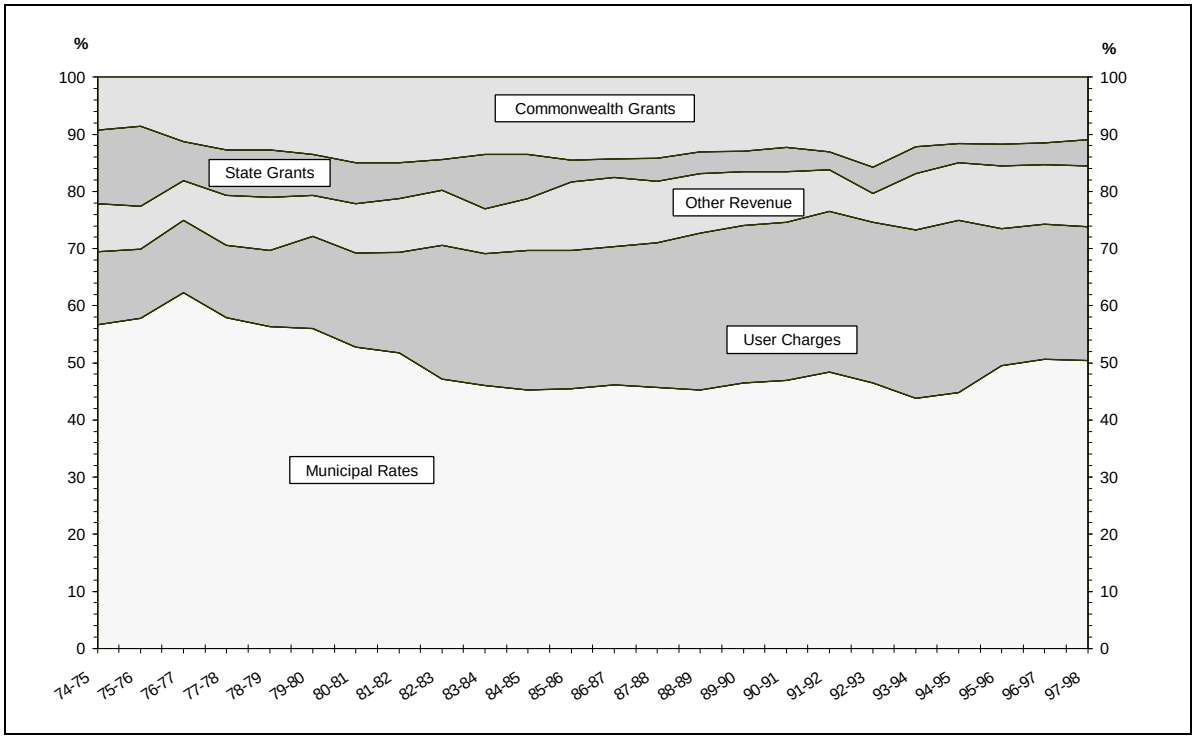
9. For local government in New South Wales:

(i) Figure 15-3 shows that, the share of revenue from own-sources appears to have increased after the introduction of the local government financial assistance grants;

(ii) Figure 15-3 shows the share of revenue from State assistance appears to have declined after the introduction of the local government financial assistance grants; and

(iii) Figure 15-4 shows the proportion of expenditure on Transport and Communication and General Public Services has declined but the proportion of expenditure has increased for all other expenditure categories.

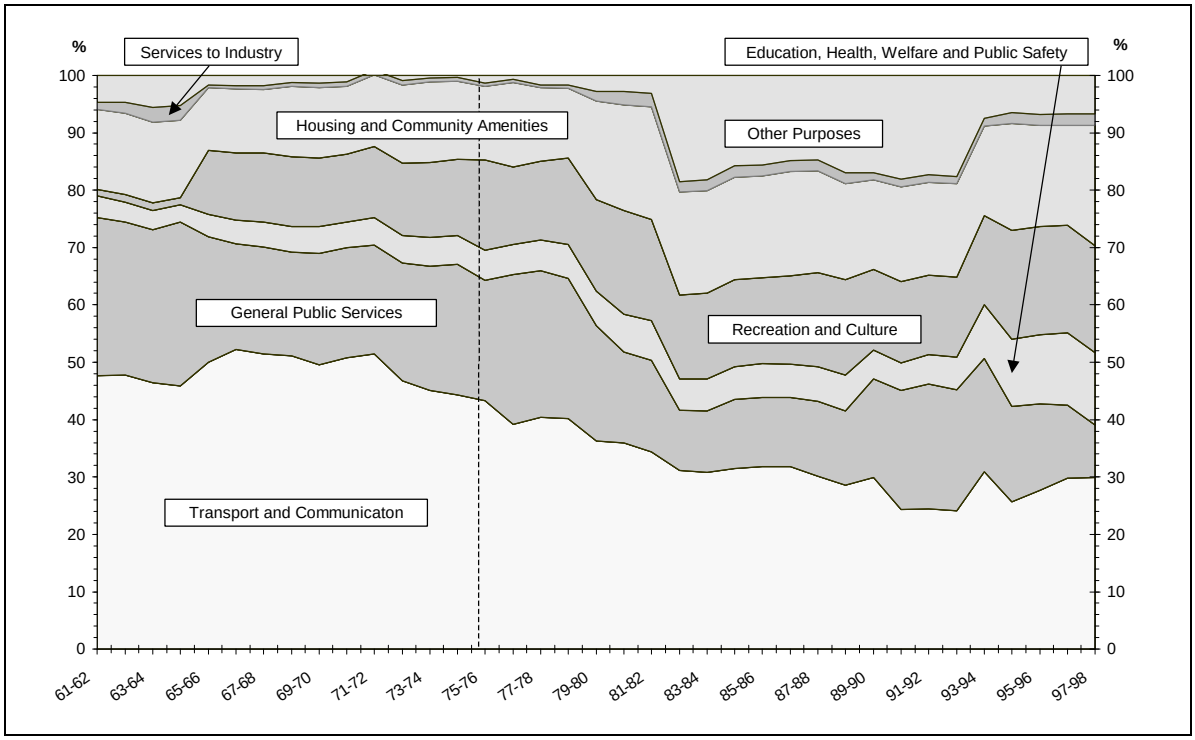
Figure 15-3 REVENUE, NEW SOUTH WALES, 1974–75 TO 1997–98



Notes: State Grants include all Commonwealth payments through the States to local government except for the local government General Purpose grants and Local Roads grants. Commonwealth Grants include local government financial assistance grants and specific purpose payments paid directly to local government.

Source: Unpublished ABS Government Finance Statistics data.

Figure 15-4 EXPENDITURE, NEW SOUTH WALES, 1961–62 TO 1997–98



Source: Unpublished ABS Government Finance Statistics

VICTORIA

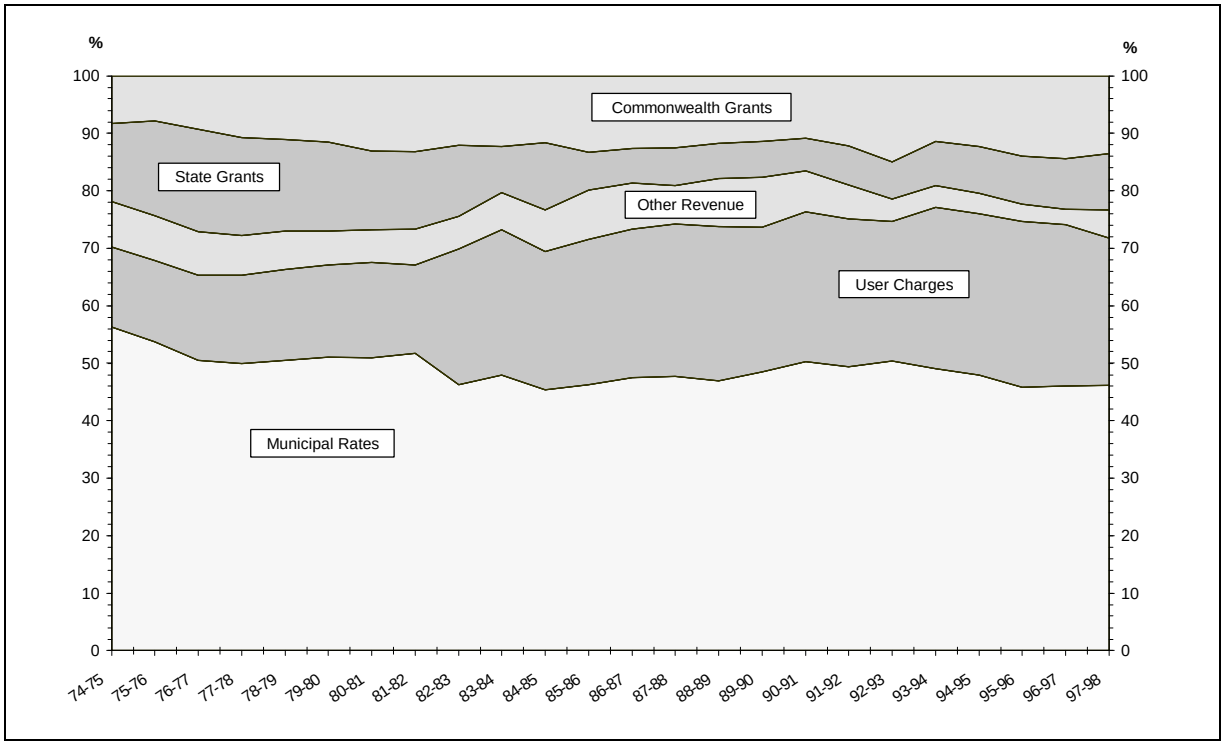
10. For local government in Victoria:

(i) Figure 15-5 shows the share of revenue from own-sources appears to have remained reasonably constant since the introduction of local government financial assistance grants;

(ii) Figure 15-5 shows State grants appear to have declined after the introduction of the Commonwealth assistance; and

(iii) Figure 15-6 shows relative expenditure on Transport and Communication, and General Public Services have declined, and all other functions have increased.

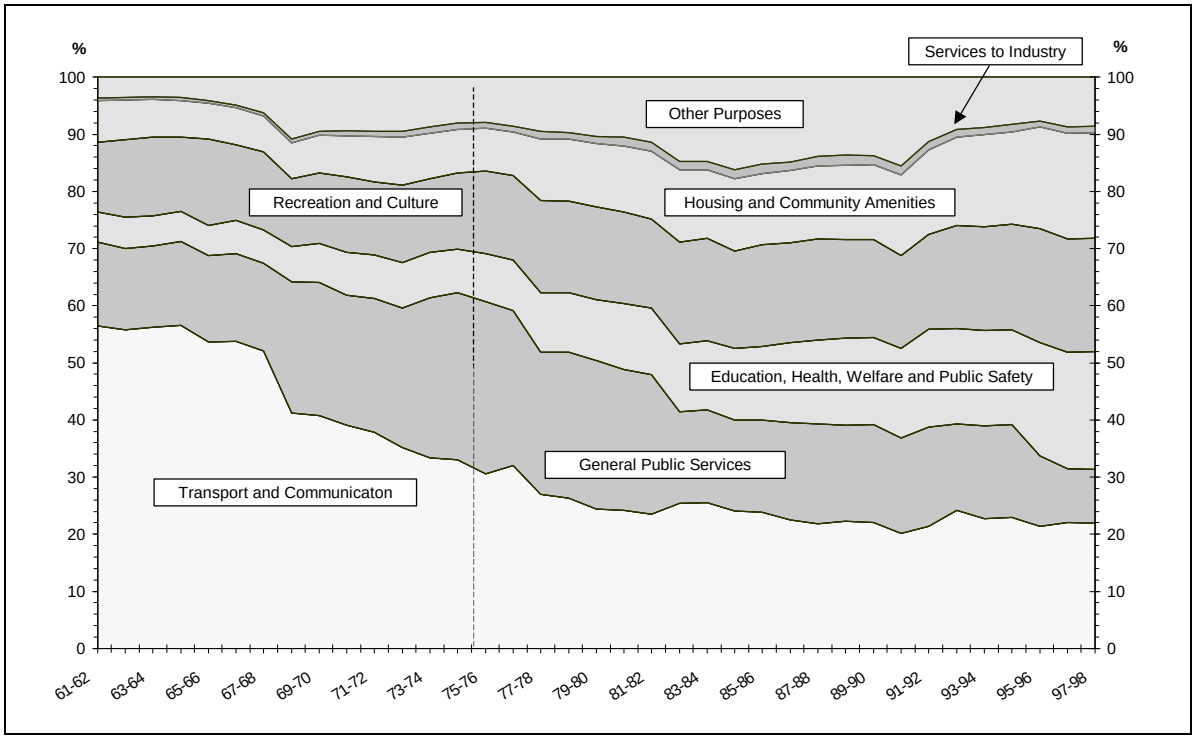
Figure 15-5 REVENUE, VICTORIA, 1974–75 TO 1997–98



Notes: State Grants include all Commonwealth payments through the States to local government except for the local government General Purpose grants and Local Roads grants. Commonwealth Grants include local government financial assistance grants and specific purpose payments paid directly to local government.

Source: Unpublished ABS Government Finance Statistics data.

Figure 15-6 EXPENDITURE, VICTORIA, 1961–62 TO 1997–98



Source: Unpublished ABS Government Finance Statistics

QUEENSLAND

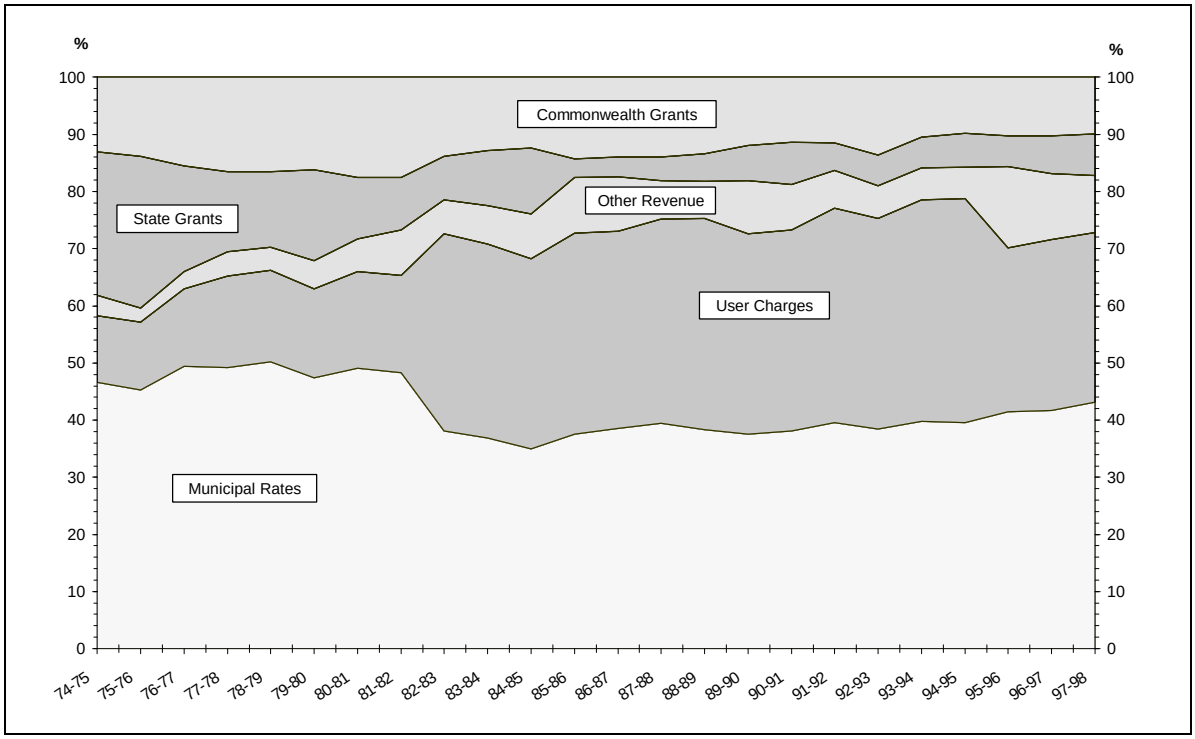
11. For local government in Queensland:

(i) Figure 15-7 shows the share of revenue from own-sources appears to have increased since the introduction of local government financial assistance grants;

(ii) Figure 15-7 shows the share of revenue from State assistance has declined after the introduction of the local government financial assistance grants; and

(iii) Figure 15-8 shows the proportion of expenditure on Transport and Communication and General Public Services declined but all others increased.

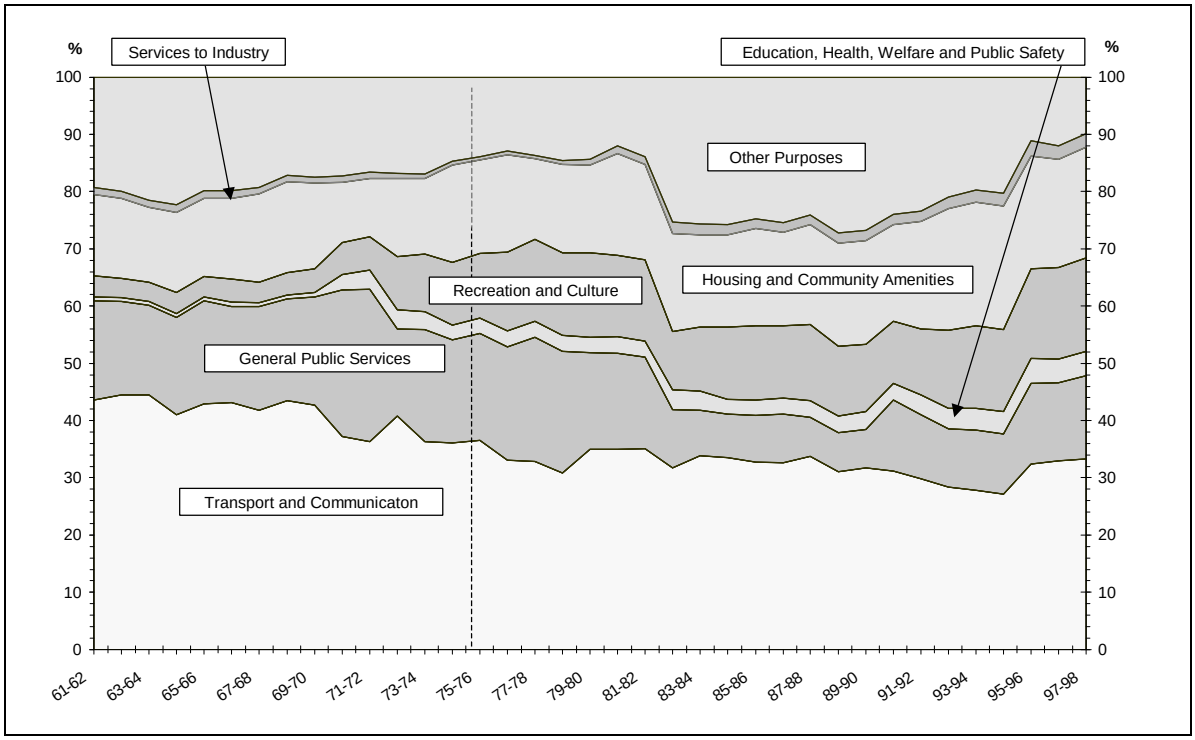
Figure 15-7 REVENUE, QUEENSLAND, 1974–75 TO 1997–98



Notes: State Grants include all Commonwealth payments through the States to local government except for the local government General Purpose grants and Local Roads grants. Commonwealth Grants include local government financial assistance grants and specific purpose payments paid directly to local government.

Source: Unpublished ABS Government Finance Statistics data.

Figure 15-8 EXPENDITURE, QUEENSLAND, 1961–62 TO 1997–98



Source: Unpublished ABS Government Finance Statistics

WESTERN AUSTRALIA

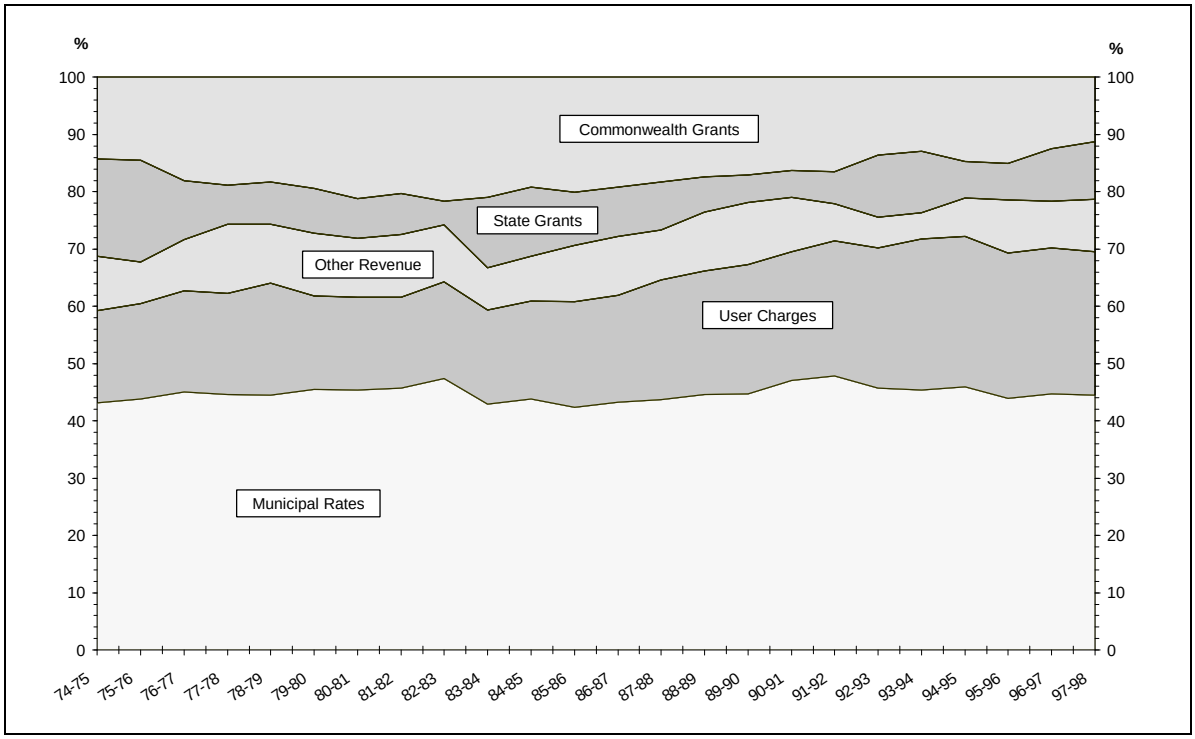
12. For local government in Western Australia:

(i) Figure 15-9 shows the share of revenue from own-sources appears to have increased since the introduction of local government financial assistance grants;

(ii) Figure 15-9 shows the share of revenue from State assistance has fluctuated after the introduction of the local government financial assistance grants but generally it has declined — for instance, it was around 17 per cent in 1974–75 but around 10 per cent in 1997–98; and

(iii) Figure 15-10 shows the proportion of expenditure on Transport and Communication, General Public Services, Recreation and Culture and Services to Industry has declined since 1961–62 but for all others it increased. Changes in the share of expenditure on Transport and Communication is different compared to other States — there was an initial increase up to the early 1970s then a gradual decline whereas in other States there was a decline over the whole period.

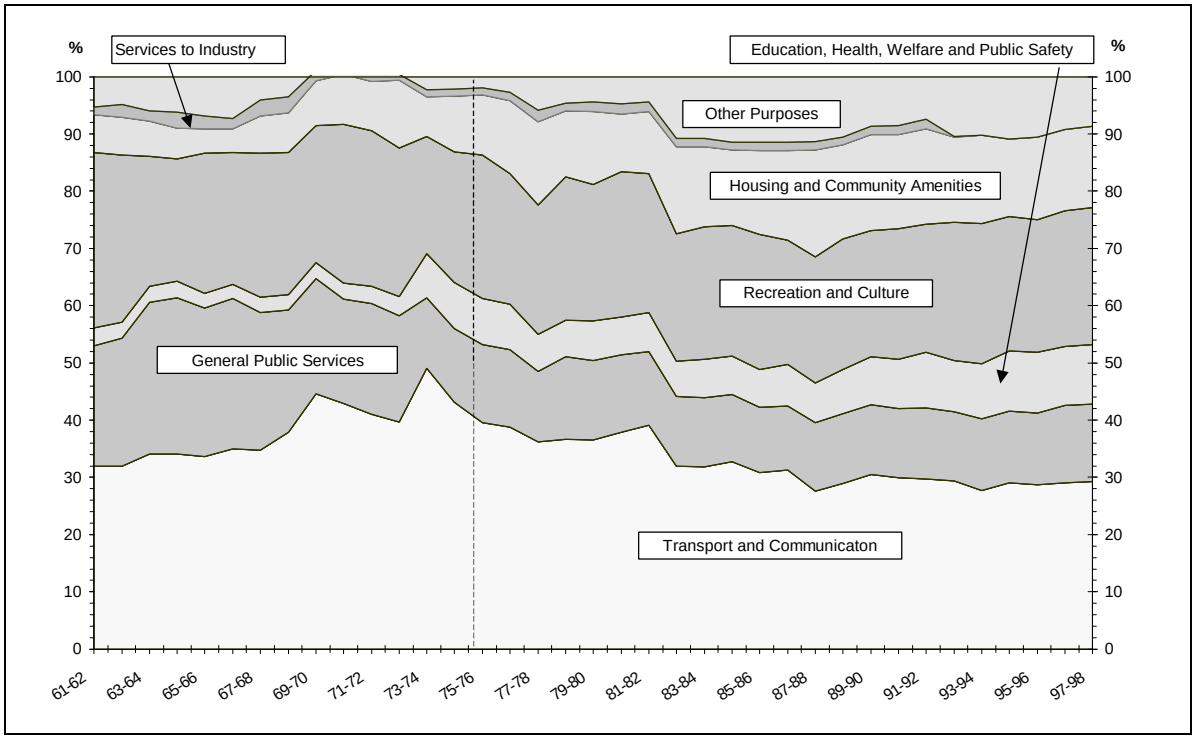
Figure 15-9 REVENUE, WESTERN AUSTRALIA, 1974–75 TO 1997–98



Notes: State Grants include all Commonwealth payments through the States to local government except for the local government General Purpose grants and Local Roads grants. Commonwealth Grants include local government financial assistance grants and specific purpose payments paid directly to local government.

Source: Unpublished ABS Government Finance Statistics data.

Figure 15-10 EXPENDITURE, WESTERN AUSTRALIA, 1961–62 TO 1997–98



Source: Unpublished ABS Government Finance Statistics

SOUTH AUSTRALIA

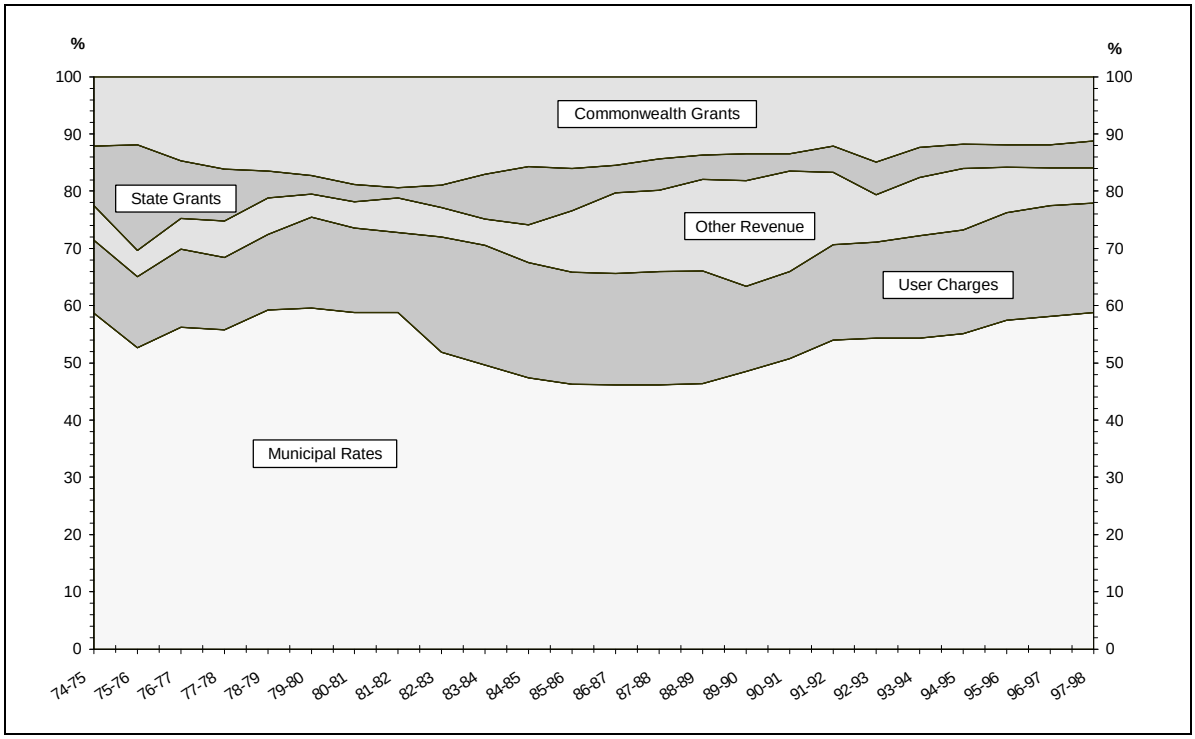
13. For local government in South Australia:

(i) Figure 15-11 shows the share of revenue from own-sources appears to have increased since the introduction of local government financial assistance grants;

(ii) Figure 15-11 shows the share of revenue from State assistance has fluctuated after the introduction of the local government financial assistance grants but generally it appears to have declined; and

(iii) Figure 15-12 shows the proportion of expenditure on Transport and Communication has declined since 1961–62 but for all others it increased.

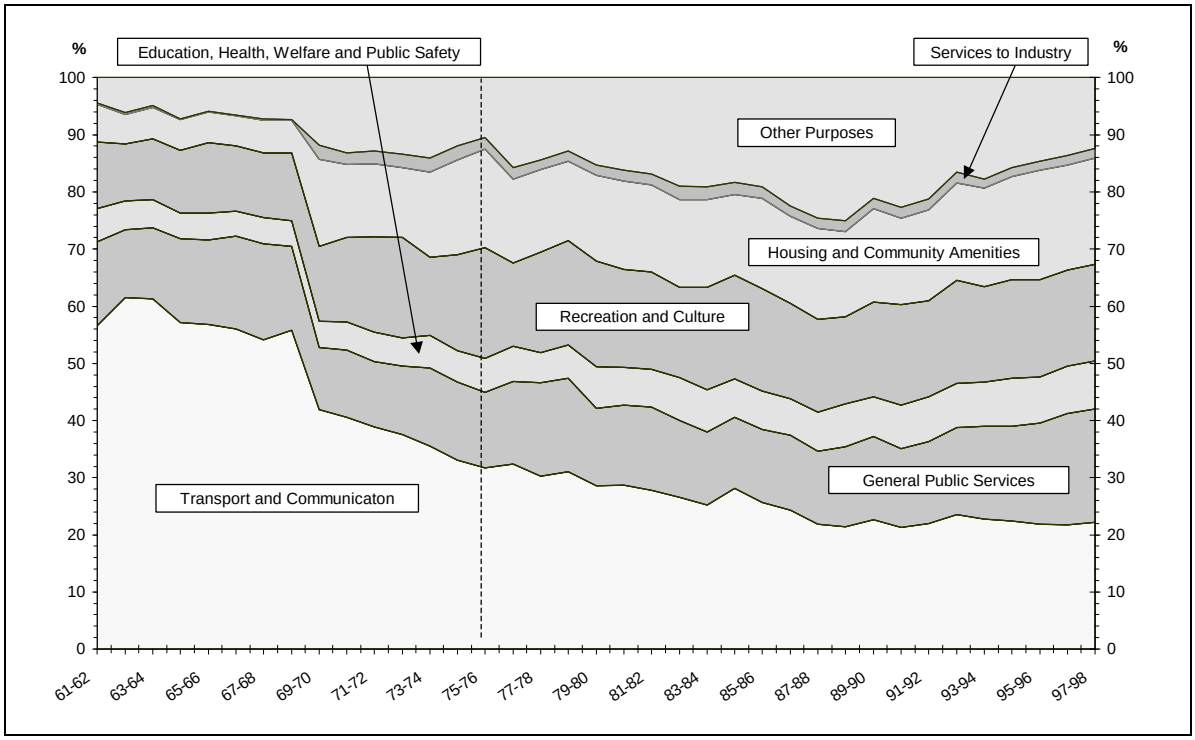
Figure 15-11 REVENUE, SOUTH AUSTRALIA, 1974–75 TO 1997–98



Notes: State Grants include all Commonwealth payments through the States to local government except for the local government General Purpose grants and Local Roads grants. Commonwealth Grants include local government financial assistance grants and specific purpose payments paid directly to local government.

Source: Unpublished ABS Government Finance Statistics data.

Figure 15-12 EXPENDITURE, SOUTH AUSTRALIA, 1961–62 TO 1997–98



Source: Unpublished ABS Government Finance Statistics

TASMANIA

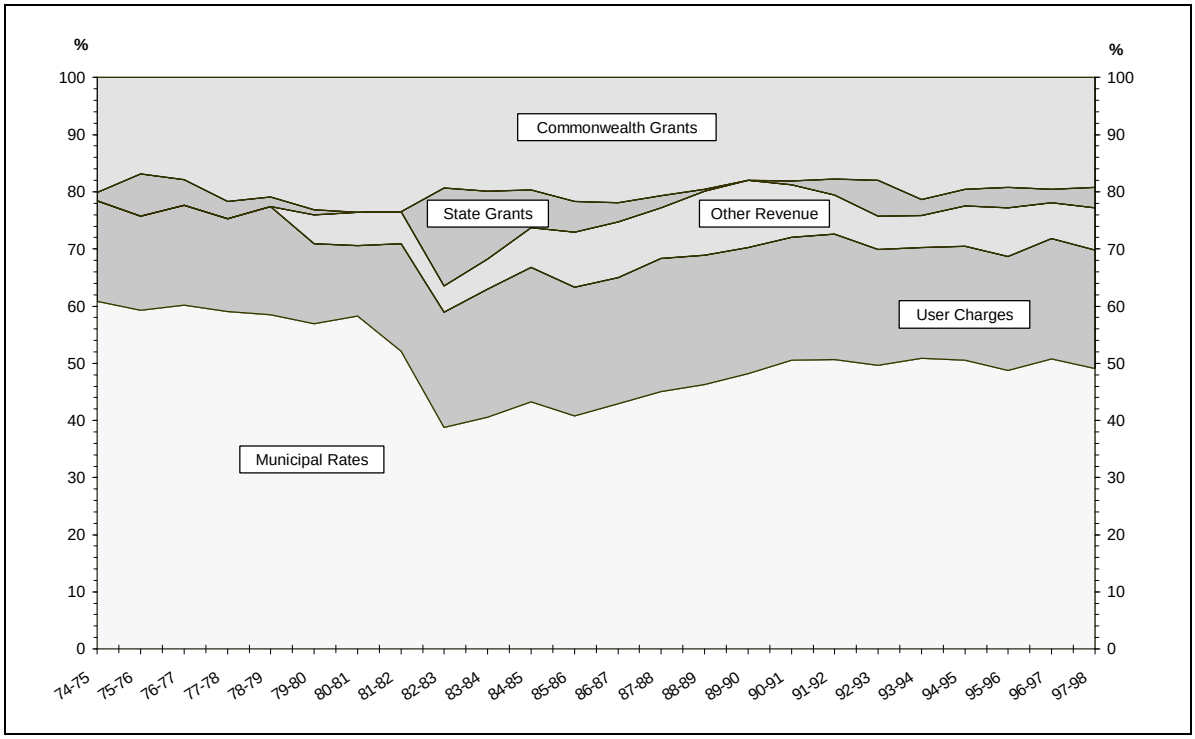
14. For local government in Tasmania:

(i) Figure 15-13 shows the share of revenue from own-sources appears to have remained constant since the introduction of local government financial assistance grants;

(ii) Figure 15-13 shows the share of revenue from State assistance has fluctuated after the introduction of the local government financial assistance grants but generally it appears to have increased; and

(iii) Figure 15-14 shows the proportion of expenditure on Transport and Communication and General Public Services has declined since 1961–62 but for all others it has increased.

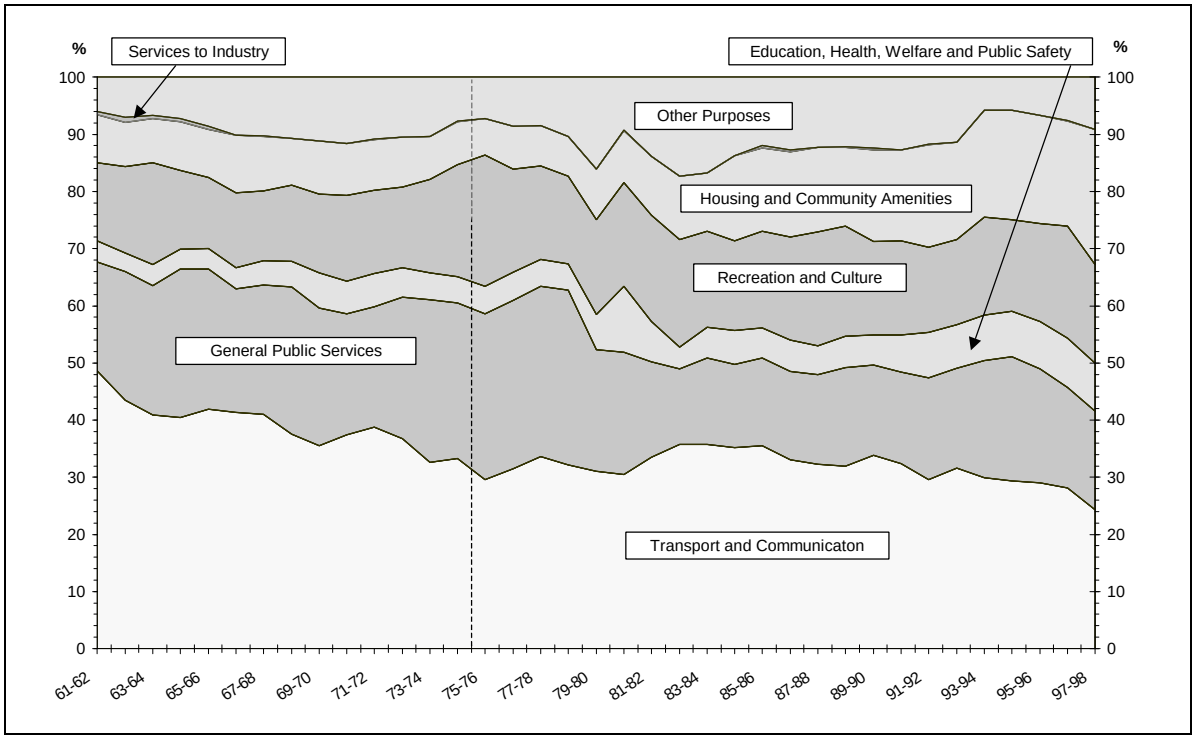
Figure 15-13 REVENUE, TASMANIA, 1974–75 TO 1997–98



Notes: State Grants include all Commonwealth payments through the States to local government except for the local government General Purpose grants and Local Roads grants. Commonwealth Grants include local government financial assistance grants and specific purpose payments paid directly to local government.

Source: Unpublished ABS Government Finance Statistics data.

Figure 15-14 EXPENDITURE, TASMANIA, 1961–62 TO 1997–98



Source: Unpublished ABS Government Finance Statistics

NORTHERN TERRITORY

15. Data for local government in the Northern Territory is only available from 1978–79. Data for 1997–98 is not included because for that year, the ABS data include Community Councils and Association Councils for the first time.

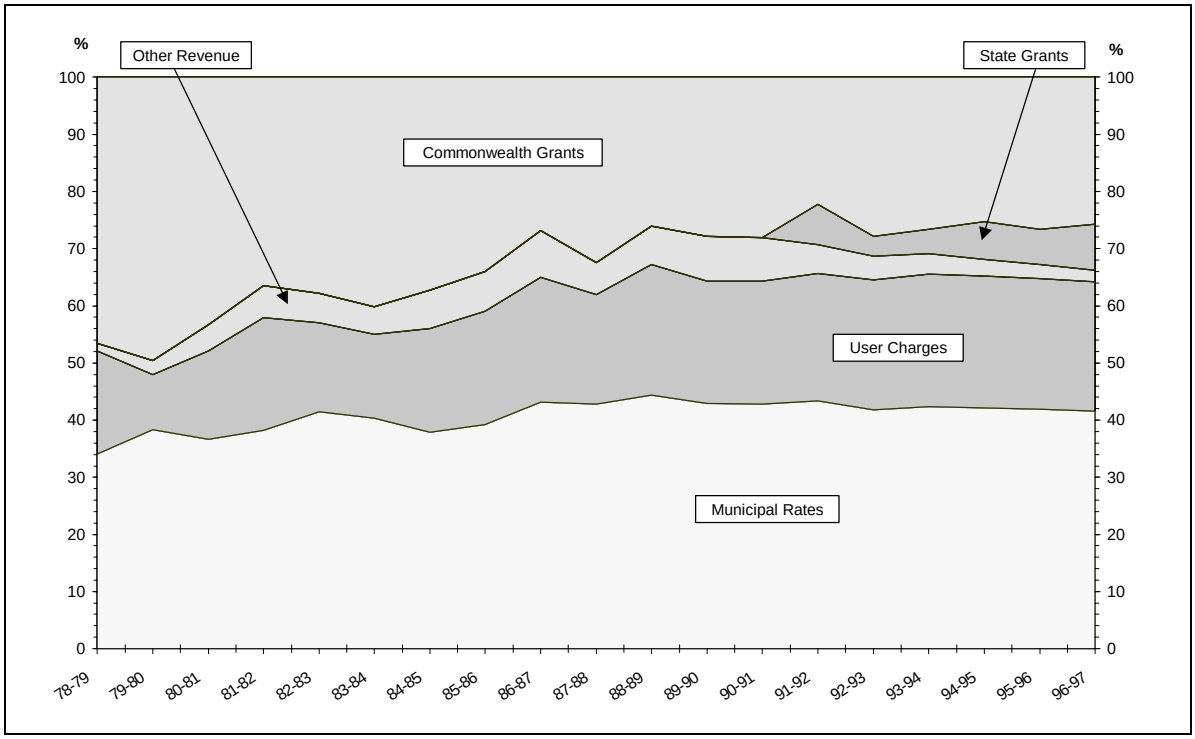
16. For local government in Northern Territory:

(i) Figure 15-15 shows the proportion of own-source revenue has increased over the period;

(ii) Figure 15-15 shows State assistance started in the early 1990s; and

(iii) Figure 15-16 shows the proportion of expenditure for the various components has been relatively constant since 1978–79. The proportion of expenditure on Transport and Communications has generally been less than 20 per cent — the lowest proportion of all the States.

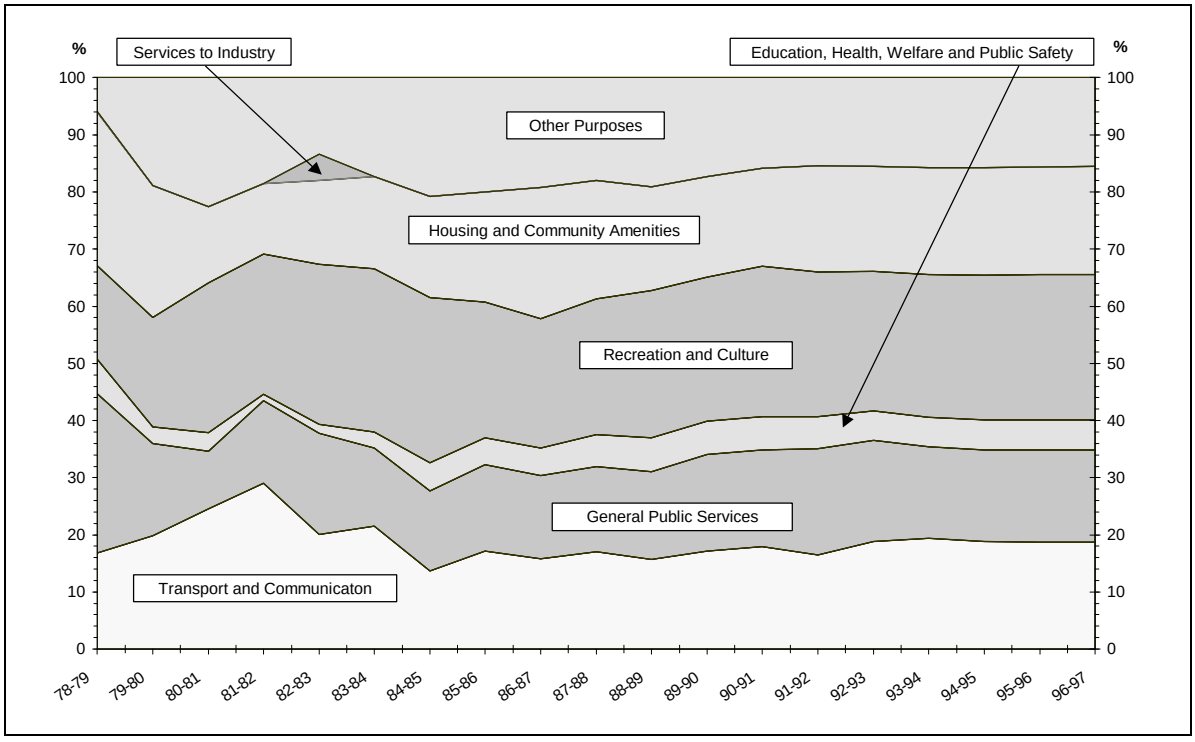
Figure 15-15 REVENUE, NORTHERN TERRITORY, 1978–79 TO 1996–97



Notes: State Grants include all Commonwealth payments through the States to local government except for the local government General Purpose grants and Local Roads grants. Commonwealth Grants include local government financial assistance grants and specific purpose payments paid directly to local government.

Source: Unpublished ABS Government Finance Statistics data.

Figure 15-16 EXPENDITURE, NORTHERN TERRITORY, 1978–79 TO 1996–97



Source: Unpublished ABS Government Finance Statistics