

**COMMONWEALTH
GRANTS COMMISSION**

DISCUSSION PAPER LG 2001/1

DRAFT REPORT

**OF THE REVIEW OF THE OPERATION OF THE
LOCAL GOVERNMENT (FINANCIAL ASSISTANCE) ACT
1995**

JANUARY 2001



As you know, the Commonwealth Grants Commission is undertaking a review of the operation of the *Local Government (Financial Assistance) Act 1995*. I enclose a copy of its draft report. The final report is to be presented to the Minister for Finance and Administration in late June 2001.

The draft report is part of the wider process of the review and is put forward for discussion. It presents work in progress and sets out the Commission's preliminary response to the terms of reference, and views on issues raised in submissions or in discussions with representatives of Commonwealth, State and local government authorities.

A volume of documents supporting the draft report will be available on the Commission's website, <http://www.cgc.gov.au> at the end of January 2001. It will cover the analysis supporting the Commission's positions, our understanding of the methods of the Local Government Grants Commissions (and the differences in those methods), and the time series analysis of local government finances.

We want to hear further from parties who can assist us progress the issues and finalise the review. There are two ways in which you can provide comment. You can provide written comments by 20 April 2001 or attend a conference at the Chifley Hotel, 102 Northbourne Avenue, Canberra, on 29-30 March 2001. The purpose of the conference is to discuss the draft report rather than receive new information on the methods of individual Local Government Grants Commissions or the circumstances of individual councils. The draft report itself will form the agenda.

We understand that not all participants will be able to attend the conference and, while representatives of individual councils will be welcome, we see it largely as an opportunity for State and Commonwealth agencies, and local government associations, to provide feedback. The Commission would welcome comment through written submission from all those who cannot attend.

It would assist our preparations for the Conference if you could advise us, by 28 February:

- (i) if you will be represented at the conference; and if so
- (ii) the names and positions of your representatives.

The Commission looks forward to receiving your comments on this document.

R J Searle
Secretary

23 January 2001

TERMS OF REFERENCE

MINISTER FOR FINANCE AND ADMINISTRATION

1 June 2000

Mr Alan Morris
Chairman
Commonwealth Grants Commission
Cypress Court
5 Torrens Street
CANBERRA ACT 2612

Dear Mr Morris

I refer to letter from Senator the Hon Ian Macdonald dated 30 May 2000 which I have received in relation to the proposed review of the *Local Government (Financial Assistance) Act 1995*.

Senator Macdonald has asked that I formally convey these terms of reference to you so as to facilitate the commencement of the review of the *Local Government (Financial Assistance) Act 1995*.

Yours sincerely

JOHN FAHEY

**TERMS OF REFERENCE FOR THE REVIEW OF THE
LOCAL GOVERNMENT (FINANCIAL ASSISTANCE) ACT 1995**

The review under Section 17 of the *Local Government (Financial Assistance) Act 1995* will examine and report on:

- a) the effectiveness of the current arrangements under the Act to achieve the purposes of the Act and the goals in providing the grants that are referred to in Section 3 of the Act;
- b) the appropriateness of the current National Principles and, in particular, the retention of or variations of the minimum grant for the general purpose component in Section 6 of the Act;
- c) the consistency with the National Principles of the methodology and policies used by each of the State and Territory Grants Commissions in distributing funds to councils;
- d) As required by Section 17 of the Act, the review shall also examine and report on:
 - (i) the effectiveness of the arrangements under this Act in relation to ensuring that the allocation of funds for local government purposes is made on a full horizontal equalisation basis as mentioned in paragraph 6(2)(a); and
 - (ii) the impact of the Act on the raising of revenue by local governing bodies and on the assistance provided by the States to local governing bodies; and
 - (iii) the implications of any changes in the functions or responsibilities of local governing bodies; and
 - (iv) the eligibility for assistance under this Act of bodies declared by the Minister under Section 4 to be local governing bodies.

The Review will not address the interstate distribution of the general purpose and local road grants or the quantum of funds available under the Act.

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ACQUITTAL AGAINST THE TERMS OF REFERENCE

This acquittal provides a consolidation of the Commission's response to the terms of reference. References are provided to the section in the report where the Commission has addressed specific matters raised by the terms of reference.

The effectiveness of the current arrangements under the Act to achieve the purposes of the Act and the goals in providing the grants (referred to in Section 3 of the Act).

- The current arrangements have achieved the Commonwealth's purposes and goals only to a limited extent.
- Some of the existing purposes and goals are not clear. The language of these purposes and goals needs to be improved if they are to be understood and more effectively achieved.
- Under the most natural interpretation of the financial capacity and certainty of funding purposes, they have been achieved (Chapter 3, paragraphs 8 to 13 and paragraphs 34 to 46).
- The Act defines equitable level of services purpose to mean horizontal equalisation. It has not been, and cannot be, achieved (Chapter 3, paragraphs 14 to 26).
- The efficiency and effectiveness purpose is not a relevant purpose for the Act and has not been achieved (Chapter 3, paragraphs 47 to 54).
- The Aboriginal and Torres Strait Islander Communities purpose is not a relevant purpose for the Act. The current arrangements have achieved this purpose only to a limited extent (Chapter 3, paragraphs 55 to 63).
- Improvements in the transparency of and accountability in the grant distribution process have been made, but further improvements are required (Chapter 3, paragraphs 64 to 67).
- Improvements in the consistency of the methods of LGGCs have been made, but further improvements are required (Chapter 3, paragraphs 68 to 74).

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

- The Horizontal Equalisation principle as defined by the Act cannot be achieved (Chapter 3, paragraphs 14 to 26). It should be replaced with the related concept of relative needs (Chapter 4, paragraphs 24 to 30).

- The Minimum Grant principle should be replaced by a Per Capita principle which would provide all Local Governing Bodies (LGBs) with a grant (Chapter 4, paragraphs 6 to 9). The level of the grant should be the level of the present minimum grant (Chapter 3, paragraphs 27 to 33).
- The Effort Neutrality, Other Grant Support and Identified Road Component are appropriate principles and should be retained but their language should be simplified to make them easier to understand for LGBs (Chapter 3, paragraphs 14 to 26).
- The Aboriginal peoples and Torres Strait Islander principle has not been consistently addressed by Local Government Grants Commissions (LGGCs) and is not required in a framework of principles directed towards distributing untied grants on a needs basis (Chapter 3, paragraphs 55 to 63).

The consistency with the National Principles of the methods and policies used by each of the State Grants Commissions in distributing funds to councils.

- Given that Horizontal Equalisation as defined by the Act cannot be implemented in the local government context, LGGCs methods cannot be consistent with Horizontal Equalisation. All LGGCs attempt to implement a form of needs-based distribution (Chapter 3, paragraphs 14 to 26).
- LGGC methods are consistent with the Minimum Grant and Effort Neutrality principles (Chapter 3, paragraphs 68 to 74).
- Some methods of some of the LGGCs are not consistent with the Other Grant Support principle (Chapter 3, paragraphs 68 to 74).
- The Aboriginal and Torres Strait Islander Communities principle has been addressed in different ways by LGGCs and some methods are not consistent with the principle (Chapter 3, paragraphs 55 to 63).
- Some methods of some of the LGGCs are not consistent with the Identified Road Component principle (Chapter 3, paragraphs 75 to 84).

The effectiveness of the arrangements under this Act in relation to ensuring that the allocation of funds for local government purposes is made on a full horizontal equalisation basis as mentioned in paragraph 6(2)(a).

- Horizontal Equalisation has not been and cannot be achieved in the local government context (Chapter 3, paragraphs 14 to 26).

The impact of the Act on the raising of revenue by local governing bodies and on the assistance provided by the States to local governing bodies.

- The Act appears to have had little impact on overall local government revenue raising effort. User charges have become an increasingly important source revenue and property taxes have fallen in relative importance (Chapter 5, paragraphs 18 to 22).
- State assistance, while continuing to increase in real terms, has declined in importance and been replaced by Commonwealth assistance (Chapter 5, paragraphs 23 to 25).

The implications of any changes in the functions or responsibilities of local governing bodies.

- The types of services being provided by local government have changed markedly (Chapter 5, paragraphs 26 to 31).
- Local government is increasingly providing human services (social welfare type services) at the expense of its traditional property-based services (particularly roads) (Chapter 5, paragraphs 26 to 31).
- Some changes are the result of the changing priorities of local government, others are imposed on them by other spheres of government. The former should be funded from local government's own sources. In the latter case, the other sphere of government should give some consideration to providing local government with additional revenue capacity (either in the form of grants or additional tax powers) (Chapter 5, paragraphs 32 to 38).

The eligibility for assistance under this Act of bodies declared by the Minister under Section 4 to be local governing bodies.

- The existing criteria are sufficiently flexible to allow any organisation that provides local government type services to be declared (Chapter 5, paragraphs 7 to 13).
- The existing arrangements should be altered to allow either the Commonwealth or State Minister to initiate a request for declaration, but both should have to agree to the declaration (Chapter 5, paragraphs 7 to 13).
- The Commonwealth and State Ministers should have the power to revoke an existing declaration provide both agree (Chapter 5, paragraphs 7 to 13).

CHAPTER 1

REVIEW OF THE LOCAL GOVERNMENT (FINANCIAL ASSISTANCE) ACT 1995

1. On 1 June 2000, the Chairman of the Commonwealth Grants Commission received terms of reference from the Minister for Finance and Administration asking the Commission to review the operation of the *Local Government (Financial Assistance) Act 1995* (the Act). This was in response to a request from the Commonwealth Minister for Regional Services, Territories and Local Government. A copy of the terms of reference is at the front of this report.

2. Under the Act, the Commonwealth provides financial assistance grants through the States¹ to local governing bodies (LGBs)². The Act sets out the Commonwealth's purposes and goals in providing this assistance. It makes clear that this assistance is to be provided in two parts — a General Purpose grant and a Local Roads grant — both of which can be spent as the LGBs choose. The General Purpose grants are to be distributed between States on an equal per capita basis and the Local Roads grants on an historical basis³. The Act states that the intrastate distribution of these grants is to be determined by the Local Government Grants Commission (LGGC) in each State.

3. In making recommendations on the distribution of the General Purpose and Local Roads grants to LGBs within their State, the LGGCs are guided by a set of National Principles, a copy of which are at Attachment A.

4. The National Principles are guidelines to assist the LGGCs implement the Commonwealth's purposes. They were developed after extensive consultation with State Ministers and officials and representatives of Local Government Associations. They were agreed to at the April 1995 Local Government Ministers' Conference, came into effect in October 1995 and were designed to establish a more nationally consistent approach to distributing Commonwealth assistance amongst LGBs.

¹ References to 'States' include the Northern Territory unless otherwise stated. Although the ACT receives a share of assistance under the Act, it has no separate Local Government sector.

² 'Local governing bodies' is the term used in the Act to define those bodies eligible for financial assistance grants. It includes mainstream councils as well as other bodies established under or by State legislation, and bodies declared to be local governing bodies by the Commonwealth Minister on the advice of the State Minister.

³ The States' fixed shares of the road grant were inherited from the previous (tied) program and the basis for the distribution is now not known. The grants under the *Roads to Recovery Act 2000*, announced in November 2000, are not to be distributed under this Act and this Review has not included any analysis of that process.

5. This chapter presents:
 - (i) the requirements of the terms of reference;
 - (ii) a brief explanation of how the review has been conducted; and
 - (iii) an outline of the structure of the report.

WHAT THE COMMISSION WAS ASKED TO DO

6. The terms of reference specified the issues the Commission was to examine, and those that it was not to examine. In general terms, they asked the Commission to consider:

- (i) whether the current arrangements achieve the Commonwealth's purposes and goals as set out in the Act;
- (ii) the appropriateness of the National Principles;
- (iii) whether the methods and policies of the LGGCs are consistent with the National Principles; and
- (iv) a range of other issues specified in Section 17 of the Act, dealing with:
 - eligibility for assistance;
 - changes in the functions or responsibilities of local government; and
 - the impact of the Act on local government revenue raising and State assistance to local government.

7. The terms of reference expressly precluded us from examining:
 - (i) the quantum of funds the Commonwealth makes available for local government; and
 - (ii) the interstate distribution of those funds.

8. Many participants said that the two excluded issues were the most important aspects of local government funding and expressed disappointment that they would not be addressed in the Review.

9. In this respect, some said the financial assistance grants had not kept pace with the growth in Commonwealth taxation revenue, and that this had made it difficult for local government to fund its services and maintain its infrastructure. Others pointed out that the funding fell well short of what would be required to fully equalise all LGBs.

10. Many claimed that distributing the General Purpose grants between States on an equal per capita basis was inconsistent with a requirement that LGGCs distribute the grants between LGBs on a horizontal equalisation basis. They pointed out that LGBs in different States were being equalised to different standards. Some particularly questioned the appropriateness of the interstate distribution of the Local Roads grants when the basis for the existing distribution is not known⁴.

HOW THE COMMISSION CONDUCTED THE REVIEW

11. We are conducting the Review in two parts. In the first phase, we sought the views of all parties with an interest in the Review. We did this by:

- (i) issuing a Discussion Paper encouraging interested parties to provide written submissions; and then
- (ii) holding meetings with Commonwealth and State agencies, Local Government Associations, LGBs and others with an interest in the Review, to discuss their views.

12. We have received more than 150 written submissions⁵ and held conferences in each State capital and 9 regional centres across Australia. We have met with relevant Commonwealth and State agencies, including the National Office of Local Government and each of the LGGCs. About 45 per cent of all LGBs have contributed to the Review, by making a submission or by meeting with us, or both.

13. Commission staff visited each LGGC to collect information and discuss the methods used to distribute funds.

14. This draft report brings the first phase of the Review to an end and sets out our preliminary thoughts on the issues. A second more technical volume of the draft report is being prepared and will present some of the analysis we have undertaken as part of the Review. It will be available on the Commission's web site (www.cgc.gov.au) at the end of January 2001.

15. The second phase of the Review has now commenced. During this phase, we are seeking reactions to our draft report. We encourage parties that wish to comment to:

- (i) participate in a two day conference in Canberra on 29–30 March 2001; and/or

⁴ On 30 November 2000, the Deputy Prime Minister and Minister for Transport and Regional Services, commented on the interstate distribution of the local roads grants in the Second Reading Speech for the *Roads to Recovery Bill* in the House of Representatives. He said: 'In the Roads to Recovery Program the government has recognised that the historical methodology for allocating funding between states and territories contains inherent anomalies. Therefore we have rectified this by establishing a fairer allocation based on historical precedents, length of local roads and population.'

⁵ A list of the LGBs that made a submission or met with us is reproduced in Volume 2 of this report.

(ii) provide comments in written submissions by 20 April 2001.

16. We will then finalise our report and provide it to the Minister for Finance and Administration by 22 June 2001.

STRUCTURE OF THE REPORT

17. The remaining chapters of the Report are as follows.

- Chapter 2 provides background information on the Local Government sector in Australia.
- Chapter 3 considers the current grant arrangements and provides the Commission's preliminary views on whether they have achieved the Commonwealth's objectives.
- Chapter 4 sets out the Commission's preliminary thoughts on what changes might be considered to better achieve the Commonwealth's objectives.
- Chapter 5 considers other issues such as the roles and responsibilities of the Commonwealth, the States and LGGCs; eligibility of LGBs; and funding arrangements.

ACKNOWLEDGMENT

18. We acknowledge the assistance provided by Commonwealth, State and Local Government agencies.

19. We also acknowledge the ready participation, openness and hospitality of the LGBs and individuals we have met during our consultations. While their contributions may not always be readily visible in the draft report, they have been invaluable in helping us understand and consider the issues.

CHAPTER 2

LOCAL GOVERNMENT IN AUSTRALIA

1. During the consultation phase of this Review, participants emphasised the extent of differences in local government both between and within States. This chapter provides some background on local government in Australia and looks at some of these differences.

2. Constitutionally, local government is the responsibility of the States. States provide the legislative framework within which LGBs operate, and oversee their operations. Historically, local government expenditure requirements have exceeded the revenue available from their own sources. Prior to 1974, the States were the main source of additional financial assistance for local government.

3. In 1974, the Commonwealth introduced a program of untied financial assistance through the States to local government. The reasons cited by the Commonwealth for providing this financial assistance were 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’¹. Subsequent Commonwealth governments have maintained and extended the program of financial assistance for local government.

4. The *Local Government (Financial Assistance) Act 1995* is the most recent in the series of Acts passed by the Commonwealth Parliament to provide untied financial assistance to local government. In 2000–01, financial assistance grants under this Act will provide local government with over \$1.3 billion. On average, this is almost \$70 per capita but, reflecting the diversity of local government, the amount individual LGBs receive varies from about \$20 per capita to over \$7 100 per capita.

5. The LGBs covered by the Act include the mainstream councils established under State local government legislation, as well as a range of other bodies. The latter group, which includes Indigenous community councils, comprise bodies which are either established under other State legislation, or ‘declared’ to be local governing bodies by the Commonwealth Minister under section 4 of the Act.

¹ Gough Whitlam MP, Second Reading Speech, *Grants Commission Bill 1973*, House of Representatives, 17 May 1973.

6. Although there are many similarities in local government between States, there are also major differences in form, governance and responsibilities². For instance:

- a major source of revenue for local government in all States is taxes on properties (municipal rates) but the basis upon which the rate is calculated varies between States;
- water supply and sewerage is a local government function in Queensland, Tasmania and rural New South Wales, but a State responsibility elsewhere; and
- LGBs in Victoria, Queensland, Western Australia and Tasmania cover virtually the whole of the State, whereas there are large unincorporated areas in New South Wales, South Australia and the Northern Territory.

7. The operating base of local government in Australia is diverse. For instance, even for mainstream LGBs:

- population varies from around 150 for Murchison Shire (Western Australia) to over 833 000 for Brisbane City Council (Queensland);
- area varies from 1.5 square kilometres for the Shire of Peppermint Grove (Western Australia) to 378 533 square kilometres for East Pilbara Shire (Western Australia);
- population density varies from 2.8 people per 1000 square kilometres for Menzies Shire (Western Australia) to 7 280 people per square kilometre for Waverley Council (New South Wales); and
- the length of local roads varies from 9 kilometres for the Shire of Peppermint Grove to 5 427 kilometres for Buloke Shire (Victoria).

8. This diversity reflects differing circumstances, differing opportunities and responses, and differing choices. State Local Government legislation imposes few, if any, limitations on what services LGBs can provide. To a significant extent, what individual LGBs do is a function of their judgement.

9. LGBs in Australia have moved from providing a limited range of mainly property-related services to a much broader range of services. In introducing the *Local Government (Financial Assistance) Act 1986*, the Commonwealth Minister for Local Government and Administrative Services observed that ‘from the early 1970s, local government has evolved from authorities dealing with roads, gutters, drains and garbage to

² A more detailed analysis of differences in services by State is in Attachment C of *Performance Measures for Councils — Improving Local Government Performance Indicator*, Industry Commission, 1997.

increasingly sophisticated multi-factional and multi-functional authorities dealing with human and community services.³ The range of services they now provide is extensive and includes:

- engineering services (roads, bridges, footpaths, drainage);
- community services (aged care, child care, fire prevention and firefighting);
- environmental services (waste management, environmental protection);
- regulatory services (buildings, restaurants, animals); and
- cultural services (libraries, art galleries, museums).

10. In 1999–2000, there were 730 LGBs receiving financial assistance grants under the *Local Government (Financial Assistance) Act 1995*. Although only 20 per cent of them were in urban areas⁴, over 60 per cent of Australia's population lived in those areas. A further 15 per cent of LGBs were in regional centres, 45 per cent in rural areas and 20 per cent in remote areas. About 100 LGBs served discrete indigenous communities in Queensland, Western Australia, South Australia and the Northern Territory.

11. There are large differences in the range of services provided by LGBs in capital cities, metropolitan areas, regional centres, rural communities and remote areas. There are also large differences in how they raise revenue and their capacity to do so.

LOCAL GOVERNMENT FINANCE

12. Local government, as a sphere of government, is small financially and its relative importance has been declining. Although local government outlays have grown in real terms since 1961–62, the growth has been slower than the growth in Commonwealth and State outlays. In 1961–62 local government was responsible for 8 per cent of total government outlays but, by 1997–98, its share had declined to 5 per cent.

13. As part of this report, we have analysed some aspects of local government revenue and outlays for the period 1961–62 to 1997–98. The data we have relates to the mainstream LGBs only. Our analysis is in response to two issues covered by the terms of reference — the impact of the Act on local government revenue raising and State assistance, and changes in local government roles and responsibilities. Our preliminary findings are in Chapter 5. The remainder of this Chapter looks at differences between States in local government revenue and outlays in 1997–98.

³ Tom Uren MP, Second Reading Speech, *Local Government (Financial Assistance) Bill 1986*, House of Representatives, 2 May 1986.

⁴ Our categorisation of LGBs into urban, regional, rural and remote is the Australian Classification of Local Government.

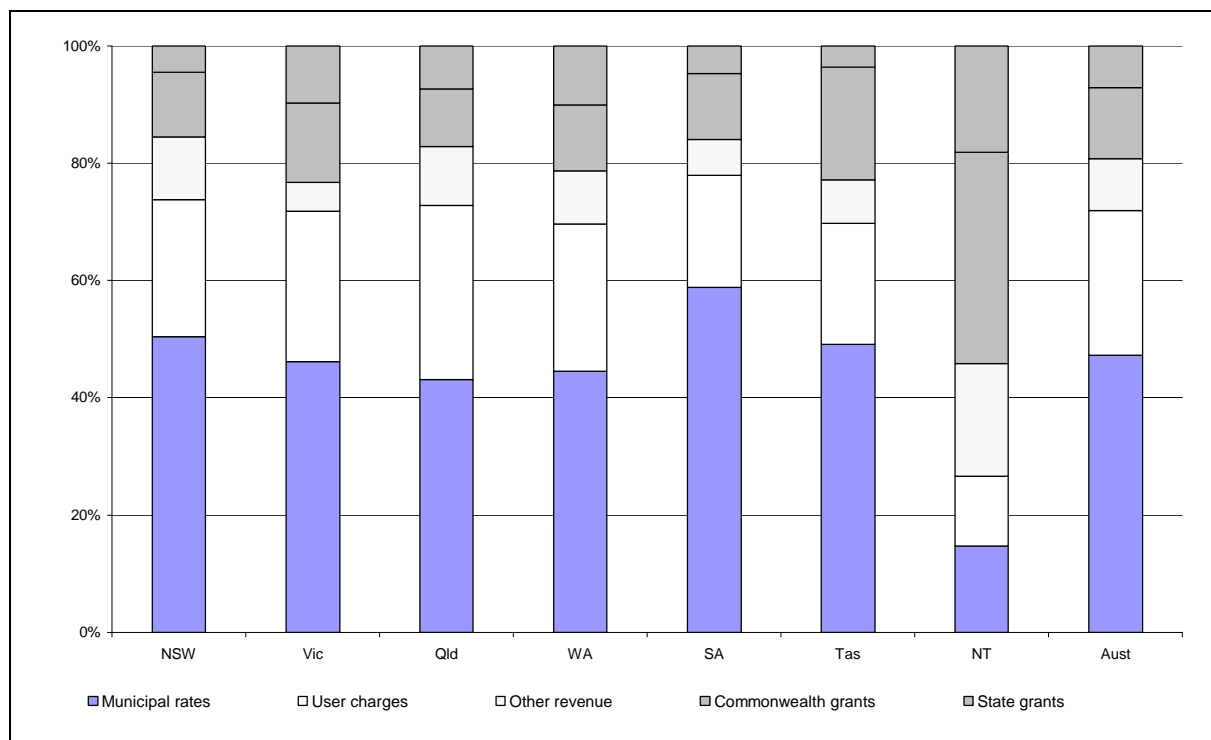
Revenue

14. Figure 2-1 shows differences between States in the sources of local government revenue in 1997–98. For all States except the Northern Territory, municipal rates (contributing on average 47 per cent of revenue) and user charges (about 25 per cent) were the main sources of revenue. Commonwealth and State grants contributed 19 per cent of revenue.

15. The local government financial assistance grants provided under the Act are a substantial share of total Commonwealth and State grants. They contribute around 10 per cent of local government revenue. The Commonwealth also provides some specific purpose payments direct to local government. In 1997–98, these represented a further 2 per cent of revenue.

16. There is broad similarity in the proportion of local government revenue contributed by rates and user charges in all States except the Northern Territory. With its greater prevalence of non-rateable land, local government in the Northern Territory has a much lower reliance on rates and a much greater reliance on grants.

Figure 2-1 LOCAL GOVERNMENT REVENUE SOURCES, 1997–98



Source: ABS Government Finance Statistics, 1997–98, unpublished data.

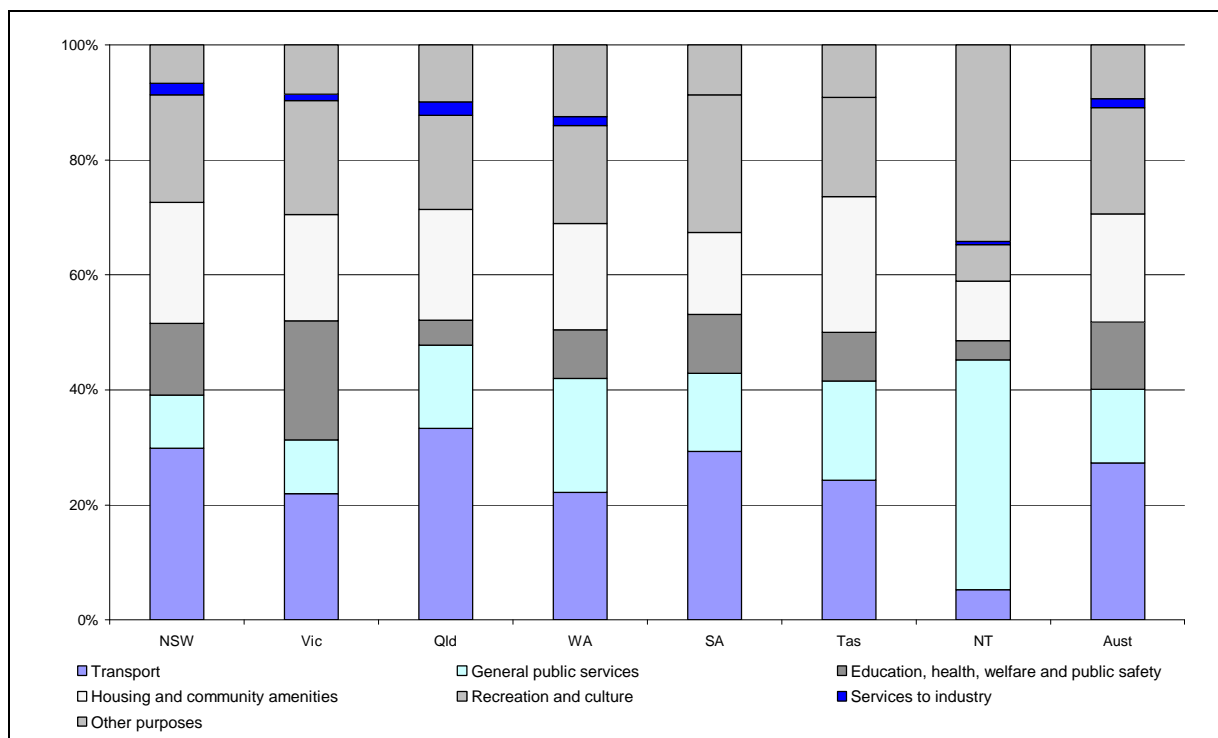
Note: Figures for the NT include municipalities, community councils and association councils.

Outlays

17. Figure 2-2 shows the different spending patterns of local government in each State in 1997–98. There were large variations between States in the services provided. For many States, expenditure on transport (mainly local roads expenditure) was the largest outlay (contributing on average around 27 per cent of outlays). Expenditure on housing and community amenity (about 19 per cent) and recreation and culture (about 19 per cent) were the next highest outlays. The Northern Territory had a very different pattern of expenditures from all other States⁵.

18. Differences among the other States are most marked on expenditure classified as ‘education, health and welfare’ and ‘housing and community amenity’. Local government in Victoria spends 21 per cent of its outlays on education, health and welfare while in Queensland it spends only 4 per cent. In Tasmania, local government spends 24 per cent of its outlays on housing and community amenity while in South Australia it spends only 14 per cent.

Figure 2-2 LOCAL GOVERNMENT OUTLAYS, 1997–98



Source: ABS Government Finance Statistics, 1997–98, unpublished data.

Note: Figures for the NT include municipalities, community councils and association councils.

⁵ This is at least partly because ABS Government Finance Statistics for the Northern Territory include data from the Indigenous Community Governments.

CHAPTER 3

THE EFFECTIVENESS OF THE CURRENT ARRANGEMENTS

1. The terms of reference ask us to examine and report on:
 - the effectiveness of the current arrangements to achieve the purposes and goals of the Act; and
 - the appropriateness of the current National Principles.
2. This chapter addresses these requirements.

The Current Arrangements

3. The Act specifies a range of elements that form the current arrangements. Section 3 sets out the objects of the Commonwealth in relation to the financial assistance. It says that there are five *purposes* (Section 3(2)) and two *goals* (Section 3(4)).

4. To achieve these purposes and goals, Section 3(5) provides for:
 - the development of *National Principles* for the purpose of allocating the funds to local governing bodies (LGBs) within a State;
 - the making of a *National Report* to the Parliament each year, reporting on the operation of the Act; and
 - an assessment of the performance of LGBs

5. The financial assistance is distributed through two *pools of funding* (General Purpose and Local Roads funding), the interstate distributions of which are fixed¹. The intrastate distribution of the pools is guided by six National Principles. Five relate to the distribution of the General Purpose pool and one to the distribution of the Local Roads pool.

¹ Section 9 mandates the continuation of the distribution of the General Purpose pool on an equal per capita basis. Section 12 mandates the continuation of the distribution of the Local Roads pool on a historical basis.

6. The Act also describes an escalation process for determining the annual increase in each pool.² The same process is applied to each pool so that both pools grow at the same rate.

7. These are the elements of the Act to which we refer when discussing whether the current arrangements have been effective in achieving the Commonwealth's purposes and goals. In this chapter, we take each purpose and goal and:

- set out our interpretation of the purpose/goal outlined in the Act;
- discuss which aspects of the current arrangements are relevant to achieving the purpose/goal;
- where the arrangements include a National Principle, discuss the appropriateness of that principle;
- discuss how the LGGCs have interpreted and implemented the requirements of the Act and the National Principles; and
- discuss whether we think the purpose/goal has been achieved.

PURPOSE 1 — FINANCIAL CAPACITY

8. The first purpose for which financial assistance is provided is 'to improve the financial capacity of local governing bodies'.

9. The Act does not elaborate what this means. It could refer to the financial capacity of each LGB or the financial capacity of the local government sector (the LGBs as a whole). We have interpreted it as referring to the financial capacity of each LGB.

10. The 1994 review of the previous Act³ interpreted this purpose as referring to the financial capacity of each LGB. It concluded that each LGB should receive a share of the financial assistance because:

- this purpose was about redressing the sector's vertical fiscal imbalance; and
- the financial assistance grants were in lieu of tax devolution which would give local government a broader tax base.

² Sections 9 and 10 describe the escalation process to apply to the General Purpose pool, and Sections 12 and 13 describe the process to apply to the Local Roads pool.

³ Australian Urban and Regional Development Review, *Financing Local Government, A Review of the Local Government (Financial Assistance) Act 1986*, Discussion Paper Number 1, Melbourne, 1994, page 14.

11. Many LGBs agree with the view that every LGB should benefit from the provision of financial assistance grants. The clear consensus among LGBs is that this purpose is about ensuring that every LGB receives a share of the financial assistance grants. While we do not necessarily agree with the arguments of the 1994 review, we think the natural reading of the Act supports this view and it should be interpreted in this way.

12. There are two National Principles that relate to this purpose.

- The Minimum Grant. The Act requires that each LGB receive at least a minimum level of assistance from the General Purpose pool — 30 per cent of its per capita share of the General Purpose pool; and
- The Identified Road Component. The Act requires that the Local Roads pool be distributed on a roads needs basis — every LGB with responsibility for local roads receives some assistance⁴.

13. Every LGB receives a share of financial assistance because the Act requires it and there are National Principles that ensure it. This improves the financial capacity of each LGB and, in that context, the current arrangements achieve this purpose.

PURPOSE 2 — EQUITABLE LEVEL OF SERVICES

14. The second purpose for which financial assistance is provided is ‘to improve the capacity of local governing bodies to provide their residents with an equitable level of services’. Although ‘equitable level of services’ is not specifically defined, in the context of Section 6 of the Act we have interpreted it as referring to horizontal equalisation.

15. This interpretation is supported by the 1994 review which said the Commonwealth’s notion of equity was that ‘Poorer communities or those where services are more expensive to provide are seen as more deserving of Commonwealth funds.’ It also concluded that the Commonwealth’s notion of equity was encapsulated within the concept of horizontal equalisation. The general consensus among LGBs is that this purpose is about equalisation.

16. The current arrangements attempt to implement equalisation using three National Principles:

- Horizontal Equalisation;
- Effort Neutrality; and
- Other Grant Support.

⁴ A very small number of LGBs, for example Silverton and Tibooburra in New South Wales, do not have responsibility for roads.

17. ***Horizontal Equalisation.*** The Act defines horizontal equalisation as distributing financial assistance on a basis that ‘ensures that each local governing body in a State is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in the State’⁵. Under this definition, LGBs are deemed to be more needy if, for reasons beyond their control, they incur higher than average per capita expenditures in providing services or have lower than average per capita capacity to raise revenue. The concept of providing greater levels of assistance to more needy LGBs was supported by virtually all participants in the review.

18. ***Effort Neutrality.*** In general terms, the Effort Neutrality principle says that the policies of an individual local governing body should not affect the grant it receives. It means that a LGB should not receive additional assistance if, through its own decisions, it has caused the higher than average expenditure (for example, by choosing to provide a higher quality service) or the lower than average revenue capacity (for example, by choosing to offer more generous rate exemptions).

19. ***Other Grant Support.*** In general terms, the Other Grant Support principle says that in determining equalisation needs, LGGCs should take into account all sources of revenue available to LGBs to finance the services they provide — including Specific Purpose Payments (SPPs) received from either the Commonwealth or the State. It means that a LGB’s receipt of SPPs must be taken into account and that it should not be able to function at a standard higher than the State average simply because it receives more than the average per capita level of such grants.

20. The application of the principle of Horizontal Equalisation requires that financial assistance grants be distributed so that, if each LGB made the same effort to raise revenue from its own sources, each would be given the capacity to provide services at the same standard. If the financial assistance was distributed so that each LGB received its equalisation assessment, we would say equalisation was being achieved. If a LGB receives more (less) assistance than its equalisation assessment, we would say it was being over equalised (under equalised) and that horizontal equalisation was not being achieved.

21. There are two features of the distribution process for the financial assistance grants that prevent horizontal equalisation from being achieved in the local government context. The first is the minimum grant requirement that places a floor on the level of grants a LGB is to receive. Those that receive the minimum grant receive a level of grants in excess of what their equalisation assessments would justify.

22. The second is that the level of assessed needs is greater than the level of financial assistance needed to equalise disadvantaged LGBs to the State average. Aside from the minimum grant arrangements, this is so because the great differences of need in the local government sector result in some LGBs being assessed as having an equalisation position that would require them contributing to the pool of funds available for distribution, but this is not possible.

⁵ *Local Government (Financial Assistance) Act 1995*, section 6(3)(a).

23. All LGBs that receive the minimum grant are being over equalised and all other LGBs are being under equalised. Horizontal equalisation is not being achieved under the current arrangements and, without substantial changes going beyond the scope of this review, cannot be.

24. To achieve full horizontal fiscal equalisation would require:

- (i) the removal of the minimum grant requirement; and
- (ii) a substantial increase in the total amount of funding to be made available to the relatively more needy LGBs.

25. We do not think the Commonwealth can achieve its equity purpose in terms of horizontal fiscal equalisation, but it can achieve this purpose if a different concept of equity is adopted. In the next chapter we discuss the concept of relative needs as a means of achieving the Commonwealth's equity objective.

26. We think Effort Neutrality and Other Grants support are appropriate principles and are important in promoting an equitable grant distribution process based on relative need. The language of these principles could be simplified to make the concepts easier for LGBs to understand.

Variation of the Minimum Grant

27. The terms of reference ask us to consider whether the minimum grant should be retained or varied.

28. A minimum grant has been included in the scheme since the mid 1970s. It embodies a concept of 'fairness' which says that every LGB should receive a share of financial assistance based on its number of residents. Currently, this requirement ensures that each LGB receives no less than 30 per cent of its equal per capita share of General Purpose funding. All LGGCs have chosen to provide minimum grants at the 30 per cent rate. In our analysis, we have considered both an increase and a decrease in this rate.

29. Table 3-1 provides an estimate, assuming no change to the current assessment methods applied in each State, of the amount of assistance required to finance a minimum grant at different rates. The table also shows this amount as a share of the General Purpose pool and how many LGBs would qualify for the minimum grant⁶.

⁶ That is, at each rate level, how many LGBs have an equalisation assessment less than their minimum grant assessment. As rate level increases, the minimum grant assessment of every LGB increases and the number of LGBs that satisfy this criterion increases.

Table 3-1 FINANCING A CHANGE IN THE LEVEL OF THE MINIMUM GRANT

		Minimum grant rate					
		0%	10%	20%	30%	40%	50%
Amount required to finance the minimum grant	\$m	0.0	21.2	43.8	74.7	127.7	179.0
Share of General Purpose pool	%	0.0	2.5	5.1	8.7	14.9	20.9
Number of minimum grant LGBs	No	72	81	84	94	106	118

30. We have found that small reductions in the level of the minimum grant have only a small effect on the grants of ‘non-minimum grant’ LGBs. Unless the minimum grant is completely removed, we do not think these gains are large enough to justify a decrease in the minimum grant.

31. Any increase in the minimum grant would require an increasing share of the General Purpose pool to finance it. Increasing the minimum grant rate from 30 per cent to 40 per cent (an increase of one third) requires a 70 per cent increase in funds. Increasing the rate from 30 per cent to 50 per cent (an increase of two thirds) requires a 140 per cent increase in funds. The increase in the amount required to finance the minimum grant (that is increasing the over equalisation) would come from reducing the grants to non-minimum grant LGBs (that is increasing the under equalisation). Increases in the minimum grant rate would also increase the volatility of the grants to non-minimum grant LGBs.

32. We have concluded that the minimum grant arrangement should be retained in some form because:

- it is a long standing element of the financial assistance scheme;
- the balance of opinion among LGBs is that it should be retained; and
- it would maintain the stability and continuity of the current scheme.

33. We have also concluded that a change in the rate of the Minimum Grant is not warranted. Chapter 7 of Volume 2 describes the analysis we undertook before forming this view.

PURPOSE 3 — CERTAINTY OF FUNDING

34. The third purpose for which financial assistance is provided is ‘to improve the certainty of funding for local governing bodies’.

35. The meaning of this purpose is not clear. It could mean:

- (i) the certainty of ongoing funding under the Act;
- (ii) certainty in the sense of providing a minimum grant to each LGB; or
- (iii) certainty in the sense of stability of each local governing body's annual grant allocation.

36. The Department of Territories and Regional Services (DoTRS) said this purpose was about providing certainty of ongoing funding for the local government sector. The 1994 review agreed, saying that 'From time to time, the Commonwealth has also attempted to improve the certainty of local government receipts, though more at the aggregate State level than at the level of individual councils'. Some LGBs, particularly those receiving the minimum grant, said that it was about providing a safety net for LGBs so that they were guaranteed a minimum amount each year. Other LGBs said it was about stability of individual grant outcomes from year to year.

37. If this purpose is intended to achieve certainty of funding for the local government sector, then the elements that deliver this outcome are:

- the Act's guarantee of General Purpose and Local Roads grants (Section 9 and Section 12 respectively); and
- the escalation arrangement for each (Sections 9 and 10 and Sections 12 and 13 respectively).

38. The escalation process specifies that the level of assistance should increase in line with population and the Consumer Price Index (CPI), but gives the Commonwealth (in special circumstances) the power to vary the rate of increase. Except for one year, the pool has been increased to maintain real per capita funding. If the intended purpose is certainty of funding for the local government sector, then the current arrangements have been effective.

39. If the purpose is to provide the certainty of at least some funding for each LGB, then the element that delivers this outcome is the Minimum Grant requirement discussed earlier in this chapter. If this is the intended purpose, then the current arrangements are both appropriate and effective.

40. If the purpose is to deliver stable grant allocations to individual LGBs from year to year, then the Act does not provide an instrument that would deliver this outcome. Instability in grant allocations from year to year was raised with us as a matter of real concern by many LGBs.

41. If stability of annual grants is what the Commonwealth intended, then it cannot be achieved through a predominantly needs based distribution process. Some volatility is inherent in a needs based approach because needs reflect things that change over time. Among other things, they are:

- the level or pattern of LGB expenditure;
- the level or pattern of LGB revenue raising;
- the level of financial assistance grants;
- the level of other grant support; and
- the methods used by LGGCs to measure expenditure need or revenue capacity.

42. A needs distribution process will produce a different assessment of needs each year if one or more of these elements changes, so some annual variation is to be expected.

43. If the Commonwealth wants greater stability it would have to require the horizontal equalisation assessments to be modified by some stability criteria. This would produce greater stability, but at the cost of horizontal equalisation.

44. LGGCs have introduced a variety of measures to reduce instability. They include:

- averaging, over a number of years, the more volatile parts of their assessments;
- phasing in new assessment methods; and
- introducing maximum annual changes (capping increases and collaring decreases) to LGB allocations.

45. Despite these measures, there continue to be large variations in annual grant allocations⁷. If stability in the annual grants to individual LGBs was the Commonwealth's purpose, it has not been and cannot be achieved through a predominantly needs based distribution process.

46. We think the natural reading of this purpose is that it refers to the certainty of ongoing funding to the local government sector. As a consequence, we have concluded that the current arrangements have been effective in achieving this purpose.

⁷ Between 1999–2000 and 2000–01, some LGBs experienced an increase in their annual allocations of up to 50 per cent, some experienced a decrease of up to 50 per cent.

PURPOSE 4 — EFFICIENCY AND EFFECTIVENESS

47. The fourth purpose for which financial assistance is provided is ‘to improve the efficiency and effectiveness of local governing bodies’.

48. The Act does not define either efficiency or effectiveness. The 1994 review discussed the need for an efficiency and effectiveness purpose, which was subsequently introduced into the Act. It talked about allocative efficiency (the optimum allocation of resources in the marketplace) and administrative efficiency (producing services at the lowest cost⁸). In its submission to this review, DoTRS said effectiveness was about the degree to which LGBs achieve their program and policy objectives, encompassing accessibility, quality of services and the appropriateness of service delivery methods.

49. Most participants agreed that improving the efficiency and effectiveness of LGBs was worthwhile. However, many had concerns about whether efficiency or effectiveness can be measured and queried the relevance of this purpose to a grant distribution system that provides untied grants. We agree with the latter concern.

50. The Act does not provide an instrument that would increase grants to LGBs that improve either their efficiency or their effectiveness. None of the LGGCs has introduced methods that redirect grants because of improvements in efficiency or effectiveness. Such an approach would be inconsistent with the concepts of horizontal equalisation and effort neutrality.

51. Horizontal equalisation is about giving LGBs the capacity to provide the average level of services — if they operate at the average level of efficiency. If a LGB is more efficient than the average, it retains the savings. Participants referred to this as ‘efficiency is its own reward’. Because horizontal equalisation is about providing each LGB with the same capacity, it does not prescribe which services they ought to provide. Instead, it bases its concept of the average level of services on the services that LGBs actually provide.

52. The Effort Neutrality principle says that the policies of an individual LGB should not affect the grant it receives. Relating a LGB’s grant to the level of efficiency at which it operates would be inconsistent with this principle.

53. The Act requires the National Report to include an assessment of the efficiency of performance of local governing bodies. When the Act was initially presented, it was intended that a range of national performance measures would be developed which would assist in this assessment. These indicators have not been developed. We do not think there is evidence that, on its own, the assessment in the National Report has led to any improvement in LGB efficiency.

⁸ In its broader sense this would include structural efficiency, that is, the optimal number of LGBs and the optimal spatial distribution of their administrative centres.

54. Our conclusions are that:

- this is not a relevant purpose for an Act that has a predominantly needs based distribution process; and
- the current arrangements have not been effective in achieving it.

PURPOSE 5 — ABORIGINALS AND TORRES STRAIT ISLANDERS

55. The fifth purpose for which Commonwealth financial assistance is provided is ‘to improve the provision by local governing bodies of services to Aboriginal and Torres Strait Islander Communities’.

56. This is the only purpose that is directed to the expenditure of LGBs. We do not think it fits with a grant distribution system that provides untied grants to LGBs. During our consultations, it was evident that many LGBs were unaware of this purpose and whatever decisions they have made on the level of service to provide to Indigenous people appear to have had little, if anything, to do with its existence.

57. The language of this purpose has led to some confusion over its meaning. Some LGGCs and LGBs interpret it as relating to discrete Indigenous communities while others take it to cover all individual Aboriginal and Torres Strait Islander people. The language of the associated National Principle lends support to the latter interpretation. It asks LGGCs to allocate financial assistance in a way that recognises the needs of Aboriginal Peoples and Torres Strait Islanders within their boundaries. We have interpreted this purpose as referring to all Aboriginal and Torres Strait Islander people.

58. The confusion over the meaning is evident from the different methods and policies used by LGGCs to encapsulate the requirement of this principle in their equalisation assessments.

- New South Wales assesses the additional costs of providing services to all Indigenous people in its Administration and Community Services assessments;
- Victoria assesses the additional costs of providing services to all Indigenous people in its Health and Welfare assessment;
- Queensland has a separate assessment of discrete Aboriginal and Torres Strait Islander communities (those declared to be LGBs for the purposes of the Act);
- Western Australia assesses the additional costs of providing services to all Indigenous people in its Health assessment;

- South Australia assesses the additional costs of providing services to all Indigenous people in its mainstream LGBs, and has a separate assessment for five discrete Indigenous communities;
- Tasmania does not have a separate assessment because it has concluded that Tasmanian LGBs do not incur additional costs in providing services to Indigenous people; and
- The Northern Territory assesses the additional costs of providing services to Indigenous people in its General Administration, Human Services and Libraries assessments. The same framework is used for all LGBs.

59. There are two National Principles that relate to this purpose:

- Horizontal Equalisation; and
- Aboriginal Peoples and Torres Strait Islanders.

60. In the application of the horizontal equalisation principle, it is implicit in the assessment of relative needs that the needs of all Indigenous people must be taken into account. The Aboriginal Peoples and Torres Strait Islanders principle makes this explicit.

61. The Act does not provide an instrument that increases grants to LGBs that increase their provision of services to Aboriginals and Torres Strait Islanders. It does, however, require an assessment of the performance by LGBs in providing services to Aboriginals and Torres Strait Islanders to be published in the National Report. In 1995, it was intended that a range of measures would be developed to assist in achieving this purpose. These indicators have not been developed and the assessment in the National Report has not, of itself, led to any improvement in LGBs' provision of these services.

62. We do not think a separate Aboriginal and Torres Strait Islander purpose fits in a process to distribute untied grants. Nor should such a National Principle be required while there is a grant distribution process based on relative needs. Any assessment of relative need requires LGGCs to recognise the needs of Aboriginal and Torres Strait Islanders in both mainstream and discrete communities, and to incorporate these assessments into its grant distributions⁹. Providing a needs based approach is retained, removing the Aboriginal and Torres Strait Islander principle should not, of itself, change the level of grants received by any LGB.

63. The Act's eligibility provisions (Section 4(2)) allow the Commonwealth Minister to declare bodies that provide local government type services to be LGBs and eligible to receive assistance under the Act. Under this provision, many discrete Indigenous communities have been declared to be LGBs and this has increased the flow of funds to them. In this sense, it may be said that the current arrangements have, in part, achieved this purpose.

⁹ Failure to recognise these needs would mean that the LGGC was failing to implement a needs based distribution.

GOAL 1 — TRANSPARENCY AND ACCOUNTABILITY

64. The first of the goals established by the Act is ‘to increase the transparency and accountability of the allocation of funds to local governing bodies’.

65. In the context of a grant distribution process we have taken the view that transparency is about LGBs being able to understand how their grants have been calculated and accountability is about LGGCs providing sufficient information to allow a LGB, if it chooses:

- to verify its grant allocation;
- to understand why its allocation has changed from its previous level;
- to understand why it differs from the grant allocation of a neighbouring or similar council; and
- to understand the key drivers of its grant allocation.

66. The mechanism in the Act for increasing the transparency and accountability of the process is the requirement that the National Report include an assessment of the methods used by LGGCs in making their recommendations. To date, it has mostly confined itself to reproducing information on LGGC methods. Understanding of the process would be improved if commentary were provided on the different LGGC approaches (an assessment of the similarities and differences of each approach, an assessment of how the approaches related to and satisfied the National Principles etc). This is a role the National Report could fulfil.

67. The views presented to us during the review indicate that this goal has only been achieved to a limited extent. The efforts that the LGGCs have made to provide information to LGBs vary considerably. In general, LGBs say they do not understand the grant allocation process and the LGGCs do not provide sufficient information. Further improvements in transparency and accountability can be achieved. Full accountability requires both the National Report and the LGGCs to provide more and clearer information. This will improve LGBs’ understanding of the process. Volume 2 sets out the information we think should be provided.

GOAL 2 — CONSISTENCY OF METHODS

68. The second goal is to promote ‘consistency in the methods by which grants are allocated to achieve equitable levels of services’.

69. The National Principles were introduced to bring greater consistency to the methods and policies of the LGGCs. Given the diversity of local government, one assessment approach is unlikely to work satisfactorily for all States. The cost influences having the largest impact in the Northern Territory (such as the proportion of the population

that are Indigenous, the dispersion of the population) are different from those that impact in Victoria. LGGCs require the flexibility to develop methods and policies that reflect the circumstances of the LGBs within their State. The aim is, therefore, not to promote uniformity of LGGC methods and policies, but to achieve general consistency in the extent to which the Commonwealth's objectives are met.

70. We have interpreted this goal as being about promoting greater consistency of methods and policies with the National Principles.

71. The only mechanism relating to this goal is the requirement for the National Report to include an assessment of the methods used by LGGCs in making their recommendations. As stated earlier, it has in the past largely confined itself to reproducing information on LGGC methods. There has been very little assessment of methods and a LGGC does not have to change a method if an adverse assessment is included in the National Report. It is not clear, therefore, how assessing the methods used by LGGCs in the National Report could achieve this goal.

72. We think the LGGCs are consistently implementing the Minimum Grant and Effort Neutrality principles, but have adopted different approaches to implementing the others. Examples include:

- the LGGCs have different approaches to assessing needs in relation to the effect of scale of operation, declining rural populations, distance etc on the costs of service provision (Horizontal Equalisation);
- the LGGCs have different approaches to the assessment of revenue capacity (Horizontal Equalisation);
- when undertaking their equalisation assessments, some LGGCs take account of SPPs received, others do not (Other Grant Support);
- some LGGCs assess needs for the additional costs of providing services to all Aboriginals and Torres Strait Islanders, others do not (Aboriginal and Torres Strait Islander Peoples); and
- the LGGCs have developed different approaches to the distribution of Local Road funds (Identified Road Component).

73. We think greater consistency can be achieved and should be required. There are cost influences that are common to all States (diseconomies of scale, dispersion of population, non-resident use etc). Some LGGCs assess them, others do not. LGGCs have taken different decisions in relation to the technical aspects of equalisation (combining assessments, factoring back etc). Our analysis in Volume 2 shows that these different decisions are affecting grant distribution outcomes. Greater consistency can be pursued in terms of both the range of influences assessed and the technical aspects of equalisation.

74. Our conclusion is that the current arrangements have not been full effective in achieving the consistency of methods goal and that improvements can be made.

THE ROADS FUNDING OBJECTIVE

75. The process of providing assistance for roads is unnecessarily complex:

- roads funding is received from two pools (General Purpose and Local Roads);
- the distribution of each pool to individual LGBs is different (because a different assessment of road needs is made); and
- the Other Grant Support principle requires that the amount of Local Roads grants be taken into account when assessing how much General Purpose grants a LGB should receive — although not all LGGCs comply with this requirement.

76. A National Principle was developed to guide the LGGCs in distributing the Local Road grants to LGBs. It tells the LGGCs to distribute their grants on the basis of relative road needs (including length, type and use of roads) and the need to preserve assets. The LGGCs have chosen different approaches to implementing this principle. Some use an Asset Preservation Model approach, others use simpler methods based on population and road length.

77. The Horizontal Equalisation principle guides the distribution of the General Purpose grants and requires them to be distributed on the basis of relative needs (including road needs). Most LGGCs use an asset preservation model within their roads assessments. Within their General Purpose grant assessments, none of them assess road needs on the basis of population and road length alone.

78. When making their General Purpose assessments, the Other Grant Support principle requires LGGCs to take into account the level of Local Roads grants received by LGBs. If they do this, it creates a link between the two pools — the more funds a LGB receives from one pool (the Local Roads pool) the less it requires from the other (the General Purpose pool).

79. This link means that the distribution of the General Purpose grants can be affected by the different methods used to assess roads needs. If for example, the Local Roads method produces larger grants for some classes of LGB than the General Purpose method, the link will reduce their General Purpose grants.

80. Some LGGCs do not take the level of Local Roads grants into account when making their General Purpose assessments. In this case there is no interaction between the two pools. However, if these LGGCs were to change their methods so as to comply with the Other Grant Support principle, it could produce large changes in the General Purpose grants of some LGBs.

81. During our discussions, it was apparent that most LGBs are unaware of these issues.

82. Almost every LGB supported a separate Local Roads pool. They said that a separate pool reflected the special significance of roads to local government. We have assumed that a separate Local Roads pool will be retained.

83. If there is to continue to be a separate pool and purpose, we think the existing National Principle, with some rewording, is an appropriate means of guiding the LGGCs in how to distribute Local Road funds amongst LGBs.

84. This section has raised a number of important questions. Two of these will be discussed in the next chapter. They are:

- (i) whether there should be different methods of assessing road needs for different pools; and
- (ii) whether the Other Grant Support principle should apply to the Local Roads grants.

CONCLUSIONS

85. The objects of the Commonwealth — its purposes and goals — are generally not being achieved effectively. In some cases, we think they need to be changed. In other cases, we think they need to be clarified.

86. Applying our interpretation of them, those that are being achieved are:

- Financial Certainty;
- Certainty of Funding;
- Transparency and Accountability — although further improvements can be achieved; and
- Consistency of Methods — although further improvements can, and ought, to be achieved.

87. The purposes that are not being achieved are:

- Equitable Level of Services — because the Act defines this to be horizontal equalisation and horizontal equalisation cannot be achieved in the current local government context;
- Efficiency and Effectiveness — because this does not fit within a grant process that distributes untied grants; and
- Aboriginals and Torres Strait Islander — because this does not fit within a grant process that distributes untied grants.

88. We think that the Commonwealth's equity purpose can be achieved if it is defined in terms other than horizontal equalisation. We also think the Act should specify a Local Roads funding purpose.

89. The terms of reference asked us to consider the appropriateness of the National Principles to achieve the Commonwealth's objects. We have found that four of them are appropriate, one cannot be achieved and one is unnecessary.

90. Of those that we think are appropriate, the Minimum Grant principle is understood and is being applied correctly by all the LGGCs. The other principles which are also assisting the Commonwealth achieve its objectives need to be clarified so that their interpretation by the LGGCs is more uniform and better understood. They are the principles relating to:

- Effort Neutrality;
- Other Grant Support; and
- Identified Road Component.

91. The Horizontal Equalisation principle is not helpful because it cannot be achieved in the local government context. We think it should be replaced by a more generally specified principle relating to relative need. In either a Horizontal Equalisation or more widely specified needs based distribution, the Aboriginal Peoples and Torres Strait Islanders principle is not required for a grants distribution process based on relative needs.

CHAPTER 4

FUTURE DIRECTIONS

1. We have concluded that, effectively, the Commonwealth's intentions in providing funding to LGBs are:

- (i) to provide every LGB with a share of the General Purpose funding;
- (ii) to provide every LGB with a share of the Local Roads funding; and
- (iii) to distribute the balance of the General Purpose funding so as to provide greater assistance to the more needy LGBs.

2. We accept that these are reasonable and appropriate intentions. There is a wide measure of support among LGBs for this structure. It enables the core objectives of the Commonwealth to be attained. In our opinion, the operation of the Act would be improved if the funding arrangements more clearly and transparently reflected these intentions.

3. In this chapter we therefore propose a different framework for the Act. The proposed framework sets out to:

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

4. The proposed framework comprises three pools reflecting the three essential objectives of the Commonwealth. There would be:

- a Per Capita pool;
- a Local Roads pool; and
- a Relative Needs pool.

5. In the next three sections we discuss how the intrastate distribution of these pools would be effected, and what National Principle(s) might be required to guide the LGGCs in distributing these pools to achieve the Commonwealth's purposes.

DISTRIBUTING THE PER CAPITA POOL

6. The Commonwealth could continue to achieve its purpose of providing every LGB with a share of the General Purpose funding, and do so more explicitly, by replacing the present minimum grant arrangement with an equivalent grant to every LGB. This would make clear the Commonwealth's role in supporting the provision of municipal services to every citizen to at least the same per capita level.

7. The proposed Per Capita pool, like the present minimum grant, would be distributed on a population basis. A new National Principle would have to be created to replace the Minimum Grant Principle. The new Principle would guide LGGCs in implementing this purpose by requiring them to 'distribute these grants on a per capita basis'.

8. Our preliminary recommendations are:

- (i) to create a pool that would provide every LGB with the same per capita level of assistance; and
- (ii) to create a 'Per Capita' National Principle that would instruct the LGGCs to distribute this pool on the basis of population.

9. These recommendations would replace the concept of a minimum grant with a new concept. They would encapsulate the fairness of providing the same per capita grant to every LGBs. They would overcome a problem with the current arrangements whereby two purposes are funded from one pool.

DISTRIBUTING THE LOCAL ROADS POOL

10. The Commonwealth could continue to achieve its purpose of providing every LGB with a share of the Local Roads funding by retaining a separate Local Roads pool.

11. While a proper assessment of relative road needs would make a separate roads pool unnecessary, there was almost universal support for retaining a separate pool. We have incorporated a separate roads pool into our proposed framework.

12. We think the Commonwealth's purpose in providing this funding has been to make a contribution to the construction and repairs of local roads. We have not heard any argument to do away with this arrangement. The Local Road pool would be distributed amongst LGBs on the basis of relative road needs. In this context, relative road needs

would cover the need to maintain, enhance and augment an existing local road network¹. This would extend the concept of road needs beyond the current definition, which we think is restricted to maintenance of existing roads. This change would recognise additional needs for some LGBs, so it has the potential to change the existing road assessments.

13. This concept of relative road needs would require LGGCs to measure the influences that impact on a LGB's cost of maintaining, enhancing and augmenting its existing network.

14. The principal influences that impact on a LGB's cost of providing road services include:

- (i) the age of its roads;
- (ii) the type and length of its roads;
- (iii) the number and type of vehicles that use its roads; and
- (iv) the climate and terrain.

15. We do not think that the Act has to define relative road needs or to prescribe a method of calculating them. LGGCs already have expertise in assessing relative road needs — they measure them within their existing road assessment(s). The Act should provide LGGCs with the flexibility to develop an assessment method that reflects the influences on the cost of preserving and developing local roads within their State. Flexibility is required because the influences that impact in one State do not necessarily impact in another, or where they do, the size of the impact can be different.

16. In the previous chapter, we raised two important questions relating to a separate roads pool. They were:

- (i) whether there should be different methods of assessing road needs for different pools? and
- (ii) whether the Other Grant Support principle should apply to the Local Roads grants?

17. Having separate distribution methods would make sense if the two pools are intended to achieve different purposes. For example, the Act could specify that Local Roads grants were intended to cover the costs of construction of new roads and that the General Purpose grants were intended to cover the costs of maintaining existing roads. If it is intended that the two sources of road grants be for different purposes, the Act should say so, but this is unlikely because both grants are untied.

¹ Some LGBs are caught in a situation where they cannot upgrade an existing road surface or construct a new road because they do not receive funding, and they do not receive funding because they have not done the work. This is a lesser problem in urban areas, because developers are often required to contribute to new roads and major upgrades of existing roads affected by their development. Thus, recognising the need to enhance and augment an existing network (not associated with development or developer contributions) will address this shortcoming.

18. If two pools are intended to achieve the same purpose, or they are truly untied funding, we see merit in using one method of assessing relative road needs.

19. We think there are two options to consider for the final report:

- (i) have one method of assessing road needs and apply the Other Grant Support principle to Local Road grants; or
- (ii) have separate methods of assessing road needs and do not apply the Other Grant Support principle to Local Road grants.

20. Under the first option, the current level of overall (General Purpose and Local Roads) grants will not change if the LGGC has been applying the Other Grant Support principle to Local Road grants. If this is not the case, this option will change the distribution of overall grants. The change would arise because of the move to apply the Other Grant Support principle to Local Road grants. The extent of the change would depend on how similar the two assessments of LGB road needs have been.

21. Under the second option, the current overall grants will not change if the LGGC has not applied Other Grant Support principle to Local Road grants. This option will change the overall distribution of grants if this is not the case. Again, the extent of the change will depend on how similar the two assessments of LGB road needs have been.

22. Our preliminary recommendations are:

- (i) to create a Local Roads pool that would be the Commonwealth's contribution to the construction and repair of local roads; and
- (ii) to create a 'Local Roads' National Principle that would instruct the LGGCs to distribute this pool on the basis of relative road needs.

23. We are seeking the views of participants on:

- whether there should be one or two methods of assessing road needs; and
- whether the Other Grant Support principle should apply to Local Roads grants.

DISTRIBUTING THE RELATIVE NEEDS POOL

24. The Commonwealth could continue to achieve its purpose of providing extra assistance to more needy LGBs by distributing this pool on the basis of relative needs.

25. This was previously expressed as the Horizontal Equalisation purpose but, as explained previously, we do not think this is a relevant or appropriate concept in the current local government funding context. We think the purpose should be changed so as to refer to

relative needs rather than equalisation. This change is mainly to introduce new language that more clearly sets out the Commonwealth's equity purpose and presents it as an objective that can be achieved. It cannot be horizontal equalisation because that cannot be attained.

26. The concept of relative needs requires LGGCs to measure the influences (beyond a LGB's control) that impact on each council's cost of providing services and capacity to raise revenues. These include:

- (i) the number and location of residents;
- (ii) the size and location of population subgroups for whom it is more costly to provide services (these could include aged people, people with disabilities, people of Aboriginal and Torres Strait Islander background, people from a Non-English Speaking background etc);
- (iii) the provision of services to non-residents;
- (iv) the value of properties; and
- (v) the receipt of grants (including Per Capita and Local Roads funding) that can be used to finance services.

27. We do not think that the Act should define relative needs or prescribe methods for calculating them. It should provide LGGCs with the flexibility to develop assessment methods that reflect LGB's differential costs of providing services or differential revenue capacities.

28. The Horizontal Equalisation National Principle should be removed. The new principle should instruct LGGCs to distribute this pool on the basis of relative needs. The current principles of effort neutrality and other grant support should be retained. They ensure that:

- an individual LGB's decisions on what services to provide and how, and how much revenue to raise and how, do not affect its grant distribution (effort neutrality); and
- all the revenue sources available to LGBs to finance their service provision needs are taken into account (other grant support).

29. Our preliminary recommendations are:

- (i) to create a relative needs pool that would provide additional assistance to disadvantaged LGBs; and
- (ii) to create relative needs, effort neutral and other grant support principles that would assist the LGGCs to distribute this pool on the basis of relative needs, after taking into account other grants received.

30. These recommendations would make the current principle relating to the needs of Aboriginal peoples and Torres Strait Islanders redundant. To separately specify that LGGCs should distribute financial assistance grants on the basis of the needs of Aboriginal peoples and Torres Strait Islanders would duplicate the requirement of the relative needs principle because these needs would be encapsulated within that principle.

THE SIZE OF THE POOLS

31. In 1999–2000, Financial Assistance Grants (FAGs) under this Act provided local government with \$1 271.3 million. This assistance was distributed through two pools:

- a General Purpose pool — \$880.6 million (69.3 per cent of FAGs); and
- a Local Roads pool — \$390.7 million (30.7 per cent of FAGs).

32. One problem with the current arrangements is that minimum grants and equalisation assessments are both funded from the General Purpose pool. As the number of LGBs that receive the minimum grant changes from year to year, this arrangement means that it is not possible to determine, in advance:

- (i) how much of the General Purpose pool will be required to satisfy that requirement; and
- (ii) how much will be left to distribute among the non-minimum grant LGBs.

33. These difficulties would be avoided under the proposed framework because the General Purpose pool would be divided into:

- a Per Capita pool — \$264.2 million in 1999–2000 — being the equivalent of the present minimum grant extended to all LGBs²; and
- a Relative Needs pool — \$616.4 million in 1999–2000 — being the equivalent of the present General Purpose pool after separation of the Per Capita pool.

34. The Local Roads pool would remain as now — \$390.7 million in 1999–2000.

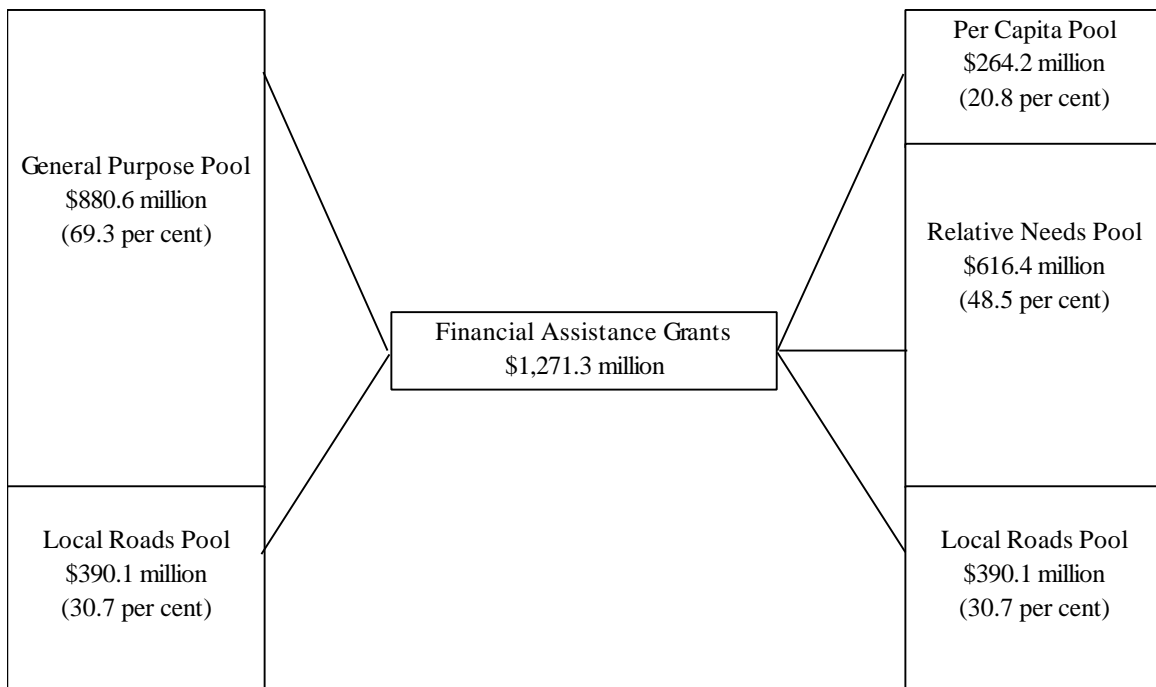
35. If the existing pool sizes were retained, there would be no transitional problems in moving to the new framework. Each LGB would simply receive the same total level of financial assistance, but through three grants rather than two. The change should not, of itself, affect the level of grants received by individual LGBs, and would improve the transparency of the funding arrangements.

² A pool of \$264 million would be required if the level of the minimum grant in 1999–2000 (about \$14 per capita) were extended to all LGBs.

36. We would, however, propose one change to the escalation process. We would continue to escalate the total financial assistance grants using a real per capita escalation process (as now), but we think the Act should give the Commonwealth the power to choose how to allocate the change in total financial assistance grants amongst the three pools. This would allow the Commonwealth to decide which of its three objectives: per capita funding; local roads funding; or relative needs funding, was more important in a given year.

37. Figure 4-1 contrasts the distribution of financial assistance grants under the current arrangements and the proposed framework.

Figure 4-1 DISTRIBUTION OF FINANCIAL ASSISTANCE GRANTS, 1999-00



BEST PRACTICE FUNDING MODELS

38. Best practice funding models are concerned not only with the fairness of the outcomes they produce but with the transparency and accountability of the process.

39. We think that the Act should include a set of general principles, as well as the specific distributional principles discussed thus far. They would define the characteristics that the Commonwealth wanted any new funding arrangements to incorporate³. Examples include:

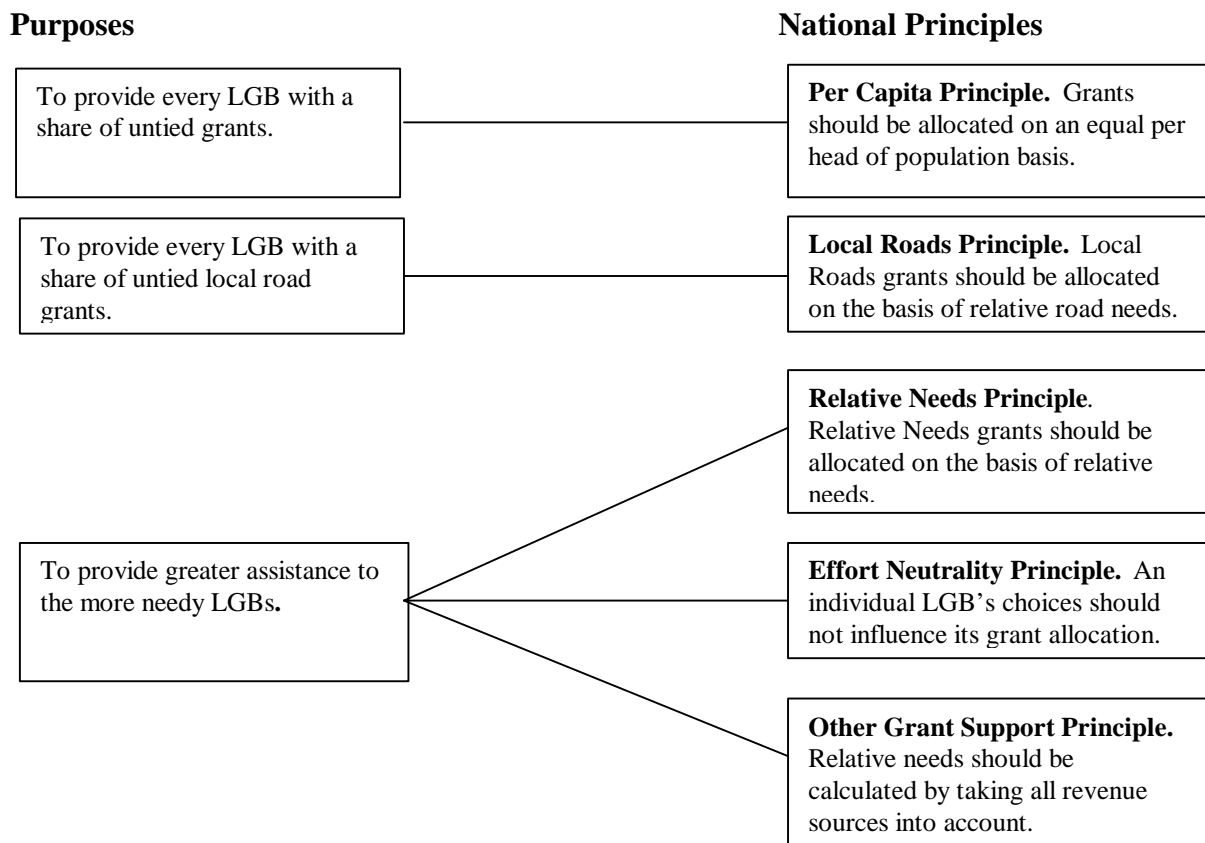
³ This is similar to proposals for UK Local Government revenue grants. See *Modernising Local Government Finance: A Green Paper*, September 2000 (UK Department of the Environment, Transport and the Regions).

- fairness — a LGB’s grants should reflect its local circumstances and should be similar to those of comparable LGBs within the State;
 - transparency — LGBs should be able to see how their grants have been calculated;
 - accountability — explanations of how grants are decided and why they have changed should be clear; and
 - predictability — there should be an explicit process for determining the level of financial assistance for local government, and LGBs should have sufficient advance notice of possible changes in their grants.
40. Such general principles would apply to the distribution of each of the three pools.

THE PROPOSED FRAMEWORK

41. Figures 4-2 shows how the new arrangements would fit together.

Figure 4-2 THE PROPOSED ARRANGEMENTS



CHAPTER 5

OTHER ISSUES

1. The issues addressed in this chapter are:
 - (i) governance;
 - (ii) eligibility;
 - (iii) changes in local government finance;
 - (iv) changes in functions or responsibility of LGBs;
 - (v) the timing of grant allocation announcements; and
 - (vi) adjusting the grants pool.

GOVERNANCE

2. Constitutionally, local government is the responsibility of the States. States provide the legislative framework within which LGBs operate, and oversee their operations. Prior to 1974, the States were the main source of additional financial assistance for local government. With the introduction of Commonwealth financial assistance grants for local government in the mid-1970s, the respective roles of the Commonwealth and the States in relation to local government and local government funding have become blurred. In line with their constitutional position, we think the States continue to have the major responsibility for ensuring the financial viability of local government, with the Commonwealth being a provider of 'supplementary' funding by way of financial assistance grants.

3. The provision of this supplementary funding by the Commonwealth to local government raises broader issues of governance, including lines of accountability and the relationships between the Commonwealth Minister, State Ministers and the LGGCs (bodies created by State legislation).

4. The Act cannot work effectively without co-operation and agreement between them, particularly the Commonwealth and State Ministers.

5. The issue of governance we think requires consideration is the Commonwealth Minister's responsibility for approving the recommendations of the LGGCs. The current Act does not allow the Minister to change the recommendations if he/she does not approve them. The only option available to the Minister is to withdraw the assistance. We think there has to be a better process than to limit the Ministers to either one of two 'unsatisfactory' options. More thought needs to be given to how to resolve potential disagreements.

6. We will develop our thinking on this issue after considering any comments made at the March Conference or in final written submissions.

ELIGIBILITY

7. Only LGBs are eligible for financial assistance grants under the Act. In Section 4, the Act defines a 'local governing body' to be:

- (i) a local governing body established by or under a law of a State, other than a body whose sole or principal function is to provide a particular service, such as the supply of electricity or water; or
- (ii) a body declared by the Minister, on the advice of the relevant State Minister, by notice published in the Gazette, to be a local governing body for the purposes of the Act.

8. In June 2000, there were 690 LGBs 'established by or under a law of a State'. There were a further 40 declared LGBs.

9. The terms of reference ask the Commission to examine and report on declared bodies. They are:

- three community councils in New South Wales;
- the Docklands Authority in Victoria;
- five Indigenous councils and a trust for providing services in the unincorporated areas in South Australia; and
- 29 indigenous community councils and a trust for providing road services in the unincorporated areas in the Northern Territory.

10. Other than the Docklands Authority, these bodies provide local government-type services in remote, sparsely populated and unincorporated areas. We think bodies providing local government-type services in these areas should be eligible for funding. This arrangement is working well and should continue.

11. Some participants in the review suggested extending eligibility to other bodies. The Act provides financial assistance for local government purposes and related

purposes. From this, we have inferred that the Commonwealth regards it as more important that local government services are funded rather than particular types of bodies are funded. We think it is appropriate that bodies that are providing local government-type services, but are not LGBs under State legislation, receive financial assistance grants. The current eligibility provisions provide for this and we do not think they need to be changed.

12. At present, the Commonwealth Minister can act to declare a LGB only at the request of a State Minister. We think either Minister should be able to initiate a proposal for a declaration but, ideally, both Ministers should have to agree to the declaration.

13. The current Act is not clear on whether an existing declaration can be revoked. We see no reason why the Commonwealth and State Ministers should not be able to agree to revoke an existing declaration.

CHANGES IN LOCAL GOVERNMENT FINANCE OVER TIME

14. The Commonwealth has been providing untied financial assistance to local government since 1974–75. Until the Territories achieved self-government, these grants did not cover the ACT or the Northern Territory. Grants for LGBs in the Northern Territory began in 1979–80 and a grant to the ACT for municipal purposes began in 1988–89. Local roads grants were added to the financial assistance grants in 1991–92¹.

15. The amount of financial assistance has grown from \$125 million in 1974–75² to over \$1.3 billion in 2000–01. The Commonwealth has always paid these grants through the States rather than directly to LGBs.

16. The terms of reference ask the Commission to examine and report on:

- the impact of the Act on the raising of revenue by local governing bodies and on the assistance provided by the States to local governing bodies; and
- the implications of any changes in the functions or responsibilities of local governing bodies.

17. To understand whether Commonwealth assistance has had any impact on local government revenue raising and expenditure patterns, or on State assistance, we undertook an analysis of expenditure data for the period 1961–62 to 1997–98 and revenue data for the period 1974–75 to 1997–98³. For the final report, we intend to start the revenue

¹ The Commonwealth previously paid these as tied grants to the States under the *Australian Land Transport Development Act 1988*.

² \$69 million of this was paid to the States as tied grants for local roads.

³ The analysis is based on unpublished Government Finance Statistics (GFS) data compiled by the Australian Bureau of Statistics (ABS). In such a long time series there may have been changes to ABS classifications and coding. However, we are not aware of any such changes and have made no adjustments. Data for 1998–99 are not included because they are prepared on an accrual basis and are not comparable with earlier years' data. The data have been converted to constant prices using an ABS Gross Domestic Product price deflator.

analysis from 1961-62⁴. The data relate to mainstream councils and, in 1997-98, Community Government councils in the Northern Territory.

Local Government Revenue

18. A number of participants at our consultations, particularly LGBs, said that:

- local government is increasingly being ‘drawn into’ new areas of service provision, often without access to additional funding;
- Commonwealth and State assistance has not been sufficient to enable local government to finance its expanding services; and
- local government has responded by increasing rates and user charges, contracting work out, generating greater efficiencies, cutting back on non-essential services, spending less on roads and increasing borrowings.

19. Figure 5-1 shows the contribution — in percentage terms — of the different sources of revenue available to local government at the national level.

20. **Own-source revenue.** Figure 5-1 shows that the importance of local government’s own relative revenue raising effort (municipal rates plus user charges and other revenue) has increased marginally. It has moved from 75 per cent of total revenue in 1974–75 to 81 per cent in 1997–98. Although reduced in importance, municipal rates remain local government’s primary revenue source. For a number of reasons, user charges have become an increasingly important source of revenue, and rates have reduced in relative importance. The growth in User Charges is not related to the introduction of financial assistance grants.

21. We have concluded that the introduction of the Commonwealth’s financial assistance grants has had little impact on local government revenue raising efforts at the national level⁵.

22. The outcome at the State level is less clear. In Volume 2, we provide a series of charts showing local government revenue by source for each State. These show that in New South Wales and South Australia, own-source revenue is at about the same proportion now as it was before the introduction of the untied Commonwealth assistance. For Victoria⁶ and Tasmania, the proportion of own-source revenue appears to have declined

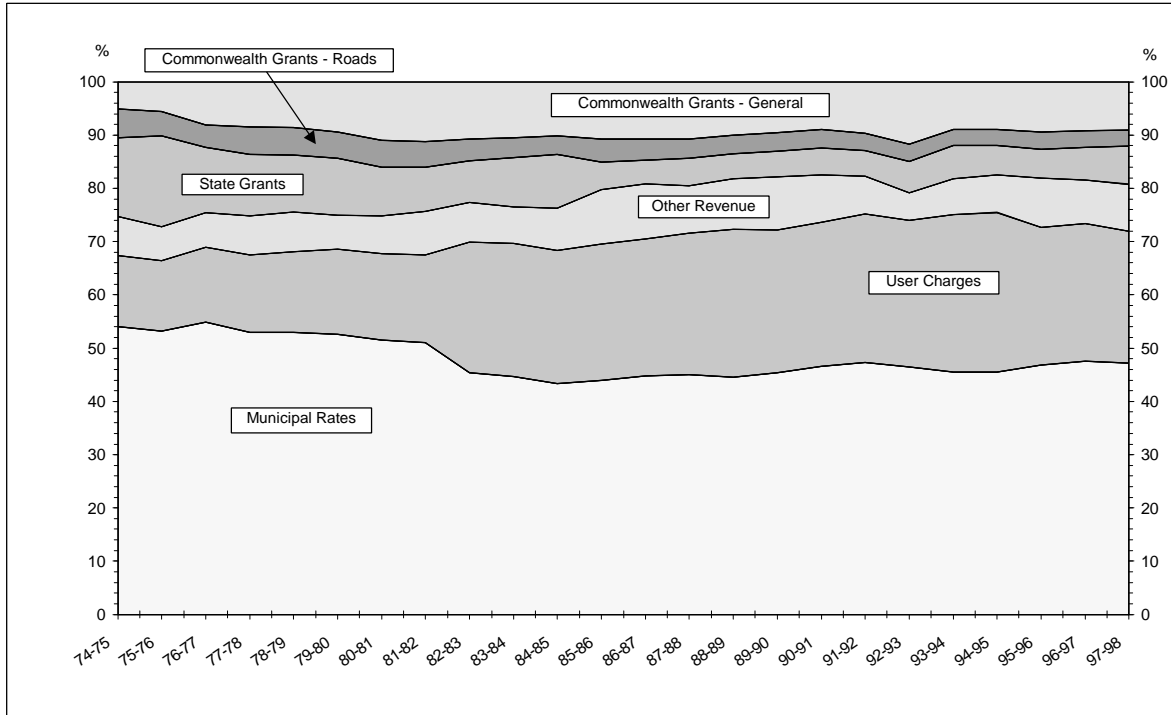
⁴ We have not yet been able to separate Local Roads funding from State assistance for the period 1961-62 to 1973-74.

⁵ We think that the approach we have used is appropriate given the terms of reference, but there are other ways we could have examined this issue. For instance, we could have assessed whether the growth of local government own-source revenue had increased in line with that of the States and the Commonwealth; or, we could have checked whether local government own-source revenue had increased in real terms. These measures are discussed in Volume 2.

⁶ The Victorian outcome is due in part to a legislated 20 per cent reduction in the level of rates in 1995-96.

while for Queensland, Western Australia and the Northern Territory, it appears to have increased.

Figure 5-1 LOCAL GOVERNMENT REVENUE SOURCES, 1974-75 TO 1997-98



Source: Unpublished ABS Government Finance Statistics data.

- (a) State Grants include all Commonwealth payments through the States to Local Government except for the local government financial assistance grants and local road grants.
- (b) Commonwealth Grants include local government financial assistance grants and specific purpose payments paid directly to local government.

23. **State assistance.** Since the introduction of untied financial assistance grants, transfers from the Commonwealth and States to local government have varied between 25 per cent of local government revenue in 1974-75 and about 18 per cent in the 1990s. The share of revenue coming from Commonwealth grants has varied between 16 per cent in the early 1980s and 12 per cent in the late 1990s.

24. Although it has increased in real terms, State assistance to local government has declined in relative importance since 1974-75. State assistance over the period has increased at a slower rate than local government own-source revenue (0.4 per cent per annum compared to 4 per cent in real terms, respectively).

25. The analyses in Volume 2 show a broadly similar outcome for State assistance for all States except Tasmania. It suggests that the importance of State assistance in Tasmania is greater now than in 1974-75.

CHANGES IN LOCAL GOVERNMENT FUNCTIONS AND RESPONSIBILITIES OVER TIME

26. Many of the LGBs we consulted said that local government's functions and responsibilities have increased. These changes were said to have resulted from:

- (i) *devolution* — where another sphere of government gives local government responsibility for new functions⁷;
- (ii) *'raising the bar'* — where another sphere of government, through legislative or other changes, increases the complexity of or standard at which a local government service must be provided, and hence increases its cost;
- (iii) *cost shifting* — where there were two types of behaviour. The first is where local government agrees to provide a service on behalf of another sphere of government but funding is subsequently reduced or stopped, and local government is unable to withdraw because of community demand for the service. The second is where, for whatever reason, another sphere of government ceased to provide a service and local government steps in⁸; and
- (iv) *increased community expectations* — where the community demands improvements in existing local government services.

27. LGB representatives claimed that changes in the responsibilities of local government have been occurring at an increasing rate. They were concerned that these increasing responsibilities, devolved by the State and (to a lesser extent) the Commonwealth, were not being matched by an increase in funding or in appropriate access to additional revenue. Local government has responded by placing more reliance on user charges (a trend evident in our earlier revenue analysis), reducing expenditure in discretionary areas (roads and administration) and by increased borrowings. Even where local government is able to introduce a user charge, there are often differences in the capacity of individual LGBs to raise revenue from this source.

28. Our analysis of local government expenditure over the period 1961–62 to 1997–98 provides support for many of these claims. Again, more details can be found in Volume 2.

29. Figure 5-2 shows the changes in the composition of local government expenditure over the period of our analysis. There have been substantial changes. Some of the bigger ones have been:

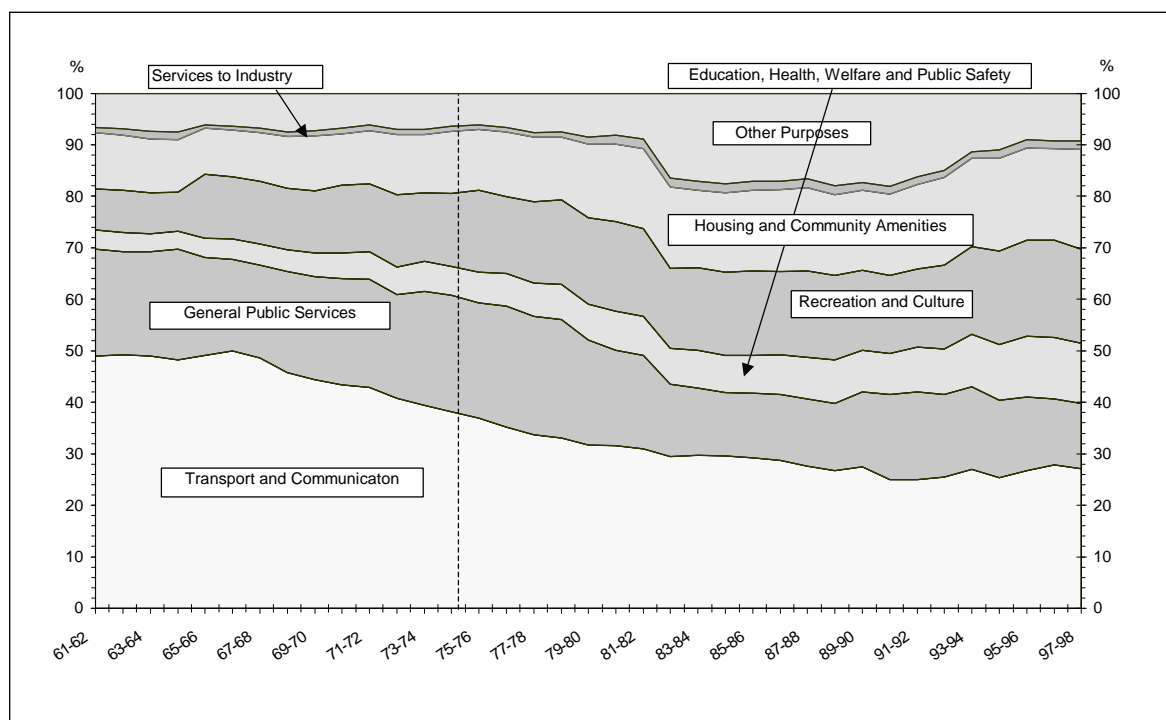
- (i) a move away from property-based services to human services;

⁷ Functions can be taken away, but this has not been the trend.

⁸ This is not limited to public services, local government is also stepping in to provide private services such as banking facilities.

- (ii) a decline in the relative importance of roads expenditure⁹ (although it remains the largest function, its level of importance has declined from about half of total expenditure in the 1960s to a little more than a quarter in the 1990s);
- (iii) an increase in the relative importance of Recreation and Culture, and Housing and Community Amenities (these are now large areas of local government expenditure, each approaching 20 per cent of total); and
- (iv) an expansion of Education, Health, Welfare and Public Safety services (this has increased from 4 per cent of total expenditure in 1961–62 to about 12 per cent in 1997–98).

Figure 5-2 COMPOSITION OF LOCAL GOVERNMENT EXPENDITURE, 1961–62 TO 1997–98



Source: Unpublished ABS Government Finance Statistics data.

30. Our analysis shows that, at the national level:
- the composition of services being provided by local government has changed markedly over the last 30–35 years; and

⁹ LGBs appear to have deferred road expenditure rather than reduce human services.

- local government is increasingly providing human services (social welfare type services) at the expense of its traditional property-based services (particularly roads).

31. Our analyses in Volume 2 suggests there are broadly similar findings for each State.

Implications

32. The terms of reference ask us to examine the implications of any changes in the functions or responsibilities of LGBs.

33. Compared with the situation before 1974–75, we have seen that:

- following the initial impact of the injection of Commonwealth funds, local government has maintained the share of revenue it derives from its own-sources;
- the share of local government revenue coming from the Commonwealth has increased;
- the share of revenue coming from State grants has declined; and
- local government responsibilities have broadened.

34. Local government organisations have argued that, to meet its new responsibilities, they need increased revenue from the Commonwealth in the form of financial assistance grants. They have said that, unless this is achieved, there will be a continuing deterioration in local government services, particularly in infrastructure and the local road network¹⁰.

35. The financial pressures being faced by LGBs are not due to a single influence. It is therefore unlikely that a single response would be reasonable or appropriate.

36. Where the source of the financial pressure is a result of the discretionary actions of the LGB itself (because LGBs have chosen to respond to particular needs of their residents), it would be appropriate for LGBs to meet these pressures from their own revenue sources.

37. Where the source of the financial pressure is the result of changing policies or actions of other spheres of government (the State or the Commonwealth), it would be appropriate for that sphere to acknowledge local government's need for greater financial assistance.

¹⁰ Recognising the need to improve local road condition, the Commonwealth recently announced the provision of \$1.2 billion over four years in tied grants for local government over four years under the *Roads to Recovery* Program.

38. LGBs in different circumstances will be subject to different financial pressures. For example, not every LGB has the same capacity to raise user charges. Giving LGBs an increased power to levy user charges does not mean they all have the same increase in capacity to provide additional services. Devolving functions to LGBs that are already highly dependent on grants risks their financial viability and there may be an argument for providing additional grants if they have low revenue capacities.

ANNOUNCING GRANT ALLOCATIONS AND DETERMINING GRANT POOL ADJUSTMENTS

39. Local government planning and budgeting requirements mean LGBs begin to prepare their budgets for the coming financial year as early as February. However, they do not receive notification of their grant allocation until August. Many participants said that this creates considerable difficulties, particularly if their grant is less than they expected and they need to adjust allocations within an already approved budget.

40. It is not possible to announce grant allocations before the Commonwealth brings down its Budget in May. However, it should be possible to announce final allocations to each LGB very shortly after that time. To do so would require:

- (i) final grant allocations to be determined using the level of funding announced in the Commonwealth budget;
- (ii) LGGCs to have their grant recommendations completed before May (based on the previous year's national pool); and
- (iii) a quicker approval process — the process by which the Commonwealth approves the LGGC recommendations.

41. The current arrangements are confusing for LGBs. The national grants pool is initially estimated based on expected increases in CPI and population. Grants are then allocated to LGBs based on the estimated size of the pool. In the following financial year, adjustments are made to the grants paid to LGBs in the previous year because actual increases in CPI and population in the previous year are different from those that were estimated.

42. Under our proposal, the final grant distribution to the States would be based on the estimates of CPI and population available at the time of the Commonwealth budget. This would allow the level of funding for each State to be announced in that budget. We propose that there be no adjustment in the following year for changes in these estimates. We think this proposal will greatly simplify the process.

43. It is possible for LGGCs to complete their grant recommendations before May. Some of them already do. Once the level of funding for the State is known, they could then finalise each LGB's grant allocation very quickly.

44. The process of approving distribution methods could begin prior to May. The new grant allocations do not need to be known to complete this process. The impact of the new recommendations could be assessed by applying them to the previous year's level of funding. Provided the information is in a form that allows the Commonwealth Minister to ensure the new assessments will distribute all the funds, the approval process could be completed prior to May. If approved, the new recommendations would then be applied to the current year's level of funding.

45. These changes may involve some compromises (for example, LGGCs may have to use older data) but there would be substantial benefits in terms to LGBs' budgetary processes. We think the Commonwealth, in consultation with the States and local government, should develop improved arrangements along the lines suggested.

ATTACHMENT A

NATIONAL PRINCIPLES FOR THE ALLOCATION OF GENERAL PURPOSE AND LOCAL ROADS GRANTS

1. The National Principles relating to the allocation of general purpose grants payable under section 9 of the *Local Government (Financial Assistance) Act 1995* (the Act) among local governing bodies are as follows:

- (i) ***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 that each local governing body in the State/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/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.
- (ii) ***Effort Neutrality.*** An effort or policy neutral approach will be used in assessing expenditure requirements and revenue raising capacity of each governing body. This means as far as practicable, policies of individual local governing bodies in terms of expenditure and revenue effort will not affect grant determination.
- (iii) ***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/Territory is entitled under section 9 of the Act in respect of the year were allocated among local governing bodies in the State/Territory on a per capita basis.
- (iv) ***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.
- (v) ***Aboriginal Peoples and Torres Strait Islanders.*** Financial assistance shall be allocated to councils in a way which recognises the needs of Aboriginal peoples and Torres Strait Islanders within their boundaries.

2. The National Principle relating to the 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 as follows:

- (i) The 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.