

CHAPTER 7

OTHER GRANT SUPPORT

1. The National Principle dealing with Other Grant Support requires LGGCs to treat:

other relevant grant support provided to LGBs to meet their expenditure needs by the inclusion approach.

2. This principle does not clarify what other relevant grant support means nor what the inclusion approach means. This chapter discusses:

- methods for treating SPPs¹ — the inclusion and exclusion approaches;
- what these methods mean for equalisation assessments; and
- what relevance this might have for deciding which SPPs should be treated by the inclusion approach.

Methods for Treating SPPs

3. The two methods of treating SPPs, inclusion and exclusion, affect how much revenue and expenditure is brought into the equalisation process. Ultimately, the choice between them is a choice between including or excluding from the equalisation process, the services the SPPs finance. Under:

Inclusion, the services funded from the SPP are brought into the equalisation process, and the SPP is seen as funds available to provide services required by the assessed expenditure needs; and

Exclusion, the services funded by the SPP are kept outside the equalisation process and differences in capacity to fund services through SPPs are not considered relevant to equalisation.

¹ The Commonwealth Grants Commission prefers the term specific purpose payments (SPPs) rather than other grant support. This term is used throughout this chapter.

4. As a general statement, equalisation is about equalising the capacity of recipient LGBs to provide services to their citizens. It is achieved by equalising both sides of the budget and is about:

- (i) taking into account the influences, over which LGBs have no control, that affect their revenue raising capacity; and
- (ii) assessing influences, over which LGBs have no control, that affect their cost of providing services.

5. **The inclusion approach.** Use of the inclusion approach brings the relevant SPP and the expenditure it finances within the equalisation system. Those that support the inclusion approach believe it is consistent with full horizontal fiscal equalisation. They argue that LGBs face the same expenditure disabilities in relation to the expenditure financed by an SPP as they do in relation to similar expenditure financed from other revenue sources and to ignore this expenditure could result in some LGBs being over equalised and others being under equalised.

6. **The exclusion approach.** Use of the exclusion approach keeps the relevant SPP and the expenditure it finances outside the equalisation system. Those that support the exclusion approach do so because they consider SPP funding to be different to the other forms of revenue². They view SPPs (and the expenditure they finance) as a separate funding arrangement, which should not be disturbed by the equalisation process. Their preference is for expenditure financed by SPPs to remain outside the equalisation process.

Example:

The disabilities that relate to roads expenditure exist regardless of how a LGB financed that expenditure — be it from the Local Roads pool, the General Purpose pool, the new *Roads to Recovery* SPP or its own taxes. The inclusion approach says that it does not matter how the expenditure was financed, all roads expenditure and all sources of revenue should be brought within the equalisation system. Exclusion says that roads expenditure financed by SPPs is different to roads expenditure financed by other revenues and the expenditure and the SPP ought to remain outside the equalisation system.

If inclusion is used for the new *Roads to Recovery* SPP, the SPP and the new roads expenditure flowing because of it will be brought into LGGC equalisation processes. If exclusion is used, the SPP and the expenditure it finances will be kept outside the equalisation process.

² There are three main sources of revenue. Own source revenue is revenue raised from LGB's own taxes and charges, it includes Municipal Rates and User Charges. Untied revenue is revenue received from another sphere of government that has no conditions attached to it, it includes General Purpose funding, Minimum Grants and Local Roads funding. SPP revenue is received from another sphere of government and has conditions attached to it, it includes HACC payments and *Roads to Recovery* payments.

What These Methods Mean for Equalisation Assessments

7. **The exclusion approach.** The exclusion approach excludes expenditure financed by SPPs from category standards. As a consequence, expenditure disabilities are not applied to this expenditure and neither the expenditure financed by the SPP nor the SPP affect equalisation outcomes.

8. Using the exclusion approach produces:

- lower expenditure standards (because some expenditure is excluded); and
- lower revenue standards (because the SPP revenue is excluded).

9. Some LGGCs calculate a discount factor, which they apply to the expenditure category standard prior to applying disabilities. The effect of this factor is to remove the expenditure financed by the SPP from the category standard. These discount factors are another way of implementing the exclusion approach, as long as the actual SPP revenue is then excluded from each LGB's revenue capacity.

10. **The inclusion approach.** The inclusion approach includes expenditure financed by SPPs in expenditure and revenue category standards. This means that expenditure disabilities are applied to the expenditure financed by the SPP and, as a consequence, equalisation outcomes are changed.

Example:

Assumptions: Two councils, A and B. Their only expenditure responsibility is roads and both spend exactly the same amount on their roads — \$100. This is also their assessed standardised expenditure. There are two sources of funds: General Purpose grants (\$160) and Local Roads grants (\$40), all of the latter is distributed to Council B.

Under inclusion, Council A's expenditure less SPPs received would be \$100 (\$100 less \$0 Local Roads grant) and Council B's expenditure less SPPs would be \$60 (\$100 less its \$40 Local Roads grant). Equalisation would require the General Purpose funding to be allocated according to this 100:60 need. Allocating the General Purpose grants in this fashion would leave both councils in the position of having sufficient funding to finance their expenditure.

Under exclusion, the expenditure standard reduces so that their equalisation assessments both fall to \$80. The Local Roads grants are ignored so that the \$160 General Purpose grants are divided on an 80:80 needs basis. Council A receives total funding of \$80 (\$80 in General Purpose grants and nothing in Local Roads grants) to finance its roads expenditure of \$100. Council B receives total funding of \$120 (\$80 in General Purpose grants and \$40 in Local Roads grants) to finance roads expenditure of \$100.

11. This simple example demonstrates some of the differences between inclusion and exclusion:

- inclusion involves higher expenditure standards — inclusion brings the expenditure financed by the Local Roads SPPs into the equalisation process, exclusion does not;

- inclusion involves higher revenue standards — inclusion brings the Local Roads grants into the equalisation process, exclusion does not; and
- inclusion takes the distribution of SPPs into account — inclusion assesses a net equalisation requirement because it deducts SPPs received, exclusion does not.

12. Exclusion benefits LGBs that receive a large share of the relevant SPP, because the SPP is not taken into account in the equalisation process and the LGBs retain the benefit of their large shares. Inclusion benefits LGBs that receive a small share of the SPP because the SPP is treated as revenue available to meet the assessed equalisation requirement of each LGB. A higher share of SPPs means, other things being equal, they need a lower share of General Purpose grants.

Which SPPs Should be Treated by the Inclusion Approach?

13. When LGGCs decide to assess a particular function, care needs to be taken to ensure all relevant expenditure is included in the category standard. A distinction should not be made between expenditure financed by an SPP and expenditure financed from other revenue sources. This suggests that:

- the decision about whether to use the inclusion or exclusion method should be subsidiary to the decision about whether or not the relevant function is included; and
- if the relevant function is included, the inclusion approach should be applied — all expenditure on the function should be included.

14. The example demonstrates that LGBs that receive a large share of Local Roads grants receive a more favourable treatment when these grants are treated by exclusion. By leaving them outside the equalisation process, LGBs that receive a large share of Local Roads grants retain that benefit. When the grants are treated by inclusion, they are treated as revenue available to finance a LGB's expenditure requirements.

15. The general rule is therefore to include SPPs if the related function is included.

16. There are exceptions to this general rule. One exception — the equivalence case — is discussed in the next chapter. Another exception is where information on the SPP is 'patchy' (because the SPP is paid to individuals in some areas, to Non-Government Organisations in other areas and to LGBs in other areas). In these circumstances, a judgement has to be made as to whether including the SPP on the basis of partial information is better or worse (in terms of impacts on equalisation outcomes) than excluding it.

Inclusion

17. The Other Grant Support National Principle tells LGGCs to include other relevant grant support provided to LGBs to meet any of their expenditure needs. LGGCs use a variety of methods to implement this principle. Table 7-1 provides a summary of their actions in respect of Local Roads grants.

Table 7-1 HOW LGGCS TREAT LOCAL ROADS GRANTS

State	Model used
New South Wales	The SPP and the expenditure it finances are both included in the standard budget.
Victoria	The SPP and the expenditure it finances are both <u>ex</u> cluded from the standard budget.
Queensland	The SPP and the expenditure it finances are both included in the standard budget.
Western Australia	The SPP and the expenditure it finances are both <u>ex</u> cluded from the standard budget.
South Australia	The SPP and the expenditure it finances are both included in the standard budget.
Tasmania	The SPP and the expenditure it finances are both included in the standard budget.
Northern Territory	The SPP and the expenditure it finances are both included in the standard budget.

18. Two LGGCs implement exclusion not inclusion. While the remaining LGGCs implement inclusion, they do not apply that approach to all the grants that LGBs receive from Commonwealth and State governments.

19. **Why does it matter?** When the inclusion approach is used, differences in the level of SPPs received are treated as differences in revenue capacity³. The decision to apply the inclusion approach on a particular SPP affects LGBs' expenditure and revenue assessments, and therefore their grant outcomes.

³ This point was made in the submission from the Central Local Government Region of South Australia.

CHAPTER 8

MINIMUM GRANT

1. The Terms of Reference for the Review included a requirement for the Commission to examine and report on:

- (i) the appropriateness of the current National Principles — in particular, the retention of or variations of the minimum grant in the general purpose component of the Commonwealth's funding.

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

The Current Arrangement

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

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

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

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

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

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

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

Example:

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

Limitation of the Analyses

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

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

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

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

Changing the Minimum Grant Threshold

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

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

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

12. The zero threshold is the same as having no minimum grant. It is not the same as a 'full' horizontal fiscal equalisation (HFE) outcome as full HFE would involve taking revenue from LGBs assessed to have a negative equalisation assessment and sharing it among the remaining LGBs. Such inter-LGB transfers are not feasible.

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

Results of the Analyses

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

Table 8-1 NUMBER OF MINIMUM GRANT LGBS, VARIOUS THRESHOLDS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Example:

The 10 per cent threshold implies a minimum grant of \$4.10 per capita. This per capita amount is applied not only to the 9 LGBs assessed to have equalisation outcomes between zero and \$4.10 per capita (10 per cent of the pool), but also to the 72 LGBs assessed to have negative equalisation outcomes.

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

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

Table 8-7 SUMMARY OF RESULTS BY THRESHOLD LEVEL

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

(a) The amount falls to \$0.3 million if the \$21.2 million is apportioned across the 72 negative equalisation outcome LGBs as well as the 9 LGBs with equalisation outcomes less than \$4.7 per capita.

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

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

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

What’s the Effect on Other LGBs?

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

based grant in each State, and how it changes as the threshold is increased¹. The last column compares the average grant under a 50 per cent threshold with the same outcome if there were no minimum grant (the zero threshold). It also shows the ratio of these per capita amounts compared to the zero threshold amount.

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

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

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

- suggest greater volatility in Queensland, Western Australia and South Australia; and
- suggest that the relative change in equalisation outcomes is smallest at the 0 and 10 per cent thresholds and largest at the 50 per cent threshold.

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

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

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

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

26. This analysis provides some justification for not increasing the minimum grant threshold level. They were:

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

27. However it also suggested that reducing the percentage threshold level will not release a large amount of funds for the LGBs receiving equalisation outcomes — unless big changes are made to the percentage threshold. If the threshold is reduced to 20 per cent, \$30.9 million (a little more than \$2 per capita²) is released. This rises to \$53.5 million (about \$4 per capita) if the percentage is reduced to 10 per cent and \$74.7 million (\$5 per capita) if it is removed completely.

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

A Different Arrangement

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

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

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

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

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

What Treatment Should Apply to the Per Capita Grants?

30. Chapter 7 said that a decision has to be made about how to treat other grants which are used to finance service provision. Two options were discussed: inclusion and exclusion. In this section, both treatments are considered for the Per Capita grants.

31. **Inclusion.** These large changes will not be relevant if, for the purposes of the equalisation assessments, the minimum grant allocations are treated by the inclusion method. In these circumstances, LGBs should receive what they receive under the current arrangements³. Chapter 10 explains why the large changes are not relevant when the inclusion method is used.

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

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

Example:

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

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

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

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

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

CHAPTER 9

LOCAL ROADS FUNDING

1. Under the current Act, Local Roads grants are paid under section 12 as ‘additional funding for local government’. Although usually referred to as ‘identified road grants’, and allocated between LGBs based on road needs, they are untied in the hands of the receiving LGB.

2. This chapter looks at two issues:

- the methods used by LGGCs to allocate Local Roads assistance; and
- whether these allocations should be treated by the inclusion or exclusion approach.

It summarises the different LGGC approaches and provides some comparisons of the outcomes of their distribution methods.

Background

3. Local government spends about \$2.4 billion¹ or around 24 per cent of its funds on local roads. Although local roads comprise around 84 per cent of Australia’s road length, they represent only 24 per cent of national road use².

4. At the 1990 Special Premiers’ Conference, the Commonwealth and the States agreed on a hierarchy of responsibilities for roads in Australia. The Commonwealth is responsible for the National Highway and roads of national importance, the States for State Highways and arterial roads, and local government for local roads. As a result, from July 1991, Commonwealth grants to local government for local roads were untied and provided as a separate component under the (amended) 1986 Act.

¹ Outlays on Transport and Communication by local government, Table 22 of ABS Government Finance Statistics (5512.0), 1997–98.

² Austroads 1997, *Road Facts '96*, p18. Road use is measured in million vehicle kms travelled.

5. Under the 1986 Act, the Local Roads grants were to be absorbed into the General Purpose grants from 1 July 1995 and all General Purpose grants were to be distributed between States on an equal per capita basis. In the review of the *Local Government (Financial Assistance) Act 1986*, the Australian Urban and Regional Development Review (AURDR) was asked to report on whether the separate calculation of roads funding and General Purpose funding should continue or, if not, how the roads funds should be distributed.

6. The AURDR recommended against absorbing the roads grants into the General Purpose grants, although it recognised that the separate allocation of roads funds distorted the achievement of horizontal fiscal equalisation³. It argued that, because of the proposed redistribution of the grants between States to an equal per capita basis, absorbing the grants would lead to much greater disruption than a continuation of the current funding methods.

7. In 1999–2000, the Commonwealth provided \$390 million to LGBs as Identified Roads grants. This is equivalent to around \$21 per capita or \$610 per kilometre of local road. It represented about 15 per cent of the funds LGBs spent on maintaining local roads. Under the current Act, the quantum of the Local Roads grants grows at the same rate as the General Purpose grants — that is, it is maintained in real per capita terms.

8. The distribution of Local Roads grants between States is based on historical shares and is the same as that which applied under the previous tied grant arrangements. The original basis for this distribution is now not known. Table 9-1 shows length of local roads and the allocation of Local Roads grants by States for 1999–2000. Table 9-2 gives the States' per capita and per kilometre relativities for the Local Roads grants.

Table 9-1 THE DISTRIBUTION OF LOCAL ROADS GRANTS, 1999–2000

	Local road length	Local Roads grants	Share of Local Roads grants	Share of population	Share of local road length
	km	\$m	%	%	%
NSW	142 159	113.0	29.0	33.8	22.3
Vic	125 318	80.6	20.6	24.9	19.6
Qld	144 104	73.2	18.7	18.5	22.6
WA	121 351	59.7	15.3	9.8	19.0
SA	74 732	21.5	5.5	7.9	11.7
Tas	14 076	20.7	5.3	2.5	2.2
NT	14 491	9.2	2.3	1.0	2.3
ACT	1 848	12.5	3.2	1.6	0.3
Total	638 079	390.7	100.0	100.0	100.0

Source: Department of Transport and Regional Services and unpublished LGGC data.

³ Macklin J. 1994, *Financing Local Government: A review of the Local Government (Financial Assistance) Act 1986*, AURDR, p115.

Table 9-2 COMPARATIVE MEASURES OF LOCAL ROADS GRANTS, 1999–2000

	Grants per capita	Grants per km ^(a)	Per capita relativities	Per kilometre relativities
	\$pc	\$ per km		
NSW	17.78	797	0.8576	1.3023
Vic	17.20	643	0.8296	1.0497
Qld	21.02	508	1.0141	0.8296
WA	32.37	492	1.5615	0.8040
SA	14.42	287	0.6954	0.4692
Tas	43.97	1 471	2.1209	2.4023
NT	47.84	632	2.3077	1.0315
ACT	40.63	6 780	1.9600	11.0716
Total	20.73	612	1.0000	1.0000

(a) Uses total length of local roads rather than lane length.

Source: Department of Transport and Regional Services.

9. The *Local Government (Financial Assistance) Act 1995* does not place any conditions on the way LGGCs distribute Local Roads grants to LGBs, except through the National Principles that emanated from it. The National Principle is that:

The identified road component of the financial assistance grants should be allocated to local government bodies as far as practicable on the basis of the relative needs of each local governing body for road 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.

10. The National Principle thus states that there are two aspects LGGCs are to take into account when allocating Local Roads grants — relative needs and preservation of assets. There is no requirement to allocate the funds on the basis of horizontal fiscal equalisation.

11. There are two different approaches followed by LGGCs. One uses a simple formula, taking into account such factors as a LGB's share of road length and population and appears to have been derived from the models in use before the funds became untied. The other approach used is an asset preservation model.

12. In Western Australia, South Australia and Tasmania, a relatively small proportion of the grant is reserved for funding major road works. These projects are selected by LGGCs based on submissions from LGBs, and usually with advice from third parties.

13. A description of the approaches used by the LGGCs follows.

New South Wales

14. The allocation model is:
- (i) 27.54 per cent is allocated to local roads in urban areas (LGBs in the Sydney, Newcastle and Wollongong Statistical Divisions) and then to LGBs on the basis of:
 - 5 per cent based on share of bridge length;
 - 57 per cent based on share of road length; and
 - 38 per cent based on share of population.
 - (ii) 72.46 per cent is allocated to local roads in rural areas and then to LGBs on the basis of:
 - 7 per cent based on share of bridge length;
 - 74.4 per cent based on share of road length; and
 - 18.6 per cent based on share of population.

There is an added condition that a rural LGB's allocation cannot decline by more than 10 per cent of the previous year's entitlement.

Victoria

15. The Victorian LGGC recently reviewed its Local Roads grant model and intends introducing a revised approach in 2001–02.

16. Under the revised approach, Local Roads grants will be allocated based on the 'average annual life-cycle costs' of each LGB's local road network. Roads will be categorised into sealed roads; formed and surfaced roads; and natural surfaced roads.

17. Key determinants of grants will be road length, traffic volumes. The method will include factors (such as freight, climate, materials availability and whether or not roads are strategic routes) which have an impact on road costs.

18. For each LGB, the Commission will:
- (i) determine the total length of each road;
 - (ii) determine traffic volumes for each road;
 - (iii) apply disability factors — freight loading, climate, materials, reactive sub-grades and strategic routes;
 - (iv) apply the average annual life cycle costs for each road; and

- (v) combine these assessments to obtain the annual estimated road expenditure need for the LGB.

19. A separate assessment will be made for bridges.

20. Until 1998–99, a portion of the Local Roads grants was made available as Special Impact Funding for specific road maintenance and construction projects that benefited Aboriginal communities. The Victorian LGGC considered submissions from LGBs and received advice from Aboriginal Affairs Victoria. In 1998–99, \$332 500 was allocated as Special Impact Funding to five Victorian LGBs.

Queensland

21. For Queensland LGBs, the allocation model is:

- (i) 62.85 per cent in proportion to road length; and
- (ii) 37.15 per cent in proportion to population.

Western Australia

22. For Western Australia, 93 per cent of the funds are distributed according to an asset preservation model and the remaining 7 per cent are allocated annually for special projects. One third of the special projects funds are for roads serving Aboriginal communities and two thirds for major bridge works. The Aboriginal Roads Committee advises the LGGC for the Aboriginal road projects, and the Main Roads Department provides advice on bridge projects.

23. The asset preservation model assesses the cost of maintaining a LGB's road network. It takes into account annual and recurrent maintenance costs, and the costs of reconstruction at the end of the useful life of a road. It recognises:

- (i) the different needs of urban and rural roads;
- (ii) the costs associated with different types of roads (sealed, gravel and formed roads); and
- (iii) the impact of different use on these roads.

24. The model calculates annual asset preservation expenditure needs for a particular work activity (eg resealing) for a LGB by the formula:

$$\text{annual expenditure need} = \text{unit cost per km} \times \text{frequency factor} \times \text{road length}$$

where

unit cost per km is the cost of maintaining the particular road type at the minimum standard for that work activity;

Chapter 9

frequency factor reflects how often the work is carried out (eg if every 15 years, then the frequency factor is 1/15); and

road length is the length of road of the particular type in the LGB area.

25. The annual cost of road work activities is calculated for each LGB and summed to obtain the LGB's total asset preservation expenditure needs. The Local Roads grants are allocated to LGBs on the basis of their total asset preservation expenditure needs.

South Australia

26. In South Australia, the LGGC allocates 85 per cent of the funds based on a simple formula. For metropolitan LGBs, it determines allocations by an equal weighting for population and road length. For non-metropolitan LGBs, it determines allocations by an equal weighting for population, road length and LGB area.

27. The remaining 15 per cent of the roads grants are used for special Local Roads grants with these funds distributed following submission of proposals by LGBs. Recommendations on proposals are provided by the Local Roads Advisory Committee.

28. The South Australian LGGC is currently reviewing its Local Roads grants methodology.

Tasmania

29. The Locals Roads grants are distributed as follows.

- (i) Road preservation component — 66.5 per cent based on relative road expenditure needs as determined using an asset preservation model.
- (ii) Bridge expenditure component — 28.5 per cent based on relative bridge deck areas for concrete and wooden bridges, but not culverts.
- (iii) Special needs component — 5 per cent allocated to LGBs with an above average proportion of rural unsealed roads, based on relative length of rural unsealed roads.

30. The Tasmanian LGGC uses a modified version of the 'Mulholland' asset preservation model to assess road expenditure based on each LGB's road assets. The approach used focuses on the maintenance and re-construction of existing road assets.

31. For each LGB, the LGGC:

- (i) determines the total length of each road category (sealed and unsealed, urban and rural);

- (ii) applies performance standards to determine the length of road that will undergo each maintenance and re-construction activity each year in order to preserve the existing road structure;
- (iii) applies disability factors — climate, drainage, material, soil, terrain, traffic and cost factors applied to re-construction; and climate, traffic and cost factors to maintenance;
- (iv) applies State-wide average costs per kilometre for each activity; and
- (v) combines cost estimates across road categories and activities to obtain the annual estimated road expenditure need for the LGB.

Northern Territory

32. The local roads component is distributed according to weighted road lengths, with the weightings as follows.

Table 9-3 LOCAL ROAD WEIGHTINGS, NORTHERN TERRITORY

Type of Road	Weighting
Sealed, kerbed and guttered	10.0
Sealed	8.0
Gravel	4.0
Cycle path	2.0
Formed	1.0
Flat bladed track	0.4

33. Municipal councils in the Northern Territory cover a relatively small proportion of the total area of the Territory and Aboriginal Community Councils are not usually given responsibility for a large area. Therefore, some local roads are not allocated to a LGB. These roads are maintained under a ‘roads trust’ with the funds managed by the Local Government Association of the Northern Territory.

34. Table 9-4 compares the indicators used by the LGGCs to distribute Local Roads funds.

Table 9-4 INDICATORS USED TO DISTRIBUTE LOCAL ROADS GRANTS

Indicator	NSW	Vic	Qld	WA	SA	Tas
Population	Yes	Yes	Yes	Yes	Yes	No
Road length	Yes	Yes	Yes	Yes	Yes	Yes
Area	No	No	No	No	Yes	No
Bridge indicator	Yes	No	No	Yes	No	Yes
Urban rural split	Yes	Yes	No	Yes	Yes	Yes
Special needs	No	Yes	No	Yes	Yes	Yes
Road surface type	No	Yes	No	Yes	No	Yes
Asset preservation	No	No	No	Yes	No	Yes
Freight indicator	No	No	No	Partial	No	Yes

Source: ARRB Transport Research and NIEIR 1999, *Review of Distribution Arrangements for Local Roads Funding in Victoria: Accompanying Paper* with corrections as noted in the 1998–99 Local Government National Report.

Comparison of Grant Outcomes Between States

35. Table 9-5 shows the range of road relativities for LGBs within each State. As expected, for most States there is a much lower variation for the per kilometre relativities than there is for per capita relativities. For those States that distribute the Local Roads grants using a simple formula of population and road length, the range of per capita relativities tends to be greater than for those that use asset preservation models to allocate the grants.

Table 9-5 LOCAL ROADS RELATIVITIES FOR LOCAL GOVERNING BODIES, 1999–2000 GRANTS

	Per capita relativities		Per km relativities	
	Minimum	Maximum	Minimum	Maximum
NSW	0.2135	33.1691	0.6594	2.8787
Vic	0.2552	9.2096	0.3544	3.7904
Qld	0.3928	68.2242	0.3808	6.9717
WA	0.0157	6.5308	0.4587	6.7155
SA	0.4154	23.2301	0.3511	19.2576
Tas	0.3542	8.5481	0.6457	1.9540
NT	0.3667	8.0689	0.0695	10.5691

Source: 1998–99 Local Government National Report and unpublished LGGC data.

36. Table 9-6 shows the average grant per kilometre for each State by each category of LGB in the Australian Classification of Local Government. There are limitations in using this table for comparing Local Roads grant outcomes across States. Categories may not reflect groupings of LGBs that have similar 'road needs' within and between States.

37. However, the table does show some very large differences between States for some categories. For instance, for the Urban Capital City category, the average grant per kilometre varies between \$1070 in Victoria to \$3302 for Perth, yet this is one category where the 'road need' might be expected to be fairly similar across States. Given the different approaches used to allocate Local Roads grants, such variations between States are not unexpected.

Table 9-6 AVERAGE ROADS GRANT PER KILOMETRE AND ACLG CATEGORY, 1999-2000 (\$ per km)

Category	NSW	Vic	Qld	WA	SA	Tas	NT	All States
Urban Capital City	1 704	1 070	1 635	3 302	1 304	2 192	3 253	1 762
Urban Developed Small	1 664	2 000	–	1 509	2 421	–	–	1 605
Urban Developed Medium	1 721	1 079	1 952	1 432	1 303	–	–	1 485
Urban Developed Large	1 653	1 115	–	1 325	1 264	–	–	1 264
Urban Developed Very Large	1 640	1 123	1 565	1 392	–	–	–	1 347
Urban Regional Small	1 031	442	530	799	650	1 763	681	628
Urban Regional Medium	1 084	513	807	750	–	2 738	–	776
Urban Regional Large	1 107	901	1 053	–	–	–	–	985
Urban Regional Very Large	1 348	1 113	1 552	–	–	–	–	1 338
Urban Fringe Small	–	679	481	1 118	1 377	1 185	3 300	693
Urban Fringe Medium	1 121	769	707	1 072	601	–	–	867
Urban Fringe Large	1 152	1 306	1 080	1 155	–	–	–	1 182
Urban Fringe Very Large	1 354	937	941	1 298	1 022	–	–	1 134
Rural Significant Growth	–	662	440	746	–	1 435	–	624
Rural Agricultural Small	544	–	328	374	155	511	–	341
Rural Agricultural Medium	582	–	343	450	131	1 166	–	426
Rural Agricultural Large	608	240	375	478	193	1 353	–	418
Rural Agricultural Very Large	651	424	398	439	216	1 548	1 857	488
Rural Remote Extra Small	–	–	329	252	200	–	458	314
Rural Remote Small	–	–	327	330	–	–	446	358
Rural Remote Medium	525	–	327	285	101	–	479	331
Rural Remote Large	541	–	337	447	–	–	–	414
All Categories	796	543	507	492	287	1 469	669	574

Source: Department of Transport and Regional Services, unpublished data.

ROADS GRANTS AND THE OTHER GRANT SUPPORT PRINCIPLE

38. In Volume 1 of this report the Commission commented on the complexity of roads funding. It said:

- 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.

39. Table 9-7 summaries the assessment methods LGGCs use:

- to distribute Local Roads grants; and
- to assess road needs within their General Purpose assessments.

40. The most striking feature of this table is that LGGCs tend to use one method for one and a different method for the other, and they are inconsistent in what they think are the better approaches for each fund. This is having an influence on the distribution of overall (General Purpose and Local Roads) grants.

41. 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. This means that, for a given assessment of road needs, the more funds a LGB receives from the Local Roads pool the less it requires from the General Purpose pool. If a LGGC takes the Local Roads grants into account, the Commission would say it has included them. If it ignores the Local Roads grants, it would say it has excluded them.

42. Table 9-7 shows that most LGGCs use the inclusion approach, two use the exclusion approach and another two use exclusion for part of the Local Roads grants.

43. The different approaches to the two assessments mean that a different answer will be produced, depending on whether the inclusion or exclusion approach is applied to the Local Roads pool.

44. In Volume 1 the Commission concluded that the different treatments raised two important questions:

- (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.

Table 9-7 MAJOR FEATURES OF LOCAL ROADS ASSESSMENT METHODS

	Identified Roads Grant		General Purpose Grant	How Roads Grant is Treated?
	Main Feature	Additional Features	Assessment Method	
NSW	Population, road length and bridge length.	Fixed percentage of pool for Sydney, Newcastle and Wollongong. Other LGBs share rest.	A version of the Mulholland asset preservation model.	Exclusion.
Vic	Asset preservation model. Roads are classified according to location and traffic use. Standard costs per road length are assumed for each road type and road length and disabilities are applied.	Special needs assessments are funded from the pool.	Factor assessment method. LGB's share of standard is calculated as road expenditure times LGB's share of road lengths. Other road disabilities are then applied. Method subject to review this year.	Exclusion ^(a)
Qld	Population and road length.	None.	A version of the Mulholland model asset preservation model.	Inclusion 70%. 30% excluded because 30% of expenditure is excluded.
WA	Asset preservation model.	7 per cent of the pool is set aside for special projects (bridges and roads serving Indigenous communities).	Asset preservation model.	Inclusion
SA	Population, road length and, for non-metropolitan LGBs, area.	15 per cent of pool is set aside for special roads projects. Remaining pool is split between metropolitan and non-metropolitan based on population and road length.	Factor assessment method. LGB's share of standard is calculated as road expenditure times LGB's share of population. Factors assessed for material haulage, soil type, rainfall and drainage and applied to LGB's share of road lengths.	Inclusion 85%. The special roads project amounts are excluded.
Tas	Asset preservation model.	5 per cent of the pool is set aside for special needs (unsealed rural roads). The remaining pool is split between an asset preservation model (66.5 per cent) and bridge deck area 28.5 per cent).	Asset preservation model. No allowance for bridge deck area or special needs.	Inclusion
NT	Factor assessment method. Cost weights applied to road length.	Minimum grant of \$20 000. LGANT receives roads funding for some of the unincorporated area.	Factor assessment method. Cost weights applied to road length. There is no minimum assessment.	Inclusion

(a) They may intend to include Local Roads grants but the method they have chosen effectively excludes them.

How Should Local Roads Grants be Treated Within the General Purpose Assessments?

45. In Chapter 7 it was concluded that SPPs could be treated by one of two methods:

- (i) inclusion — the SPP and the expenditure it financed are brought into the equalisation assessments; or
- (ii) exclusion — the SPP and the expenditure it finance are left out of the equalisation assessments.

46. There are two reasons for treating Local Roads grants by the inclusion method:

- it is what is required by the Other Grant Support National Principle; and
- it is more consistent with the practice of equalisation in Australia.

47. The Commonwealth Grants Commission thinks that the present Horizontal Equalisation and Other Grant Support principles require inclusion to be used for Local Roads grants. It is an important decision because the use of exclusion produces a different distribution of grants.

Should There be One or Two Methods of Assessing Road Needs?

48. Much of the debate between inclusion and exclusion arises because LGGCs use one method to distribute Local Roads grants and another to assess road expenditure needs within their General Purpose assessments. If they used one method, then LGBs' overall grants will be the same⁴ regardless of whether:

- (i) the expenditure financed by the Local Roads assistance is included in the Roads category and disabilities are applied to it (the inclusion method); or
- (ii) the expenditure financed by the Local Roads assistance is excluded from the Roads category (the exclusion method).

49. The question is, therefore, whether LGGCs should have two different methods of assessing road needs.

⁴ This equivalence arises because if the expenditure financed by the Local Roads assistance has the same distribution pattern as the Local Roads grants then, since one is an expenditure and the other a revenue, they would offset one another within the General Purpose assessments.

50. Having separate distribution methods would make sense if the two pools are intended to achieve different purposes. If, for example, the Local Roads grants were intended to include the costs of construction of new roads while the General Purpose grants were intended to cover only the costs of maintaining existing roads. However, this is unlikely because both grants are untied.

51. If the two pools are intended to achieve the same purpose (or they are truly untied funding) there is merit in using one method of assessing relative road needs.