

CHAPTER 4

THE NATIONAL REPORT

1. The *Local Government (Financial Assistance) Act 1995* introduced a requirement for the Federal Minister to have an annual report prepared on the operation of the Act. This report has been produced covering each grant year from 1996–97 and is referred to as the *Local Government National Report*. This chapter provides details of the current status of the National Report.

2. The production of the National Report was one of the recommendations of the Australian Urban and Regional Development Review (AURDR) of the 1986 Act.

There is clearly a need for uniform national reporting on the main features of local government finance. A national reporting framework would enable the Commonwealth to monitor how grant funds are spent. It would allow the Commonwealth, the States and local government to compare outcomes between similar LGBs in different States.¹

3. However, the reporting requirement introduced by the 1995 legislation goes beyond reporting on grant outcomes. Under section 16 of the Act, the Federal Minister must have a report on the operation of the Act prepared ‘as soon as practicable after 30 June in each year’. Copies are then to be tabled in each House of Parliament. In practice, these reports have been tabled within six months of the end of the financial year.

4. The Act also requires the Minister to ensure that State Ministers and Local Government Associations are consulted in connection with the preparation of the Report. Each year, the State Ministers and the Local Government Associations have been asked for and have provided material for the Report.

5. The Act requires that:

16 (3) The report or one of the reports must include an assessment by the Minister (based on comparable national data), in relation to the year, of:

(a) the extent (if any) to which the allocation of funds for local government purposes has been made on a full horizontal equalisation basis as mentioned in paragraph 6(2)(a); and

¹ Macklin, Jenny (ed) 1994, *Financing Local Government: A Review of the Local Government (Financial Assistance) Act 1986*, Australian Urban and Regional Development Review Discussion Paper 2, p.15

- (b) the methods used by the Local Government Grants Commissions in making their recommendations; and
- (c) the performance by local governing bodies of their functions, including:
 - (i) their efficiency; and
 - (ii) services provided by them to Aboriginal and Torres Strait Islander communities.

6. During the House of Representatives second reading speech for the 1995 Act, it was said that:

The new national report will include information on the grants to individual councils and categories of councils. It will report on Local Government Grants Commission methodologies in relation to both equalisation and local roads grants, on achievement of horizontal equalisation amongst councils and on council efficiency and effectiveness. The report will also provide information on the operation of the Act in relation to service delivery to Aboriginal and Torres Strait Islander communities.

I am sure that honourable members will ... recognise that local government efficiency and effectiveness and service delivery to Aboriginal and Torres Strait Islander communities are important and legitimate national priorities.

Reporting on services to Aboriginal and Torres Strait Islander communities will not be a simple task. The Commonwealth does not hold most of the information and we will need to work hard and co-operatively to ensure data are comparable and meaningful.

7. The reporting task thus described in the second reading speech is very close to the form that the National Reports have taken.

LGGC Methods and Grant Allocations

8. In relation to financial assistance grant allocations and LGGC methods, information in the 1998–99 National Report included:

- an explanation of the grants distribution process, how grant pools are calculated, how the funds are distributed between States and the basic features of grants distribution methods within a State;
- a statement of the key features for rating capacity, roads grants and expenditure assessments of each of the LGGC methods;
- a comparison of average General Purpose grants per capita, by State and by LGB classification;

- a comparison by State of the number of LGBs on minimum grants, the share of the State population in minimum grants LGB areas, and the share of the State General Purpose grants going to minimum grant LGBs;
- the impact of LGGC capping policies on grant outcomes;
- an assessment from a Victoria Grants Commission review of the Commissions' Local Roads grant methods and the compliance of State methods with the National Principle;
- the National Principles;
- descriptions provided by LGGCs of their methods for distributing grants to LGBs;
- a guide to differences in LGGC methods, showing the impact on grant outcomes and on the achievement of horizontal fiscal equalisation; and
- details of grant allocations to each LGB (for both the current and coming year, providing General Purpose, Local Roads and total grants), plus some basic data on each LGB.

9. The task of assessing the achievement of horizontal fiscal equalisation is difficult as there is no objective basis for assessing this. For instance, if an alternative but slightly different distribution of funds for a State is proposed, it is not possible to say with any certainty which distribution is closer to achieving the horizontal fiscal equalisation ideal. There may be some subjective assessments of the distributions that could be made. The minimum grant requirement also complicates this issue as it limits the extent to which horizontal fiscal equalisation can be achieved within a State.

10. Although one goal of the Act is to encourage consistency in methods across States, demonstrating that different outcomes are achieved across States does not identify which of the methods comes closer to meeting the requirements of the National Principles. One State may have different outcomes compared to all other States but these outcomes may align better with the National Principles.

Local Government Efficiency

11. There has been limited success in using comparable national data to assess the efficiency of LGBs.

12. LGGCs do not consider the efficiency of LGBs when allocating grants. Commissions allocate grants based on an average level of efficiency for a service in the State. This means that LGBs that are more efficient than average are able to provide more services from available revenue (or have lower rate imposts) and the less efficient are able to provide fewer services (or have higher rate imposts). Thus, efficient LGBs were already rewarded for their improved performance.

13. Following the AURDR, the Local Government Ministers agreed to jointly pursue a Benchmarking and Efficiency Program. The program included three strategies for increasing LGBs' efficiency and effectiveness, one of which was to measure the performance of LGBs by using performance indicators.²

14. In 1997, the Industry Commission (now the Productivity Commission) was asked to review the value and feasibility of developing national performance indicators for local government. It concluded that a nationally consistent approach to performance indicators was not warranted but that there would be considerable benefit to the community by improving existing State and Territory performance measurement systems³. It also concluded that although national performance indicators would facilitate reporting by the Minister on local government's performance, this requirement could be met by providing information and analysis on:

- (i) the application of the national competition policy to local government;
- (ii) progress by the States in improving the use of performance indicators; and
- (iii) developments in areas such as competitive tendering and contracting, the increased use of service charters and measures of customer satisfaction, and changes in the structure of local government.

15. In reporting on LGB performance, subsequent National Reports have tended to focus on these issues. For instance, the 1998–99 National Report provided summaries of:

- State progress with developing key performance indicator systems for local government;
- State progress with microeconomic reform, including National Competition Policy, competitive tendering and contracting and structural reform;
- LGBs and their innovations that received the Federal Government's National Awards for Innovation in Local Government in 1999;
- approaches to improving planning and development systems;
- the community satisfaction measurement program in Victoria; and
- examples of leading practice in local government.

² The other strategies were to encourage LGBs to adopt continuous improvement techniques such as process benchmarking, and to examine innovations that had the potential of providing significant gains in efficiency.

³ Industry Commission 1997, *Performance Measures for LGBs: improving local government performance indicators*, AGPS, Melbourne, October.

Services to Indigenous Communities

16. Although assessing the performance of local government in providing service to Indigenous communities was recognised by the Commonwealth Minister in the second reading speech for the 1995 Act as ‘not being a simple task’, this reporting requirement was supported by resolutions passed at the Local Government Ministers’ Conference (LGMC). At the 1995 LGMC, Ministers resolved to report annually on progress by LGBs in meeting the needs of Indigenous communities.

17. These reports have been published in the National Report, together with the outcomes of projects seeking to improve services to Indigenous communities funded under the Commonwealth’s Local Government Development Program. The Commission heard nothing to indicate that the National Report has had any substantial impact on levels of local government services provided to Indigenous communities.

CHAPTER 5

HISTORY OF COMMONWEALTH UNTIED FINANCIAL ASSISTANCE TO LOCAL GOVERNMENT

1. The Commonwealth has been providing untied financial assistance to local government since 1974–75. Grants for LGBs in the Northern Territory began in 1979–80 after the Territory achieved self government, and a grant to the ACT for municipal services began in 1988–89, again after self government was granted. Local Roads grants, which had previously been paid as a specific purpose payment to the States for on-passing to local government, became untied and were added to the financial assistance grants in 1991–92¹, although they remain a separately identified part of the Commonwealth assistance.

2. The amount of financial assistance has grown from \$56 million in 1974–75² to over \$1.3 billion in 2000–01. The Commonwealth has always paid these grants through the States — under section 96 of the Constitution — rather than direct to LGBs. Local government also receives about \$125.5 million from the Commonwealth in 2000–01 through specific purpose payments, largely for child care programs administered by local government on behalf of the Commonwealth and funding for aged and disabled persons' homes and hostels.

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

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

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

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

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

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

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

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

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

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

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

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

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

13. ***Local Government (Financial Assistance) Act 1995.*** This Act was introduced following the AURDR review. It provided for the establishment of National Principles that replaced the separate State principles developed under the 1986 Act. The objective was to guide LGGCs in the distribution of grants between LGBs, thus ensuring greater similarity of approaches between States. Enhancements to the accountability requirements of States required the Commonwealth Minister to present an annual report to Parliament — called the Local Government National Report — on the operation of the Act. Under this Act, Local Roads funding continued to be distributed according to historical shares³.

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

CHAPTER 6

ESCALATING THE NATIONAL GRANTS POOLS

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

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

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

- (i) unless the Treasurer decided otherwise, each grants pool is maintained in real per capita terms;
- (ii) the increase in the grants pool for the grant year is in line with expected CPI change¹ for the year; and
- (iii) LGBs receive their full entitlement — each year the grants paid comprise an estimated entitlement for that year plus an adjustment for the previous year's entitlement because of errors in estimating the CPI and population growth change.

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

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

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

CURRENT ARRANGEMENT

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

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

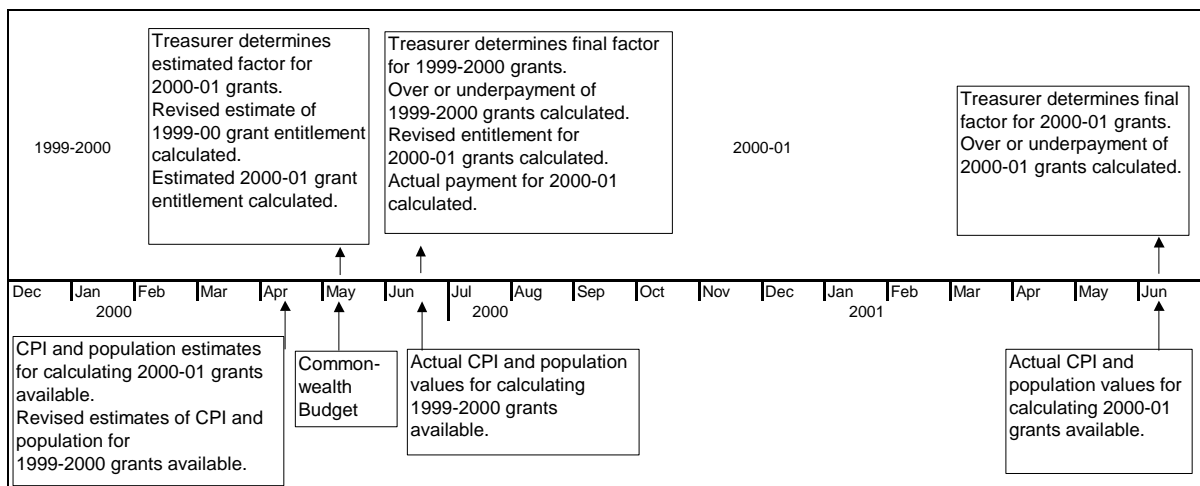
where

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

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

Pop this year = the population as at December prior to the relevant financial year (ie population for December 1998 is used to calculate the 1999–2000 grants pool)

Figure 6-1 THE CURRENT ARRANGEMENT



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

7. This is shown in Figure 6-1 above. The table below shows how the availability of data has an effect on the grant calculations. The 2000–01 year is used as the example.

Table 6-1 HOW DATA AVAILABILITY AFFECTS GRANT CALCULATIONS

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

THREE OPTIONS

Option 1— Use CPI and Population Estimates

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

9. This approach is shown in Figure 6-2 and in Table 6-2 below. It uses the same definitions of CPI and population as are used in the current arrangements.

Figure 6-2 OPTION 1

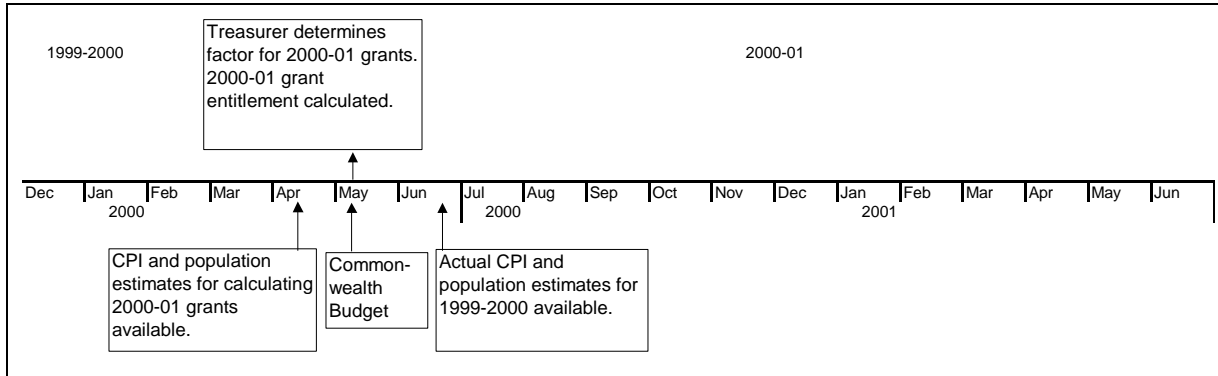


Table 6-2 DATA AVAILABILITY AND OPTION 1

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

Advantages and Disadvantages

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

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

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

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

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

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

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

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

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

17. This is shown in Figure 6-3 and Table 6-3.

Figure 6-3 OPTION 2

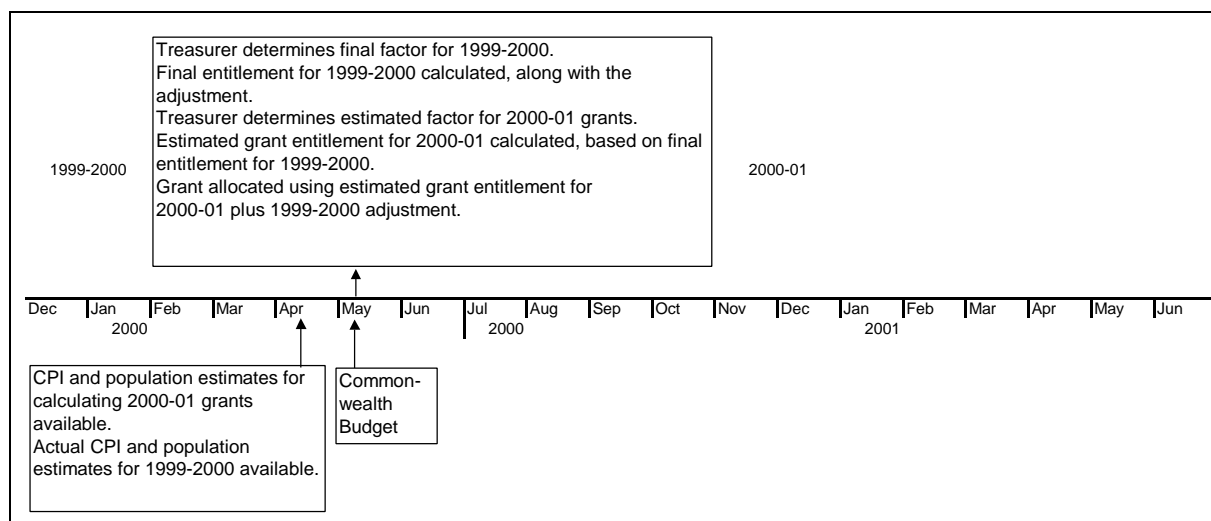


Table 6-3 DATA AVAILABILITY AND OPTION 2

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

Advantages and Disadvantages

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

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

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

21. Different definitions of CPI and Population are used:
 - *CPI* movement is for the previous financial year (ie *CPI* movement for 1998–99 is used for the 1999–2000 grants); and
 - *population* is at June three years prior to the current financial year (ie population for June 1997 is used for the 1999–2000 grants).
22. This is shown in Figure 6-4 and Table 6-4.

Figure 6-4 OPTION 3

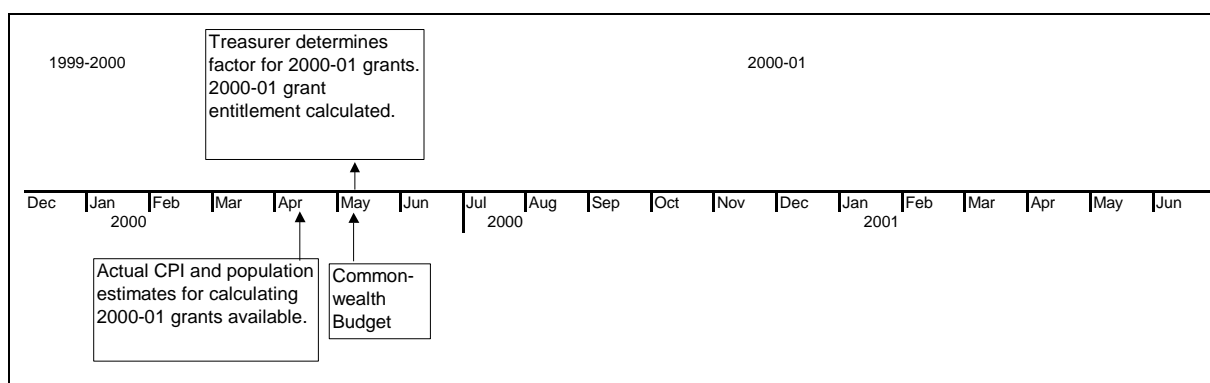


Table 6-4 DATA AVAILABILITY AND OPTION 3

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

Advantages and Disadvantages

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

SOME OBSERVATIONS

25. In comparing these approaches:
- (i) in a low inflation environment, there may be little difference between the three options;
 - (ii) because the grants pool this year equals the grants pool last year multiplied by a factor, use of an estimated CPI which is different from actual CPI to escalate the pool (as in option 1) can have a long term impact on grants received²; and

in periods when the growth in the CPI is increasing, the estimates of CPI are likely to underestimate the change. Conversely, in periods when the growth in the CPI is declining, the estimates are likely to over-estimate the change

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