6

Commonwealth funding of local government

6.1 The payment of FAGs to local government has played a vital role in the local level of governance in Australia.

6.2 The Federal/local government relationship has grown in importance as a result of the increasing focus on local delivery of Federal programs, the need for local government input into the policy and program development of national priorities and the reduced financial support for local government by State governments which has been exacerbated by widespread cost shifting.

6.3 It is important to recall the intention of the Local Government Grants Bill when presented to the Federal Parliament in 1974:

> The Government's aim is that the Grants Commission should play the same role in reducing local governing authorities' inequalities as it has between the States since 1933. In accordance with the principles of fiscal equalisation which have been developed by the Grants Commission over many years and which have been incorporated in the relevant legislation, the grants are designed to reduce inequalities between local government bodies in the provision of ordinary services.
>
> ... However, these funds should in no way be a substitute for revenues normally raised by councils by long established methods such as rates and charges for services, nor should they replace assistance normally provided by State governments.

> It is in the nature of the Commission's task that in any year some local authorities will receive lower grants than their neighbouring Councils or Shires, and some authorities will not receive any grants.[1]

6.4 The Opposition offered support to the Bill:

> The Opposition supports this legislation- not because it represents an adequate response to the financial problems of local government, but because the funds proposed will be of assistance to those municipal bodies which are at a comparative financial disadvantage.
>
> … The Opposition believes that there is an urgent need to establish an advisory council of inter-governmental relations to examine the problems which arise between the 3 tiers of government in Australia. We also believe that a national inquiry to investigate and report on local government finance should be instigated. Both the inquiry and the on-going advisory council would provide a real basis for action to meet many of the financial difficulties now arising in the area of local government in Australia.[2]

History of General Purpose Assistance

6.5 The following history of General Purpose Assistance to local government is an extract from a Department of the Parliamentary Library paper Commonwealth General Purpose Financial Assistance to Local Government.[3]

Whitlam government

6.6 The Commonwealth first provided general purpose assistance to local government in 1974–75 in line with the Labor Party's policy of providing assistance to local government to promote equality among regions, and to ensure adequate services and the development of resources at local and regional levels. The Grants Commission Act 1973 authorised the Commonwealth Minister to approve the establishment of regional organisations to represent local governments located in the

1 Special Minister of State, House Hansard, Second Reading, Local Government Grants Bill, 23 October 1974, p. 2746.

2 Member for Flinders, House Hansard, Second Reading, Local Government Grants Bill, 23 October 1974, p. 3570.

3 Department of the Parliamentary Library, *Commonwealth General Purpose Financial Assistance to Local Government*, Research Paper No. 1 2003-04, 11 August 2003, pp 5-10.

region, and laid down procedures for the organisations to apply for financial assistance. The Act further provided for the Commonwealth Grants Commission to inquire into and report on applications. In the event, the Government distributed the grants among local governments in each State in accordance with the Commission's recommendations. In the following two years, the Commission assessed the applications and the Government again accepted the Commission's recommendations.

Fraser government: tax sharing arrangements

6.7 In 1975, the Liberal-National Country Party coalition adopted the provision of assistance to local government as part of its federalism policy. The arrangements the Whitlam Government had put in place changed with the election of the Fraser Government and its 'new Federalism' policy of sharing personal income tax revenue among the Commonwealth, State and local governments.

6.8 Under the provisions of the *Local Government (Personal Income Tax Sharing) Act 1976*, local government received in 1976–77 the equivalent of 1.52% of net personal income tax collections in the previous year. In November 1977, the Prime Minister, the Hon. Malcolm Fraser MP, announced the Government's intention to increase this proportion to two per cent over the following three years. In the event, the proportion was increased to 1.75% in 1979–80 and to 2% in 1980–81.

6.9 The method of allocation of grants among the States was changed from full equalisation to a method based partly on per capita grants (the so-called minimum grant) and partly on equalisation. Responsibility for determining the intrastate distribution of grants of the part-equalisation component was passed to the newly-created Local Government Grants Commissions established by the States. The sharing of personal income tax receipts continued through to 1984–85.

Hawke government

6.10 The Hawke Government dropped these arrangements, arguing that the economy could not afford tax sharing with the States and local government. Instead, the Government increased local government assistance in 1985–86 by the change in the consumer price index and an additional 2% growth factor over the 1984–85 level. The distribution among the States remained the same as that specified in the *Local Government (Personal Income Tax Sharing) Act 1976*.

Self Report and the 1986 Act

6.11 On 10 May 1984, the Government announced the establishment of a Committee of Inquiry into Local Government chaired by Professor Peter Self. The Committee's terms of reference were wide-ranging and included the level and form of Commonwealth funding. The Committee presented its report on 29 October 1985. In April 1986, the Government announced that it had accepted the thrust of the report and that arrangements for the provision of assistance would change from 1986–87 onwards. The new arrangements closely followed the Inquiry's recommendations. Key features of the new arrangements, contained in the *Local Government (Financial Assistance) Act 1986,* were:

- financial assistance grants replaced personal income tax sharing;
- in 1986–87, grants were to be increased by the greater of either the 1985–86 level of assistance adjusted for inflation (that is, a 'real terms' guarantee) or the percentage change in general purpose payments to the States;
- for 1987–88, the level of assistance was to be determined by the same means as for 1986–87 but using 1986–87 payments as the base;
- in following years, the level of assistance to local government would be linked to the level of assistance to the States, whereby the annual level of local government assistance would be determined by increasing the amount paid in the previous year by the percentage change in general purpose payments to the States;
- the distribution of assistance among the States was to be phased from existing arrangements—which were still partly based on the recommendations of the Commonwealth Grants Commission made in 1977—to an equal per capita basis by 1989–90 ;
- the State Grants Commissions were to determine the intrastate distribution of grants according to principles, formulated by each State, that took fiscal equalisation into account;
- all local governments would be entitled to a minimum grant based on population; and
- provision was made for informal local government bodies, such as Aboriginal communities in remote areas, to receive grants.

6.12 Local government benefited from the 'real terms' guarantee in 1986–87 and 1987–88 because grants to the States fell in real terms in those years, but suffered cuts in real terms in 1988–89, 1989–90 and 1990–91 when real State general purpose funding fell.

6.13 The interstate distribution of local government assistance in 1988–89 reflected the transition to equal per capita grants. In 1989–90, grants were distributed on an equal per capita basis.

Commonwealth Grants Commission 1991 Report on the Interstate Distribution of Grants

6.14 Despite the decision to allocate grants on an equal per capita basis, the 1989 Premiers' Conference agreed that the Commonwealth Grants Commission should report on the interstate distribution of general purpose grants to local government. The Commission's two main tasks were to comment on the desirability of adopting full fiscal equalisation (as distinct from the part-equalisation under the Fraser Government noted above) and to calculate what the distribution of grants would be if full fiscal equalisation were adopted.

6.15 The Commission's report was released in March 1991. The Commission supported, in principle, the adoption of fiscal equalisation:

> In principle, we believe it would not be appropriate to continue indefinitely an interstate distribution of general purpose assistance for local government on a basis (equal per capita) which departs so markedly from fiscal equalisation.[4]

6.16 However, the Commission recommended against using the per capita relativities that it had assessed for allocating assistance for local government among the States in 1991–92 because of data and methodology deficiencies.

6.17 The Premiers' Conference of 31 May 1991 considered the Commission's report. Given the Commission's concerns, the Commonwealth announced in May 1992 that grants would continue to be distributed on an equal per capita basis. Hence financial assistance grants have continued to be distributed on this basis since 1989–90.

Untying of local road funds and Identified Roads Grants

6.18 Until 1990–91, the Commonwealth provided specific purpose grants to local government for local roads under the *Australian Land Transport Development Act 1988*. The October 1990 Special Premiers' Conference agreed that road funds would be untied with effect from 1 July 1991, that is, the conditions applying to road grants would be abolished and local governments could spend the funds for any purpose. The untied grants are called identified road grants.

4 Commonwealth Grants Commission, *Report on the Interstate Distribution of General Purpose Grants for Local Government 1991*, AGPS, 1991, p. xxv.

6.19 In June 1991, the *Local Government (Financial Assistance) Act 1986* was amended to allow road funding to be added to financial assistance grants from 1995–96 and hence distributed on a per capita basis. This this would have been to the detriment of Western Australia, Tasmania, the ACT, the Northern Territory and Queensland. The 1995 Premiers' Conference therefore decided that local road funds would continue to be distributed on the basis of the criteria in the *Australian Land Transport Development Act 1988*. The effect of this decision has been to freeze the interstate distribution of identified road grants at the historical shares that applied in 1991–92 when grants were untied.

Review of the 1986 Act

6.20 In June 1993, local government Ministers agreed to a review of funding arrangements to ensure an efficient and effective use of resources under the *Local Government (Financial Assistance) Act 1986* given the level of funding and distribution of funds among the States. The Australian Urban and Regional Development Review undertook the study. The review's findings included:

- there had been a shift in the share of funding to rural councils in all States (except Victoria) and the Northern Territory;
- State Grants Commissions were following two models of fiscal equalisation: in one, an increasing share of funds was allocated to local governments with increasing populations whereas in the other model, the reverse was true;
- in most States, an increasing share of assistance went to local governments with the greatest socio-economic disadvantage;
- the need for a uniform national reporting framework was urgent;
- absorbing local road funding into financial assistance grants and hence distributing road funding on an equal per capita basis would be disruptive and was not recommended; and
- additional measures to encourage efficiency in local government should be implemented.

Local Government (Financial Assistance) Act 1995

6.21 Following consideration of the review and consultations with State and local governments, the Commonwealth undertook further reforms, which were contained in the *Local Government (Financial Assistance) Act 1995*. This Act retained most of the features of the 1986 Act. The main change was the requirement that national principles replace the arrangements whereby each State formulated principles. The main objective of the national principles (see Box) was to establish a more nationally consistent and transparent basis for the way State Grants Commissions determine the intrastate allocation of funds.

National Principles Relating to the Allocation of Grants

1. The national principles relating to the allocation of general purpose grants are:

(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 the expenditure requirements and revenue-raising capacity of each governing body. This means as far as practicable, that policies of individual local governing bodies in terms of expenditure and revenue effort will not affect grant determination.

(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 identified road component of the general purpose grants is:

Identified road component. 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.

6.22 Other changes to the 1986 Act included:

- recognition of the need for local government to be efficient and effective;
- recognition of the need to improve the provision of services to Aboriginal and Torres Strait Islander communities;
- the requirement that the Commonwealth Minister with portfolio responsibility for administering Commonwealth financial assistance to local government, report annually to Parliament on the operation of the 1995 Act; and
- the requirement that a review of the 1995 Act be carried out by 30 June 2001.

6.23 The 25 March 1994 Premiers' Conference decided that financial assistance grants paid to the States would be maintained in real per capita terms over the next three years. This decision affected local government grants because the 1995 Act provided for local government general purpose assistance to be increased annually by an escalation factor that reflected the underlying movement in general revenue assistance paid to the States. The escalation factor for State grants reflected indexation for population growth and the consumer price index. The consequence of the Conference decision was to maintain the level of grants in real per capita terms and thereby place a 'floor' under the value of assistance.

A New Tax System

6.24 As part of *A New Tax System* (ANTS), the Howard Government proposed that the States assume responsibility for providing financial assistance grants to local government from 1 July 2000. Payments were to be made under the terms of the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, which heads of government signed at the 1999 Premiers' Conference. But under the agreement between the Government and the Australian Democrats to modify the goods and services tax (GST) and implement a package of other proposals, the Government agreed to retain responsibility for assisting local government.

6.25 The Howard Government's decision to replace financial assistance grants—and revenue replacement payments—to the States with revenue from the GST from 1 July 2000 severed the link between grants to the States and grants to local government established in the 1986 Act. The Government therefore introduced the *Local Government (Financial Assistance) Amendment Act 2000*. The main purpose of this Act was to maintain the level of assistance to local government in real per capita terms. Thus since 2000–01, the increase in general purpose assistance has been based on an escalation factor based on population growth and the increase in the consumer price index but excluding the estimated effect of the tax reform measures in *The New Tax System*.

6.26 Local governments can claim input tax credits for the GST. It seems likely that local government, overall, obtained savings from the implementation of the GST.

Current Issues relating to financial assistance grants

6.27 In June 2001 the CGC published its Review of The Operation of the *Local Government (Financial Assistance) Act 1995*. The findings of the Review are at Appendix E.

6.28 An explanation of the current operation of the FAGs is at Appendix F.

6.29 In its submission to this Inquiry, DOTARS highlighted the issues raised following the release of the CGC Review:

- the **interstate distribution** of the general purpose and local roads pools and the proposal to use relative need **using equalisation principles in place of horizontal equalisation**;
- the **quantum of the funds**;
- the proposal to retain the **minimum grant** provision;
- the impact on grants to councils of the proposal to split the general purpose funding pool into a **Per Capita pool and a Relative Needs pool**; and
- the proposal to **remove the purpose of 'improving the provision by local governing bodies of services to Aboriginal and Torres Strait Islander communities'**.[5]

6.30 While these issues remain to be addressed, since the Review the increasing community expectations and demands on local government, the extent of cost shifting and the pressure of the infrastructure backlog have focussed further attention on the issues below:

- the need for **certainty of funding**;
- the need for a **growth base** for FAGs;
- the need to leave **FAGs untied**;

5 DOTARS, Submission No. 103, p. 59.

- the performance of **Local Government Grants Commissions**;
- the **direct payment of FAGs** to local government; and
- the need for **a new approach to funding local government**.

6.31 The Committee has addressed each of the issues raised in the DOTARS submission and paragraph 6.30 above and they will form the structure of this chapter and the recommendations relating to funding.

Interstate distribution and equalisation principles

6.32 In the early 1990s, the CGC was asked to review the interstate distribution of FAGs in time for consideration at the 1991 Premiers' Conference. The CGC prepared two sets of relativities. Both implied a large redistribution of funds away from NSW and Victoria towards the less populous States. The CGC did not recommend that either set of relativities be adopted. The relativities were subject to important reservations about the appropriateness of the methodology being used and the quality and availability of relevant data and highlighted the complexities of moving from a per capita basis to a horizontal equalisation distribution.

6.33 DOTARS stated:

> The CGC believed that suitable relativities could be determined provided there were improvements in data sources and refinements in methodology. However, it advised of issues that governments would need to take into account to change from the per capita distribution. These were:
>
> (i) The per capita distribution is simple and predictable;
>
> (ii) The costs for the States and the Commonwealth to change to an equalisation system relative to the size of the pool; and
>
> (iii) A move to an equalisation basis would be disruptive to councils in New South Wales and Victoria.
>
> The current requirement in the 1995 Act for the distribution of grants within States being, as far as is practicable, on a horizontal equalisation basis aims to bring all councils in that State up to the same fiscal level. However, the actual effect of distributing general purpose grants between States on a per capita basis means councils in different States may be brought up to different fiscal levels. The distribution of general purpose grants on an equal per capita basis does not recognise the differences between local government sectors in their States in their capacity to raise revenue and their expenditure needs.

> This deficiency is most likely to occur in the Northern Territory where there is a very low population density, a relatively long length of road per capita, a relatively high proportion of people in remote areas and a substantial population living in community councils that need high levels of financial support. For instance, in 2001–02 the NT with 196,000 people received $9.7 million in general purpose grants. However, Greater Geelong, in Victoria, with 188,000 people received $10.8 million and Wollongong, in New South Wales, with 186,000 people received $9.5 million.
>
> As detailed, the distribution of grants between States on a per capita basis, rather than horizontal equalisation, evolved as a result of difficulties in determining the latter.[6]

6.34 The interstate distribution of the general purpose and local roads pools has been a contentious issue which has proved very difficult to resolve. The CGC's Report on the Interstate Distribution of Grants released in March 1991 supported, in principle, the adoption of fiscal equalisation:

> In principle, we believe it would not be appropriate to continue indefinitely an interstate distribution of general purpose assistance for local government on a basis (equal per capita) which departs so markedly from fiscal equalisation.[7]

6.35 However, as DOTARS noted, there is no agreed methodology for determining 'need' across States[8] and the Commonwealth has not acted unilaterally to change the distribution.

Local government views on the interstate distribution of FAGs

6.36 The LGASA estimated that its general purpose grants based on population rather than need is costing South Australian councils in the order of $20 million to $30 million per annum.[9]

6.37 The SA LGGC called for a rethink on the interstate distribution:

> We are suggesting it is time that the way it is done currently is reviewed—a substantial review of the way that allocation happens at the moment. There is no representation of need in

6 DOTARS, Submission No. 103, pp. 60-1.

7 Commonwealth Grants Commission, *Report on the Interstate Distribution of General Purpose Grants for Local Government 1991*, AGPS, 1991 p. xxii.

8 DOTARS, Submission No. 334, p. 9.

9 LGASA, Submission No. 223, p. 6.

> the general purpose allocation and nobody can understand what the roads proportions represent.[10]

6.38 The SA government also called for the relative cost disadvantages in SA and disadvantages in revenue raising capacity to be fully addressed through the adoption of horizontal equalisation methodologies.[11] In its supplementary submission, the SA government claimed that the states with smaller populations are disadvantaged by the current national methodology of distribution. The SA government believes that the allocation to SA on a per capita basis in the case of the general purpose grants and on a historical basis in terms of the local road grants is inequitable.[12]

6.39 The Northern Territory Department of Local Government and Regional Development stated that its highest priority issue to bring before the Committee's Inquiry was the need for greater equity in the distribution of FAGs:

> Changes to the interstate distribution to redress current anomalies and the reduction of the minimum grant to provide additional funding to needy councils are policy shifts which would be welcomed in the Northern Territory. The disadvantages faced by rural and remote councils in their revenue raising capacity and in the delivery of cost effective services are significant and widely documented.[13]

6.40 The NT Grants Commission also believed that the NT is disadvantaged by the current methodology of interstate distribution.

6.41 The Tasmanian government did not provide a submission to the Inquiry but the Local Government Association of Tasmania commented:

> Because the Commonwealth's financial assistance grants for local government are allocated to states on a per capita basis, Tasmania is likely to be heavily disadvantaged due to its falling population. Indeed LGAT believes that this change in demographics will have substantial impact on not only this source of revenue for Tasmanian Local Government (FAGs) but will also cause a significant erosion of the individual rateable income base for local government.[14]

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10 SA LGGC, Official Hansard, 27 June 2003, Canberra, p. 863.

11 SA Government, Submission No. 266, p. 1.

12 South Australian Government, Submission No. 385, p. 5.

13 Northern Territory Government, Submission No. 358, p. 1.

14 LGAT, Submission No. 279, p. 9.

6.42 The Victorian and Western Australian governments supported the findings of the CGC Review and urged the Federal government to implement those findings.[15]

6.43 The Shire of Gnowangerup in Western Australia stated:

> …per capita funding in a place like Australia really does not work. It would be great to have our population in a little place the size of Peppermint Grove, where you could walk around it.[16]

6.44 The Urban Local Government Association of Queensland Inc (ULGAQ) argued that Queensland local government is also disadvantaged by the current per capita distribution system due to it having more extensive functions and responsibilities than their counterparts in other States:

> The per capita distribution does not recognise either the more extensive nature of Queensland local government's role, nor this State's more dispersed population and decentralised nature particularly compared to New South Wales and Victoria. In other words disability in cost of service provision or revenue raising ability is ignored in the current formula. ….The redistribution need is far greater in Queensland, because of its size, population distribution, cost of services and revenue raising disabilities. Yet, the interstate distribution does not in any way account for this.[17]

6.45 The Queensland government considered that the interstate distribution should be based on the principles of fiscal equalisation.[18]

6.46 The NSW government did not provide a submission to the Inquiry. The Local Government Associations in NSW expressed strong opposition to changes in the interstate distribution of FAGs.

Interstate distribution of GST payments

6.47 In distribution of the GST payments to the States, Horizontal Fiscal Equalisation (HFE) is taken into account:

15 Department of Local Government and Regional Development Western Australia Submission No. 298, p. 8; Victorian Minister for Local Government Submission No. 176 p. 3.

16 Shire of Gnowangerup, Official Hansard, Perth, 6 August 2002, p. 25.

17 ULGAQ, Submission No. 299, pp. 3-4.

18 Email dated 8 August 2003.

> NSW, Victoria and Western Australia receive less than equal per capita shares under the Horizontal Fiscal Equalisation (HFE) arrangements because the Commission has assessed their fiscal capacity to be relatively strong. For example, the Commission assessed that NSW has a relatively stronger capacity to raise revenue from land tax and stamp duty on property transfers; Victoria has a relatively lower cost of providing state government services; and WA has a relatively strong capacity to raise revenue from mining activities. The remaining States receive more than an equal per capita share of funding because the Commission has assessed their fiscal capacity to be lower and/or their costs of service delivery to be higher.[19]

6.48 The Committee noted that while it may require a more complex methodology to apply HFE principles to 721 councils than it does for six States and two Territories, it is only appropriate that, if State differences are taken into account and HFE principles are applied in the distribution of GST payments, then local government differences and HFE principles should also be applied to the distribution of FAGs.

6.49 The Committee concluded that FAGs should be distributed on the basis of equalisation principles and not on a per capita basis. (Recommendation 16)

The quantum of funds

6.50 In 2002–03, the Federal government provided $1.455 billion nationally – the equivalent of $74.51 per capita – in financial assistance to local government. The total estimated entitlement for 2003-04 is $1.509 billion.

6.51 As the quantum of FAGs is below that needed to apply full horizontal equalisation principles, the CGC recommended the use of equalisation principles. According to DOTARS:

> For full horizontal equalisation to be fully achieved, the minimum grant requirement would have to be removed and some higher capacity councils would have to receive negative grants (that is, they would have to contribute funds to the grants pool rather than receive them).

19 *Federal Financial Relations 2002-04*, Budget Paper No. 3, p. 11.

> This means that in all States, because some councils in each State are on minimum grants, as provided for in the Act, horizontal equalisation cannot be achieved.
>
> It is for that reason that the Commonwealth Grants Commission proposed the concept of relative needs using equalisation principles to describe the objective (that councils with relatively greater need receive a relatively greater share of the funding) and the allocation process.[20]

6.52 This Inquiry was conducted on the basis that the outcomes would be budget neutral for the Commonwealth. However, the quantum of funds and the need for certainty of funding on a growth base are issues that were raised constantly in both submissions and at hearings.

6.53 Both councils and peak bodies argued that there is a need for a fixed share of Federal revenues supported by a growth tax. The ALGA submission said:

> The lack of an appropriate methodology to share the nation's public sector revenues in an equitable manner is the most significant problem faced by local government in Australia.
>
> …Successive Commonwealth governments have failed to adequately address this issue.[21]

6.54 Another significant complaint made about the current arrangements concerned the escalation factor:

> Tax sharing grants should grow at the same rate as Commonwealth estimates and projections for Commonwealth taxes (exclusive of GST) and GST revenues (collected by the Commonwealth on behalf of and paid to the States), not less quickly as in the case of FAGs to local government.[22]
>
> Last year, GST revenues grew by 7.1%, but FAGs by only 4.4%. Over the next two years, GST revenue is projected to grow by around 5.5% per annum. Moreover, the 'real' increase in FAGs is limited to the CPI less an adjustment for recent changes to indirect taxation – a figure well below the cost increases faced by local government.[23]

20 DOTARS, Submission No. 313, p. 14.

21 ALGA, Submission No. 340, p. 7.

22 The Victorian group of CEOs, Submission No. 357, p. 12.

23 South Sydney Regional Organisation of Councils, Submission No. 162, p. 15.

6.55 One proposal put forward by a Victorian group of Chief Executive Officers suggested that FAGs:

- be 'tied to 1.3% of total Commonwealth taxes';
- be funded from an allocation from the expected GST windfall payment to the States plus other sources; and
- be deducted from the States' GST allocation by the Commonwealth.[24]

6.56 However, ALGA suggested linking FAGs to Commonwealth taxation using a methodology which sets total FAGs to local government at an equivalent of 5% of the GST revenue that flows to the States and Territories.[25] ALGA also provided the following table to demonstrate the effect of its proposal:[26]

Table 6.1 FAGs grants at 5% equivalent of GST

	2003-04 $m	2004-05 $m	2005-06 $m	2006-07 $m
GST as at May 2003	32,050.0	33,815.0	35,860.0	37,690.0
Equivalent of 5% of GST	1,602.5	1,690.8	1,793.0	1,884.5
Current FAGS	1,505.4	1,561.9	1,618.3	1,676.7
Difference	97.1	128.8	174.7	207.8

6.57 City of Port Phillip commissioned Access Economics to prepare a paper entitled *The Case for Increased Funding to Local Government*. The paper shows that between 1983-84 and 2000-01, Commonwealth tax collections increased by 74% while grants to the States increased by 21% and to local government by 5% in real terms.

6.58 The paper further noted that FAGs (and any inadequacy in their levels) are not the cause of Vertical Fiscal Imbalance (VFI). VFI is caused by the uneven distribution of taxing powers and expenditure functions. FAGs merely serve to offset – not reduce – VFI. As such, FAGs are a symptom of VFI. Only an evening up of the local sector's tax powers and expenditure responsibilities would reduce that sector's VFI problems.[27]

24 The Victorian group of CEOs, Response to the Discussion Paper, Submission No. 357 p. 2.

25 ALGA, Submission No. 340, p. 7.

26 ALGA, Email dated 9 July 2003.

27 Access Economics, *The Case for Increased Funding for Local Government, An assessment prepared for the city of Port Phillip*, February 2003, pp. 25-26.

6.59 Aware of the requirement that the recommendations of the Inquiry be budget neutral, the paper also considered ways for local government to consolidate further its financial position.

6.60 The main alternatives to increased FAGs identified in the Access Economics paper are:

- the local sector cuts back its expenditure on unfunded mandates imposed by higher levels of government;
- the Federal government facilitate changes to State policies on exemptions, concessions, rate capping and the like; and
- the State and Federal governments allow an increase in local government revenue, initially by allocating 'tax on tax' associated with the GST to the local government sector and, over time, by amending the relevant inter-governmental agreement to eliminate such tax effects, making room for an offsetting increase in local government rates on residential property.[28]

6.61 Following a meeting of the Local Government and Planning Ministers' Council in July 2003, the President of MAV was quoted as saying:

> Unless we see a reappraisal of the current tax base of local governments, councils will need to continue to go out to ratepayers cap in hand on an annual basis.
>
> … The MAV would investigate several options, including a suggestion that part of the State Government's GST funds be set aside for councils.[29]

6.62 Access Economics argued for a correction of an anomaly in the New Tax System which further disadvantages local government:

> One option for sharing revenue would be to amend the Intergovernmental Agreement (IGA) to correct an anomaly in the way the *New Tax System* operates.
>
> Specifically, the original IGA always envisaged that the interaction between remaining State taxes and the GST would eliminate 'tax on tax' problems. Following the deal between the Commonwealth Government and the Democrats, the application of the GST has seen this principle violated in two ways:

28 Access Economics, *The Case for Increased Funding for Local Government, An assessment prepared for the city of Port Phillip*, February 2003, p. i.

29 Northcote Leader, 'Councils seek overhaul of current taxes', 16 July 2003, p. 7.

- Some State taxes form part of the tax base for the GST (e.g., fire services levy in those States retaining this very inefficient and unfair tax).
- The GST forms part of the tax base for other State taxes (e.g., stamp duties).
- As a result, in some cases, and in particular involving property (the potential tax base for local government), we now have 'tax on tax on tax' problems. For example, the fire services levy in Victoria is part of the tax base for GST, and both are part of the tax base for stamp duty on property insurance.

One option for augmenting local government revenue (which, in a way, is GST-related) has two parts:

- Initially, calculate the total revenue for each State attributable to 'tax on tax' effects associated with the introduction of the GST. For each State, allocate this revenue to the local government sector immediately.
- Over time, and ideally, amend the IGA to eliminate all 'tax on tax' effects associated with the GST, making room for a corresponding increase in revenue from local government rates. [30]

6.63 The problem with this proposal is that it may institutionalise some tax on tax effects of the GST as a revenue source for local government and this would be at the expense of the States.

6.64 Local government is not a party to the inter-governmental agreement on the GST and it would be preferable for the Commonwealth, States and local governments to address tax on tax effects of the GST.

Recommendation 15

6.65 **The Committee recommends that the Commonwealth, States and local governments consider what tax design improvements would be necessary to eliminate tax on tax effects arising out of the GST.**

6.66 There is a need for action by all levels of governments to address the current funding situation, for example:

- better management of both budgets and community expectations by councils at the local level; and

30 Access Economics, *The Case for Increased Funding for Local Government, An assessment prepared for the city of Port Phillip*, February 2003, p. 29.

- a review at the Federal level of:
  - ⇒ SPPs paid to the States and Territories with a view to isolating funds for direct payment to local government
  - ⇒ relevant anomalies of ANTS; and
  - ⇒ the revenue-raising capacity of councils and consideration of financial penalties for States and Territories which fail to adequately support or deliberately suppress that capacity. (Recommendation 17)

Summit on Inter-governmental Relations

6.67 The Committee concluded that the findings of the CGC Review and the evidence collected for this Inquiry all point to the need for COAG to convene a *Summit on Inter-governmental Relations* to address inter alia:

- cost shifting and the provision of Federal and State government management of SPPs;
- unfunded mandates;
- State policies which restrict revenue-raising capacity of local government;
- the elements of the New Tax System which affect local government;
- the capacity of local government to maintain its infrastructure; and
- progress in the allocation of FAGs to local government on a needs basis. (Recommendation 17)

Certainty of funding

6.68 Many councils raised as an issue their need for certainty of funding particularly in relation to cost shifting. The often unforseen demands imposed through increased compliance measures, new legislation and regulations were made more difficult to deal with when funding was neither fixed nor predictable.

6.69 Further, local government is worried that past experiences with cost shifting will be repeated if it offers to accept an even greater role in acting as an agent for the Federal or State governments in delivering programs.

6.70 The Committee concluded that successful long term strategic and financial planning at the local government level depends on certainty of funding and this matter should be addressed at the COAG Summit.

Local Government revenue-raising capacity

6.71 When considering the need for certainty of funding, local government must be responsible for maximising its revenue raising capacity. Rate capping is a major issue for NSW, the only State which caps rates, and was raised by nearly all councils in that State as a significant impediment to revenue raising. There are many examples of suppressed revenue raising capacity and not all relate to rate capping.

> Yarrowlumla has done rate pegging twice in the last 15 years. The first time, we got an eight or nine per cent increase because we had a fight with the New South Wales farmers. They engaged a consultant to do an economic survey on us and prove that we were well behind in our rating capacity because of local political decisions not to accept rate pegging when it first started, when it was very high increases per annum. I was not there at the time, but there was basically a farmer council and they did not want to increase their farm rates. They said when there was an eight per cent increase they took zero.
>
> Access Economics did it on behalf of the New South Wales farmers and they presented us with the report. It showed we were something like $1.2 million behind in what our rate revenue should have been. Had the council done it and increased the rates as they should have when rate pegging was available, our rate base would be quite considerable.[31]

6.72 The inequities developed from different bases of rate levels can be found in many instances. According to Tweed Shire:

> If we rated our properties on the same basis as Lismore we would have an extra $12 million income on a base of $22 million income we have from that rating. Tweed was one of the councils that were caught with a very low rate base 30 odd years ago.[32]

6.73 At the same hearing, Hunters Hill Council then added:

> That is not uncommon in Sydney. For instance, I did a comparison of the rates between Hunters Hill and Lane Cove, Ryde and Canada Bay, which are our three adjoining councils. If our ratepayers paid the same rates, their rates would more than double, yet on average our property values would be significantly higher than in those adjoining councils.

31 Yarrowlumla Shire Council, Official Hansard, Moruya, 30 April 2003, p. 828.

32 Tweed Shire Council, Official Hansard, Sydney, 28 April 2003, p. 712.

> ..In New South Wales, you will find that the rates as a proportion of overall revenue of councils have decreased over that 30-year period. You might expect, because we are growing in terms of property values, that councils might have more rate revenue. In fact, you will find the rate revenue as a proportion of overall revenue has decreased. That is not necessarily the same for the Western Sydney councils. You will find that has probably increased.[33]

6.74 The response to the issue of rate capping by the Chairman of the NSW LGGC shed some light on the attitude of the State government:

> The rate pegging issue is a big one in New South Wales. However, keeping rate pegging alive and where it is has bipartisan support in the parliament. A lot of people think it is a pretty strange system, and no other states have it, but the fact is that, politically, no-one seems to want to remove it. The other point I would make is that rates, as a percentage of total income of councils, vary a great deal across the 172 councils in our state. The amount of money some councils would get through what they call 'other charges' and so forth would be greater than the amount that some councils raise in rates. The income side of it has changed a lot. The importance of rates varies a great deal across the state.[34]

6.75 At the hearing in Newcastle, the Committee also heard evidence of the effect of charges set by statute which was representative of the issue across the country:

> Rates are not our only income pegged by the state government. Many of our charges are also set by statute. If you combine rates and charges for quite significant areas, like the development area for example, you will find that a substantial proportion of our income is pegged. Given that our entire expenditure increases by the CPI, or more in the case of salaries and wages, it is not difficult to see how we run into financial difficulties and how that is exacerbated as time goes on.[35]

6.76 The City of Newcastle provided information on new responsibilities placed on it, particularly as a result of State government decisions. In total, the effect of these responsibilities was additional costs to

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33 Hunters Hill Council, Official Hansard, 28 April 2003, Sydney, p. 709.

34 NSW LGGC, Official Hansard, Canberra, 27 June 2003 p. 869.

35 Lake Macquarie City Council, Official Hansard, Newcastle, 29 April 2003, p. 795.

Newcastle City Council nearing $4.481 million per annum on an on-going basis.[36]

6.77 At the final public hearing, a succinct summary of the difficulties faced by councils due to State control of revenue-raising by local government was outlined and it reflected the situation across the country in one form or another:

> One of the big causes of cost shifting is revenue denial, in effect, by the state, which could be looked at in the next agreement. I will give you a very practical example. In my city between 15 and 20 per cent—I cannot remember the exact percentage—of my revenue comes from fees I charge which are totally controlled by the state. …. the point is that I have probably 70 or 80 statutory charges which they have not put up for five years because, (1), they do not want to, and, (2), it is not front of mind. That effectively means that I have to put another one per cent of rates on, because I have a section of my income that is going nowhere.
>
> There is a range of them: parking fines, building registration, planning fees, some aged care fees. These are all things that are prescribed and you are not allowed to put them up and that puts a lot of strain on us. It is one of the major sources of cost shifting. It seems to me that maybe those sorts of things can be picked up when we are doing agreements. It is no different from, say, rate capping in New South Wales; that is a similar example. It just puts strain on the system. Those things probably can be addressed in agreements.[37]

6.78 The Committee concluded that rate and charge capping is inconsistent with local government being fully accountable for its own financial circumstance and that the effect of State policies on the revenue-raising capacity of local government should be considered at the COAG Summit on Inter-governmental Relations. (Recommendation 17)

Minimum grants

6.79 The Committee recognises that the minimum grant represents an artificial constraint on the methodology of distributing FAGs. The CGC noted:

36 The City of Newcastle, Email dated 30 July 2003.

37 City of Stonnington, Official Hansard, Canberra, 27 June 2003, p. 883.

> 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.[38]

6.80 LGMA stated that its members do not support the retention of the minimum grant.[39]

6.81 LGMA also recognised that the minimum grant could be a deterrent to structural reform:

> That is a serious issue where we have minimum grants and people get to rely on that amount of money, and you have an inherent inefficiency in the system.[40]

6.82 There was a predictable difference of opinion regarding the minimum grant which, in the main, reflected the financial position of the council. Examples from Queensland demonstrate the breadth of opinion.

6.83 The ULGAQ asserted:

> The urban councils need to be protected and would fiercely oppose any reduction in the minimum grant to further subsidise some of the smaller areas. Here in Queensland, we think that we are paying too much for that as it is.[41]

6.84 The tension between urban and rural claims on funding was obvious at the hearing in Longreach:

> Under the formula, if they [councils] are not entitled to it but they are given it and yet there are other councils that are entitled to it that are not getting it, is that fair? It is all the bigger councils that are on the minimum grant. We are only talking about 0.1 per cent or less of impact on their rates. Out here, you are talking about 100 per cent impact on their rates.[42]

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38 CGC, *Working Papers for Review of the Operation of the Local Government (Financial Assistance) Act 1995*, p. 52.

39 LGMA, Official Hansard, Canberra, 27 June 2003, p. 891.

40 LGMA, Official Hansard, Canberra, 27 June 2003, p. 875.

41 ULGAQ, Official Hansard, Townsville, 13 March 2003, p. 678.

42 Longreach Shire Council, Official Hansard, 12 March 2003, Longreach, pp. 632-3

6.85 Somewhere in the middle of this tug of war was the following considered position adopted by Redcliffe City Council which is a minimum grant council classified as Urban Development Medium:

> This Council is of the strong opinion that Queensland is being disadvantaged by the current per capita distribution of general purposes funding in the Commonwealth grant / local government (Financial Assistance) Act and whilst there has been much debate recently regarding the methodology of the Queensland Grants Commission there needs to be a fairer distribution of the Federal funding across local governments in Australia.
>
> The current method of distribution does not take into account the environment nor circumstances of local government in the more sparsely populated areas and until that is done there will be the inequitable situation that currently prevails.[43]

6.86 The Queensland government supports continuation of the minimum grant[44] and the LGAQ does not support any reduction in the current minimum grant entitlement.[45]

6.87 The Shire of Eurobodalla, expressing the views of many councils across the country, made the following arguments to support the abolition of the minimum grant:

- metropolitan councils have completed their construction of infrastructure while councils outside these areas have in many instances 40 years of backlog works;
- major population centres utilise rural and regional roads and facilities while making no contribution to their construction and provision;
- metropolitan communities enjoy an enhanced level of facilities which are funded from State taxes, whereas, in regional and remote communities the provision of facilities is at the cost of the local ratepayers;
- rural and remote centres do not have the economies of scale associated with the high population density of cities. Similarly, the returns from rates over a smaller landmass are far greater per square kilometre than their country counterparts; and

43 Redcliffe City Council, Submission No. 277, p. 6.

44 Email dated 8 August 2003.

45 LGAQ, Submission No. 363, p. 2.

- in many instances rural and remote communities do not enjoy essential 'telecom', rail or air services which have a impact on the creation of sustainable employment opportunities.[46]

6.88 The Shire of Chittering referred to the minimum grant as inequitable and unjust:

> The grant is merely a handout to affluent Councils without any real or measurable justification. The pool of funds created of up to $75 million could be used more beneficially for Local Governments and their communities.[47]

6.89 The CEO of the City of Stirling made the observation that the FAGs grant is a very small part of the income of some councils, which in many cases would consider the administration of the minimum grant a chore:

> I would suggest that a very large number of councils now on minimum grants really might find, when they look at the end value and what it means in the total picture of income for that local government, that going through the submissions and the requirements to comply that they need to go through to gain that grant is really too much of a chore. In those areas, there are more important issues and other alternative avenues of funding that we might place greater emphasis on.[48]

6.90 The SA government supported the reduction of the minimum grant to enable financially strong councils to reduce their reliance on grants by instead increasing own source revenue.[49]

6.91 At the hearing in Hobart where the matter of abolition of the minimum grant was raised LGAT commented:

> There are 27 (of 29) councils that say it is a wonderful thing, but perhaps it is best that those that have got minimum grants to speak for themselves.[50]

6.92 NSW and Tasmanian governments did not provide submissions to the Inquiry.

6.93 The Victorian and NSW Local Government Associations both supported retention of the minimum grant.

46 Eurobodalla Shire Council, Submission No. 378, p. 11.

47 Shire of Chittering, Submission No. 370, p. 5.

48 City of Stirling, Official Hansard, 27 June 2003, Canberra, p. 873.

49 SA Government, Submission No. 385, p. 5.

50 LGAT, Official Hansard, Hobart, 18 February 2003, p. 428.

6.94 The Committee concluded that the minimum grants should be abolished in line with equalisation principles but phased out over a period of three years. (Recommendation 16)

A growth base for FAGs

6.95 Local government as a whole has called for an increased and growth based share of Commonwealth taxation collections.

6.96 Many councils have claimed that local government would be better served by having a defined share of public dollars, and in an effort to secure a growth base for FAGs, it has been suggested that FAGs be linked to the GST.

6.97 Under the *Intergovernmental Agreement on the Reform of Commonwealth–State Financial Relations* (IGA), all GST revenue is paid by the Federal government to the State governments. Oversight of the IGA is vested in a Ministerial Council and any issues to be considered by the Ministerial Council are ultimately determined by unanimous agreement.

6.98 Commonwealth Treasury stated that under the IGA it has always been envisaged that the GST funds that the States received would grow faster than the guaranteed minimum amounts paid, so that over time the States would be better off under the IGA.

6.99 However, the transitional period for the full introduction of the GST arrangements affords the Commonwealth savings:

> During the transitional period, the Commonwealth can make savings on budget balancing assistance, to the extent that GST is higher than forecast. But once the transitional period ends, all additional GST revenue accrues to the states.[51]

6.100 It could be argued that, due to GST revenue being higher than originally forecast, the saving made by the Commonwealth on budget balancing assistance paid to the States during the phase-in period could fund an increase in FAGs. This increase could make up lost ground due to the inconsistency of the escalation factor.

Tying FAGs

6.101 The FAGs are not specific purpose grants; they are intended to equalise the capacity to provide services. Many councils rely on FAGs for a

51 Ms Edsor, Department of the Treasury, Official Hansard, 27 June 2003, p. 877.

substantial amount of their income especially in rural and regional Australia and councils claimed that attributing FAGs to specific purposes would be difficult to do as they are discretionary in nature and enable a council to respond to its local community's priorities.

6.102 The Committee recognised the need for discretionary funding in order for local government to maintain the capacity and flexibility to be able to plan for, and deal with, local needs as they arise.

6.103 The NT government however supported the tying of FAGs to ensure that funds are spent on core local government services.[52]

6.104 The Committee concluded that, as both the General Purpose pool and Identified Road component of FAGs are currently untied and provide the discretionary funding necessary to meet local needs, they should remain untied and be collapsed into one pool. (Recommendation 16)

Local Government Grants Commissions

6.105 The lack of transparency of the methodologies used by the LGGCs was criticised by local government. Those councils which expressed concern maintained that they should be able to understand both why they received the funding allocated as well as how the funding formula works. The Committee considers that if any formula used to allocate FAGs is transparent, albeit complex, then the representatives of councils would either be able to accept the funding allocated or argue on reasonable grounds as to why the formula should be amended.

6.106 The Department of the Parliamentary Library in a 2003 paper, *Commonwealth General Purpose Financial Assistance to Local Government*, stated that the LGGCs do not use consistent methodologies to determine the intrastate allocation of grants. Moreover, it was questionable whether some of the methodologies meet the objective of fiscal equalisation.[53]

6.107 In its submission to the CGC *Review of the Operation of the Local Government (Financial Assistance) Act 1995*, the National Office of Local Government stated:

52 Northern Territory Government, Submission No. 358, p.1.

53 Department of the Parliamentary Library, *Commonwealth General Purpose Financial Assistance to Local Government*, Research Paper No. 1 2003-04, 11 August 2003, p. 18.

> The Act does not appear to be meeting its goal in promoting consistency in the grant distribution methodologies employed by the State and Territory Grants Commissions.
>
> … It would be unreasonable not to expect grant outcomes to reflect the unique situation of each State and Territories' Local Government structure. However, **it appears that the differences in grant outcomes are not solely explained by these State and Territory differences and reflect aspects of State and Territory Grants Commissions methodologies which according to the Local Government National Report are difficult to defend and not consistent with the objective of horizontal equalisation**.[54]

6.108 The National Office of Local Government therefore advocated that:

> The Commonwealth Grants Commission assess the feasibility of developing, in consultation with State and Territory Local Grants Commissions, a standard framework that could be adopted by all State and Territory Grants Commissions to guide them in their application of the National Principles and their general purpose and local road grants methodologies. This standard framework would seek to promote, as far as is practical, greater consistency in methodologies between State and Territory Grants Commissions and greater consistency in the application of the National Principles.[55]

6.109 The differences in methodology used in each state compound the confusion of councils, particularly when comparisons were made about differences in funding received by similar councils in different States and Territories.

6.110 Many councils have questioned whether the distribution methods used by the LGGCs are logical and fair. For example, LGMA referred to the formulas in South Australia revolving around population rather than around properties:

> Any methodology that has a correlation between the capital values of properties and the capacities of councils to raise revenue, particularly from their residential populations, is fallacious, I think. It ignores many of the sections of communities that do not have access to income. They may be

54 Department of Transport and Regional Services, Submission to the CGC *Review of the Operation of the Local Government (Financial Assistance) Act 1995*, pp. 26, 34.

55 Department of Transport and Regional Services, Submission to the CGC *Review of the Operation of the Local Government (Financial Assistance) Act 1995*, p. 6.

> asset rich in one sense but in another sense their flow of income is quite restricted, either as self-funded retirees or as pensioners. I think there is a fundamental flaw there. If we are talking about equity, we ought to be talking about people's capacity to pay, about their capacity to consume and about what the local authorities owe them in terms of provision of service—and I do not believe that can revolve around pure populations. [56]

6.111 Hume Shire Council suggested distributing a portion of the total allocation to high population growth areas based on some type of betterment factor. This would recognise that the need for services follows increases in population.[57]

6.112 Maroondah City Council summed up the sentiment of a range of councils across the country in calling for the Commonwealth to take a lead on this matter through a statement or agreement setting out policy, objectives and processes that would assist in facilitating the operation of the FAGs system:

> At the moment each municipality plays the game of 'trying to maximise your grant' at the expense of other councils playing the same game in a scenario where none of them fully understand the rules of that game. This is a recipe for a waste of effort and perennial frustration. [58]

6.113 The LGGCs maintained that consultation with councils is an important part of their requirements. All LGGCs have visiting programs and call for submissions on methodology. The LGGCs noted that the consultation process and reviews of methodology is a cost borne by the State governments.[59]

6.114 The LGGCs also maintained that their allocation process is apolitical, although the Committee understood some councils were reluctant to express a view on the performance of the LGGCs for fear of funding repercussions.

6.115 The Committee concluded that a national approach should be developed for distribution of financial assistance to local government. (Recommendation 16)

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56 LGMA, Official Hansard, 27 June 2003, Canberra, pp. 867 & 871.

57 Hume Shire Council, Submission No. 381, p. 2.

58 Maroondah City Council, Submission No. 395, p. 3.

59 Victorian LGGC and SA LGGC, Official Hansard, 27 June 2003, Canberra, pp. 860 & 870.

Direct payment of FAGs to local government

6.116 There are naturally differing views of direct funding of FAGs from the Federal to local government. LGGCs oppose a central distribution model for FAGs. Not surprisingly, those councils concerned by the current allocation processes of the LGGCs, a naturally complex process, call for a direct funding relationship with the Federal government; they want the allocation of funds determined by a model which will apply to all councils.

6.117 Councils in each State and Territory applauded the successful Roads to Recovery Program and on the basis of this experience with the Federal government asked that FAGs be delivered in the same way; ie. direct to local councils rather than via a LGGC.[60]

6.118 ALGA in the hearing of 5 September 2002 said:

> The direct funding approach that is used in Roads to Recovery has been highly successful. …The principle has been very strongly supported within our constituency and if that principle were to be extended to the financial assistance grants then it would certainly be an approach that we would like to seriously discuss with the Commonwealth that is, an extension of the direct funding principle from Roads to Recovery to financial assistance grants.[61]

6.119 In its submission to the Inquiry, LGMA stated:

> There appears to be no benefits derived from filtering Federal Grants through state agencies which add unnecessary costs, delays and potentially distort outcomes.[62]

Differences of views on the direct payment of FAGs

6.120 The SA LGGC claimed that a model which allocates centrally to all councils will not work, whereas a model which allocates through organisations based at the State level would assist in allocation between councils within each State.[63]

6.121 The City of Salisbury suggested as an alternative:

> … the possibility of the Commonwealth distributing grants directly to local government, based on a single national

60 Hume Shire Council, Submission No. 381, p. 2.

61 ALGA, Official Hansard, 5 September 2002, Canberra, p. 151.

62 LGMA, Submission No. 380, p. 7.

63 SA LGGC, Official Hansard, 27 June 2003, Canberra, p. 864.

> formula, but drawing advice within states from State Grants Commissions.[64]

6.122 The NT Grants Commission stated:

> It is inconceivable to me that some centrally managed pool of people to manage funds nationally can surpass the sum total knowledge of the state and territory grants commissions.[65]

6.123 However, Katherine Town Council noted:

> We believe we should perhaps be dealing directly with the Commonwealth government. Local government, I believe, should be looked at on a national basis rather than on a state by state or territory basis.[66]

6.124 The Victorian LGGC wrote:

> In summary, the Victorian Government Grants Commission strongly opposes any suggestion that financial assistance grants should be allocated directly by the Commonwealth Government. The Commission believes that this would necessitate the adoption of a single allocation methodology that, together with a centralised administrative structure, would be unable to respond adequately to the differing needs of local governing bodies across Australia.[67]

6.125 Knox City Council stated:

> A model of direct responsibility complemented by direct funding is supported. This model will assist with addressing the gap in resources funding.[68]

6.126 The WA LGGC advised that given the strong local government support in WA for the current arrangements, it is considered that local governments would resist a centrally based system.[69]

6.127 However, WALGA, at the first public hearing of the Inquiry, observed:

64 City of Salisbury, Submission No. 307, p. 2.

65 NT Grants Commission, Official Hansard, 7 October 2002, Katherine, p. 865.

66 Katherine Town Council, Official Hansard, 7 October 2002, Katherine, p. 865

67 Victorian Grants Commission, Submission 389, p. 13.

68 City of Knox, Submission No. 148, p. 19.

69 WA LGGC, Submission No. 388, p. 4.

> What you need are efficiencies in the system and you need appropriate accountabilities, not layers and layers of accountabilities. For all the legal and jurisdictional issues, you still ask why the Commonwealth should collect money, hand it to the state, have an administrative process by the state and then transfer it to local government. A far more direct relationship would be more efficient and more effective if we can solve the jurisdictional and political argument that goes with that.[70]

6.128 The LGAT discussed the change to a model of direct payment of FAGs to councils at the public hearing in Hobart:

> How do you deal with a significant change of circumstance? If it is a Canberra run bureaucracy, how does the little council in the outback feel it can get its fair value? It is a dichotomy. We love the Roads to Recovery model. We deal with Canberra bureaucrats and there is no trouble; we love them.[71]

6.129 Gatton Shire Council in Queensland submitted:

> The mechanism used to deliver Commonwealth Grants Commission funding to local governments through a state bureaucracy appears to be inefficient and could be more effectively managed directly through the Commonwealth. Funding formulae which take into account differences between the needs of local governments in different states could still be applied as required under a more centralised model.[72]

6.130 The Queensland LGGC expressed the following view:

> The risk with one central body performing this role, is that local governments will feel distanced from the allocation process and become dissatisfied. It may also be less responsive to the changing needs of local governments. It is difficult to see a central body having an in-depth knowledge of the factors affecting 722 councils across all States and Territories.[73]

6.131 The LGGCs have the in-depth knowledge of factors affecting the 721 councils across all States and Territories but as the City of Salisbury and the Shire of Gatton point out, there is no reason why that knowledge cannot be fed into a central distribution model.

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70 WALGA, Official Hansard, Perth, 6 August 2002, p. 6.

71 LGAT, Official Hansard, Hobart, 18 February 2003, p. 441.

72 Gatton Shire Council, Submission No. 197, p. 1.

73 Queensland LGGC, Submission No. 392, p. 5.

6.132 A new federal funding model for local government has a number of advantages:

- greater transparency due to the uniform application of one methodology;
- distribution of FAGs on the basis of equalisation rather than per capita;
- input from LGGCs on the individual factors of the methodology necessary to reflect local need;
- a strengthened relationship between local and federal governments; and
- a federal / state / local government partnership in allocation of FAGs.

6.133 Moving to a national formula for providing FAGs poses a number of challenges including:

- the need for a new national allocation model;
- the need for resolution of data collection issues; and
- the development of administrative arrangements to operate the new allocation system.

6.134 The Committee carefully considered the concerns of councils, the Local Government Associations and the LGGCs and sought to find a solution to maintain local input through the work of the LGGCs, while at the same time producing a more efficient direct funding model.

6.135 The Committee concluded that the CGC is the appropriate organisation to develop the new funding model in consultation with local government, LGGCs, and State and Territory governments.

6.136 When the model is developed the CGC would be responsible for local government funding in a similar manner as it is for allocating GST payments to the States.

6.137 The expertise currently residing in the LGGCs would have a continuing role in assisting local government to present data and argument to the CGC under administrative arrangements to be worked out between local government and State and Territory governments.

Federal and Local Government Finance Advisory Group

6.138 The Committee believes the optimum arrangement for funding local government would be a partnership between the Federal government and the LGGCs in each State and Territory in order to ensure there is a consistent allocation of funds irrespective of State boundaries.

6.139 A key stakeholder group of Federal government, LGGCs and relevant experts should be established to commence work on the development of a specific local government funding model.

6.140 Given that the intention of the Act is to provide assistance to the relatively disadvantaged LGBs and, taking into account local government concerns with the current arrangements including the lack of clarity of purpose of the funding at the federal government level, the Committee discussed the need for a funding arrangement that:

- equalises the allocation of funds to all LGBs, irrespective of State, on the basis of need;
- utilises a new approach to funding and resolves the capacity to pay issue;
- is uniform, transparent and predictable;
- works with State and Territory governments and utilises their information and expertise; and
- acknowledges the special requirements of indigenous people by means of a weighted factor in the formula.

6.141 The Committee concluded that a new funding arrangement for financial assistance to local government should be implemented which would address both the outstanding issues highlighted by the CGC as well as the current issues raised during the course of the Inquiry.

6.142 The Committee also concluded that the development of a new local government model should draw on the expertise of key stakeholders, the range of models suggested by Professor Farish, and that the distribution of funds should be managed independently by the CGC. (Recommendation 16)

Reporting on expenditure

6.143 The Committee also carefully considered the financial reporting demands placed on local government. According to some councils there is already too much form filling required for both FAGs and SPPs.

6.144 Many indigenous community councils in the Northern Territory and Queensland added that they found it difficult to meet the reporting requirements of all the funding programs of the Commonwealth and the Territory and State governments.

6.145 Also, there are a plethora of surveys to complete regarding aspects of community life. Barunga Manyallaluk Community Government Council stated that there were 18 surveys to be completed within seven months.[74]

6.146 The Torres Strait Regional Authority stated that because they must draw on financial assistance from many jurisdictions, they face rigorous accountability and compliance requirements.[75]

6.147 The NT LGGC stated:

> The problem is of an incredible scale and it is terribly debilitating for remote councils in particular to have to deal with this never-ending procession of bureaucrats, either Commonwealth or state, in an uncoordinated way. Invariably they arrive without any planning and unannounced and each expects the exclusive time of that remote council, which by any measure is probably least equipped to deal with this myriad of functionaries who want that focused attention.[76]

6.148 Barunga Manyallaluk Community Government Council provided an example of 'accountability gone mad':

> Our grant under the HACC program is about $9,334 per quarter (average for 2001/2002), and yet as well as submitting financial acquittal information and reports on achievements, our women who provide the service have to keep detailed statistics of every meal provided and other personal information about each recipient and every 3 months fill out the answers on a 19 question form for each person who is provided with meals. This is not an easy task for the women, most of whom are grandmothers and have limited education.[77]

6.149 The NT LGGC suggested that the answer is to empower those remote councils to coordinate when, in what order and who they will see. DOTARS suggested a solution might be to operate on a regional level much like the Sustainable Regions program where local management is set up to draw resources from both Commonwealth and State agencies.[78]

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74 Barunga Manyallaluk Community Government Council, Submission No. 295, p. 5.

75 Torres Strait Regional Authority, Submission No. 362, p. 8.

76 NT LGGC, Official Hansard, 27 June 2003, Canberra, p. 899.

77 Barunga Manyallaluk Community Government Council, Submission No. 295, p. 9.

78 DOTARS, Official Hansard, 27 June 2003, Canberra, p. 900.

6.150 It was understandable also that those councils with a strong track record of sound financial management asked that they be rewarded with greater trust and less onerous reporting requirements.

6.151 LGMA supported the introduction of performance monitoring of local governments that rewards efficiency and those that are achieving. LGMA stated it would welcome accountability and transparency where grant funds are being passed on through the system.

> … most of our local governments are moving into the situation where they are recording performance indicators themselves. They are keen to start looking at benchmarking with others. It is important when we benchmark, if we are going to gain any efficiencies out of benchmarking, that we must compare apples with apples; so there are some ground rules that need to be set so that that information is uniform. Certainly, we believe the grants commissions could gather some of that information. Providing that it is available openly and transparently, we believe it can only serve to benefit local government and raise standards.[79]

6.152 The Committee concluded that the:

- new local government funding model should incorporate realistic financial reporting requirements which take into account the differing capacities of councils; and
- new arrangements be phased in over three years. (Recommendation 16)

A new approach to funding local government

6.153 The *Local Government (Financial Assistance) Act 1995* identifies two goals of the Commonwealth in providing the financial assistance. They are to:

- increase the transparency and accountability of the allocation of funds by LGGCs; and
- promote greater consistency in the methods used to allocate equalisation grants.[80]

79 LGMA, Official Hansard, 27 June 2003, Canberra, p. 892.

80 CGC, *Review of the Operation of the Local Government (Financial Assistance) Act 1995,* June 2001, p. xii

6.154 Further the CGC notes that because the Act recognises that full horizontal equalisation cannot be achieved, it is clear that its intention is to provide assistance to the relatively disadvantaged LGBs.[81]

6.155 Councils argued for greater transparency, accountability and consistency in the allocation of FAGS. Further, there were calls for clarity of the purpose of FAGs on the part of the Federal government. Change was sought in response to:

- the desire on the part of local government for a strengthened relationship with the Federal government;
- the success of the Roads to Recovery program which distributes funds direct from the Federal government to local government;
- the demand from councils in a majority of States and the NT to address per capita interstate distribution of FAGs and the minimum grant;
- the need for consistency and transparency of methodology across the nation; and
- the performance of LGGCs.

6.156 A funding arrangement which took into consideration these issues would go a long way to addressing the following concerns raised by the CGC in its recent review in relation to LGGCs:

> They do not assess all areas of expenditure and revenue, they do not assess all of the influences that affect the cost of providing services or the capacity to raise revenue, and some of them do not assess relative advantage and disadvantage. These aspects of their practices are not consistent with a proper assessment of relative needs and would not, therefore, be consistent with delivering equalisation outcomes.[82]

6.157 In 1990, when the CGC was asked to review the interstate distribution, there were reservations about the appropriateness of the methodology being used and the quality and availability of relevant data. The CGC believed that suitable relativities could be determined provided there were improvements in data sources and refinements in methodology.[83]

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81 CGC, *Review of the Operation of the Local Government (Financial Assistance) Act 1995*, June 2001, p.15.

82 Commonwealth Grants Commission Review of the Operation of the Local Government (Financial Assistance) Act 1995, p.17.

83 DOTARS, Submission No. 103, p. 60.

6.158 There is now a methodology available, based on equalisation principles, which has been applied centrally. The model adopted by the Commonwealth Department of Education, Science and Training to fund non-government schools centrally distributes funding to 980 schools on equalisation principles. The Committee requested an explanation of that model at the hearing in North Sydney to determine whether it could apply to the distribution of local government FAGs.[84]

6.159 Professor Farish explained in subsequent correspondence that possible models include but are not limited to:

- non-socio economic status (SES) data-driven models utilising data from LGAs and other sources;
- SES plus other data models, with all funding based on a hybrid of SES data and other data;
- SES-only models, with all funding based on one of many possible SES models that utilise ABS data at the LGA level;
- part-funding models where existing policy and other factors dictate one portion of total funding – for example, equal-per-capita, or minimum grant provisions, or capped amounts – and one of the above three options are used for the balance; and
- any form of the above that include growth factors, for example, growth associated with increased economic activity that leads to increases in funding levels necessary to maintain HFE principles.

6.160 Further, Professor Farish noted:

> In addition, state-based differentials in funding local government can be incorporated into any approach based on the above models.
>
> A formula-based model would also allow for some certainty of funding, and allow for transparency of the funding process, whilst still permitting active healthy debate about the rationale and relative importance of different components.[85]

6.161 The Farish model also incorporates one particular factor which LGGCs found difficult to calculate, the capacity of a community to pay:

> In assessing capacity to pay, it takes some account of differences in family income but, simply because of the lack of

84 Professor Farish, Official Hansard, 28 April 2003, North Sydney, p. 751
85 Professor Farish, Correspondence 20 August 2003.

> data, I personally think it is the hardest and most vexatious question the grants commission has had to answer. [86]
>
> … we have been wrestling with this issue of capacity to pay for some time and we have put in place some temporary arrangements ... we recognise that there is no simple solution to that. We have had a couple of goes at it and this will be our third major attempt to look at that capacity to pay issue. [87]
>
> ….Capacity to pay in an ageing population is another issue which the LGGCs are grappling with.[88]

6.162 At the hearing in Hobart, the General Manager, Devonport City Council reflected on his experience of the non-government schools funding model:

> I have had some exposure to the SES, because I was chairman of a school board when it was introduced. Frankly, I think it would be more appropriate for local government than it is for schools. …I do not see the need for a Grants Commission in each state. If there were a proper, rigorous system which was transparent – and the type of thing you were talking about is quite transparent – I do not have any problems with that being used to distribute money directly to councils.[89]

6.163 If a central distribution model based on equalisation principles exists and the methodology can accommodate factors relevant to local government, the building of a new and specific local government funding model which incorporates the information held by local government and LGGCs and other relevant factors should be possible.

86 Queensland LGGC, Official Hansard, 27 June 2003, Canberra, p. 872.

87 Victorian LGGC, Official Hansard, 27 June 2003, Canberra, p. 871.

88 SA LGGC, Official Hansard, 27 June 2003, Canberra, p. 872.

89 Devonport City Council, Official Hansard, Hobart, 18 February 2003, p. 442.

Recommendation 16

6.164 **The Committee recommends that a new methodology for the distribution of FAGs to local government be designed which incorporates the following elements:**

- **a national model which is consistent across each LGB;**
- **distribution of funds on equalisation principles i.e. on the basis of need;**
- **funds to be paid direct to local government;**
- **funds to remain untied and be allocated from one pool;**
- **data on local conditions/factors to be provided by LGGCs;**
- **a weighted factor be applied to indigenous community councils to ensure their level of disadvantage is taken into account;**
- **appropriate acquittal arrangements; and**
- **a new model, as presented by Professor Farish, to be designed by a Federal and Local Government Finance Advisory Group of experts and phased in over three years, with the process to be facilitated by the Commonwealth Grants Commission.**