

DEPARTMENT OF TRANSPORT AND REGIONAL SERVICES

SUBMISSION TO THE PRODUCTIVITY COMMISSION

ASSESSING LOCAL GOVERNMENT REVENUE RAISING CAPACITY

INTRODUCTION

1. This submission has been provided by the Department of Transport and Regional Services (DOTARS) to provide information for the Productivity Commission's study on local government revenue raising capacity.
2. DOTARS has separately provided significant data on local government sourced from its own records, the Australian Bureau of Statistics and state local government grants commissions.

EXECUTIVE SUMMARY

3. Local government is a State and Territory (the States) responsibility and councils are constituted and operate under State legislation.
4. There are 700 local governing bodies in Australia with wide diversity ranging from rural agricultural councils facing severe population depletion and low economic growth, to large urban councils facing infrastructure pressures due to growth.
5. Local government in all states has general powers to deliver good governance for its local communities. Local Government is well placed to consult with local communities on what services to provide and how to pay for them. Communities expect local government to provide a range of services while often not having sufficient information on the long term costs of delivering those services.
6. Over the last two years, reports commissioned by State Local Government Associations in South Australia, New South Wales and Western Australia, and similar work by the Municipal Association of Victoria (the State sustainability reports), have concluded that the financial sustainability of local government in Australia is a major issue. The recent report (December 2006) by PriceWaterhouseCoopers (PwC) commissioned by the Australian Local Government Association (ALGA) draws on these reports to find that up to 30 per cent of local governments are currently not sustainable.
7. A definition of local government financial sustainability was formulated in 2005 by the Financial Sustainability Review Board's independent inquiry into South Australian local government which has been broadly adopted by subsequent inquiries in New South Wales and Western Australia. The Financial Sustainability Review Board proposed that a council can be considered financially sustainable if it:
undertakes long term financial and asset management planning, delivers operating surpluses over the medium term and fully funds asset depreciation.

8. The issue of local government sustainability is broader than simply financial sustainability and includes issues connected to the structure of local government, its regulatory environment and its responsiveness to community needs.
9. Although the State sustainability reports are not definitive because they rely on council data, which is poorly developed and not directly comparable between states, a sizeable proportion of local government appears not to be financially sustainable in the long term under current funding arrangements. The State sustainability reports indicate that some local governments are not fully funding annual asset renewal and an infrastructure renewal backlog has been allowed to accumulate.
10. In 2005-06 total local government revenue was \$23.1 billion and expenditure was \$20.5 billion. More than 85 per cent of its revenue was own-source revenue.
11. However, the proportion of total local government revenue sourced from local government rates has declined from 54 per cent in 1974-75 to 38.6 per cent in 2005-06, while the proportion of revenue raised by user charges has grown from 13.3 per cent to 30.3 per cent over the same period.
12. The Australian Government and state and territory governments provide significant grant funding to local government, making up more than 9 per cent of total revenue.
13. The assumption of additional responsibilities, additional regulation, restrictions on local government revenue-raising, the inefficient structure and operation of some local governments, the accumulation of community assets without appreciation of their lifecycle funding needs and the reduction in state funding all directly affect the financial viability of local government.
14. State financial assistance to local government has declined over time and increased pressure is being placed on the Australian Government to meet local government's calls for increased funding.
15. In this context the Australian Government has asked the Productivity Commission to examine the capacity of local government to raise revenue and the factors contributing to capacity and the variability of capacity over time.

Local government in Indigenous communities

16. In 2006-07, around \$30 million of Australian Government assistance will be provided to 91 Indigenous councils, many of which need to be considered separately from other local government bodies as they do not operate under the same legal and financial arrangements as mainstream local governing bodies.

OVERVIEW OF LOCAL GOVERNMENT

Regulatory and legal framework

17. There are currently 700 local governing bodies in Australia, including 91 Indigenous local governing bodies.
18. Local government is established under State laws, with the Constitutions of all the States and the *Northern Territory Local Government Act* providing for systems of local government.
19. Local governments are entities separate from the States with their own budgets and revenue raising capacity. Local governments are accountable to the States through the reporting and regulatory regimes administered by State local government departments. Although local governments are separate legal entities from the States, ultimately the States bear the risk of failed local governments.
20. In all jurisdictions local governing bodies have the authority and responsibility to provide generally for the 'good governance' of their local government area. In effect, this confers on local government the powers of general competence, or the power to take action in any area not expressly precluded by other legislation.
21. As the States provide the legal and regulatory framework for local government operations there are significant differences between jurisdictions in the roles, functions and responsibilities of local governments and the services they deliver.

Local government's roles and functions

22. Local government has roles in governance, advocacy, service delivery, planning and community development and regulation. Local governing bodies determine service provision according to local needs and the requirements of the various state and territory local government Acts. They are increasingly providing services above and beyond those traditionally associated with local government (roads and refuse disposal financed by rates). Examples of local government functions and services include:
 - engineering (public works design, construction and maintenance of roads, bridges, footpaths, drainage, cleaning, waste collection and management)
 - recreation (golf courses, swimming pools, sports courts, recreation centres, halls, kiosks, camping grounds and caravan parks)
 - health (water sampling, food sampling, immunisation, toilets, noise control, meat inspection and animal control)
 - community services (child care, elderly care and accommodation, refuge facilities, meals on wheels, counselling and welfare)
 - building (inspection, licensing, certification and enforcement)
 - planning and development approval
 - administration (of aerodromes, quarries, cemeteries, parking stations and street parking)
 - cultural/educational (libraries, art galleries and museums)
 - water and sewerage, in some States
 - environmental services
 - other (abattoirs, sale-yards, markets and group purchasing schemes).

Local government's size and diversity

Population

23. The average population of local governing bodies in 2004–05 was 28,432. However, 50 per cent of councils had less than 7,293 residents. The population of local governing bodies ranges from nil for the Northern Territory Roads Trust to more than 970,000 in the City of Brisbane.
24. The average population of local governing bodies by state differs markedly, varying from 3,016 in the Northern Territory to 62,774 in Victoria.
25. Table 1, derived from data provided by the local government grants commissions in each jurisdiction, shows selected characteristics of local governing bodies by jurisdiction as at 30 June 2005.

Table 1: Selected characteristics of local governing bodies by jurisdiction, as at 30 June 2005

State	No. of bodies	Characteristic	Minimum	Median	Maximum	Average	Total
NSW	155	Population (no)	57	20 357	283 458	41 339	6 773 615
		Road length (km)	0	881	3 245	895	143 782
		Area (sq km)	0	2 689	53 511	4 568	708 067
Vic.	80	Population (no)	3 191	39 744	217 349	62 774	5 021 886
		Road length (km)	7	1 293	5 168	1 615	129 171
		Area (sq km)	3	1 532	22 087	2 841	227 316
Qld	157	Population (no)	57	3 558	971 757	25 234	3 961 698
		Road length (km)	2	834	5 562	904	174 522
		Area (sq km)	0	2 422	117 084	11 153	1 751 096
WA	142	Population (no)	150	2 743	182 047	14 156	2 010 113
		Road length (km)	9	738	4 147	866	122 993
		Area (sq km)	2	2 000	378 533	17 515	2 487 130
SA	74	Population (no)	67	8 282	154 514	20 838	1 542 033
		Road length (km)	0	941	3 882	1 018	75 310
		Area (sq km)	0	984	8 860	2 102	155 581
Tas.	29	Population (no)	877	11 454	65 021	16 733	485 263
		Road length (km)	154	437	980	485	14 079
		Area (sq km)	80	1 158	9 750	2 379	68 982
NT	64	Population (no)	0	530	69 262	3 016	193 035
		Road length (km)	5	145	2145	220	14 108
		Area (sq km)	0	5	28 700	1 453	92 989
All	701	Population (no)	0	7 293	971 757	28 432	19 987 643
		Road length (km)	0	727	5 562	923	646 965
		Area (sq km)	0	1 824	378 533	7 833	5 491 161

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

Length of local roads maintained

26. In 2004–05, local governing bodies were responsible for 646,965 km of local roads nationally. This is over 80 per cent of the nation's roads by length. The average length of road for which

local governing bodies are responsible is 923 km. However, 25 per cent of local governing bodies are responsible for less than 310 km of local road and 25 per cent are responsible for more than 1,273 km.

Area

27. The area for which local governing bodies are responsible varies considerably within and between States. Nationally, the average area of local governing bodies is just over 7,833 km². However, 50 per cent of local governing bodies have an area of less than 1,824 km². Nine local governing bodies in Western Australia and Queensland cover areas greater than 100,000 km².
28. The shire with the largest area is East Pilbara in Western Australia with 378,533 km². Some local governing bodies have no area because either their boundaries are not defined (for example, some Indigenous Community Councils) or they are not responsible for providing property services within a particular area of land, such as the Outback Areas Community Development Trust in South Australia. A large proportion of South Australia (around 85 per cent) is unincorporated (that is, not included within the boundary of a local governing body). Large areas of the Northern Territory and New South Wales are also unincorporated.

LOCAL GOVERNMENT REVENUE

29. As a whole, local government raises about 85 per cent of its revenue from its own sources. However, there is a significant disparity between jurisdictions in local government's own source revenue capacity, ranging from 78.5 per cent of total revenue in the Northern Territory to 93.0 per cent of total revenue in Queensland.
30. In 2005-06, the Federal Government raised \$245,223 million in taxes representing 82.3 per cent of taxation revenue. At the same time, the States and Territories raised \$44,235 million representing 14.8 per cent of taxation revenue, mostly from payroll taxes, financial transactions and the use of goods. Local government's share of taxation revenue was \$8,920 million or 3 per cent and this was mostly raised from municipal rates. Local government taxation revenue increased 7.4 per cent from \$8,306 million in 2004-05 to \$8,920 million in 2005-06.
31. Local government raises revenue through:
 - rates and other taxes
 - sale of goods and services
 - interest
 - grants from other governments
 - other revenue (including from business undertakings).

Almost 70 per cent of local government's revenue is obtained through rates and taxes and sale of goods and services.

Table 2: Local government revenue sources by jurisdiction, 2005–06

		NSW	Vic	Qld	WA	SA	Tas	NT	Aust
Taxation	\$	2,613	2,519	1,807	928	785	207	62	8,920
	%	36.6	51.9	27.1	41.5	60.2	32.6	23.8	38.6
Sales of goods and services	\$	2,447	943	2597	478	217	258	60	7,000
	%	34.3	19.4	39.0	21.4	16.6	40.6	23.1	30.3
Interest	\$	319	69	134	74	21	20	7	644
	%	4.5	1.4	2.0	3.3	1.6	3.1	2.7	2.8
Current grants and subsidies	\$	635	547	464	190	154	69	56	2,117
	%	8.9	11.3	7.0	8.5	11.8	10.9	21.5	9.2
Other revenue	\$	1,124	779	1,656	564	128	81	76	4,407
	%	15.7	16.0	24.9	25.2	9.8	12.8	29.2	19.1
Total	\$	7,138	4,856	6,659	2,234	1,305	635	260	23,088
	%	100	100	100	100	100	100	100	100

Source: Australian Bureau of Statistics, *Government Finance Statistics*, cat. no. 5512.0.

Notes: The sums of all individual state jurisdictions may not agree with total state figures due to transfers between jurisdictions.

Table 3: Local government revenue by source by jurisdiction, \$ per capita, 2005–06

	NSW	Vic	Qld	WA	SA	Tas	NT	Australia
Taxation	384.78	495.04	446.21	455.30	503.35	423.69	296.97	441.06
Sales of goods and services	360.34	185.32	641.29	234.52	139.14	528.08	287.39	346.12
Interest	46.98	13.56	33.09	36.31	13.47	40.94	33.53	31.84
Current grants and subsidies	93.51	107.50	114.58	93.22	98.75	141.23	268.23	104.68
Other revenue	165.52	153.09	408.92	276.71	82.07	165.79	364.02	217.91
Total	1051.13	954.32	1644.34	1096.06	836.77	1299.74	1245.34	1141.61

Source: Australian Bureau of Statistics, *Government Finance Statistics*, cat. no. 5512.0.

Notes: a The sums of all individual state jurisdictions may not agree with total state figures due to transfers between jurisdictions.

Rates

32. Rates on property are the main taxation source available to local government and its largest single source of revenue. The proportion of total local government revenue sourced from taxation has declined from 54 per cent in 1974-75 to 38.6 per cent in 2005-06.
33. Rates in each state and the Northern Territory are based on a valuation of the land upon which they are charged. However, methods for assessing land value differ significantly between states. New South Wales and Queensland have a state-wide requirement that rates be based on the unimproved value of the land. Victoria, however, operates on a differential system where different valuation assessments are used depending on the type or the primary use of the land. In the Northern Territory a variety of systems may be used for rate assessments and the way they are applied is at the discretion of the individual council. For a more detailed comparison of land value assessments used to calculate rates charges see Attachment A.
34. There is a wide disparity between jurisdictions in the proportion of local government total revenue raised from taxation, which in 2005-06 ranged from 23.8 per cent in the Northern Territory to 60.2 per cent in South Australia. Per capita rates tend to be higher in the states where local governments has few other sources of revenue (eg from the provision of water and sewerage services).
35. Rates levied on property are the principal source of local government taxation revenue in New South Wales, Queensland and the Northern Territory, while it is the only source of local government taxation revenue in the other jurisdictions. Local government in all jurisdictions levies various ad valorem charges, such as on the value of building construction, which are characterised as taxes in New South Wales, Queensland and the Northern Territory but included with rate revenue in other jurisdictions.
36. Local government itself has not maintained its revenue raising effort measured as a share of gross state product. The following section examines the per capita rate income by State and the level of local government revenue as a percentage of gross state product. Although rates revenue per capita has increased in real terms in most states, as a share of gross state product it has declined.
37. Local government in New South Wales can require developer contributions to help fund the infrastructure needs of new land developments. There is insufficient information available about access to developer contributions in other states.

Local government taxation revenue per capita

38. Over the period from 1992-93 to 2005-06, rate growth nationally has been low. Over this period local government taxation revenue per capita increased by 54.6 per cent in nominal terms from \$285.33 per capita to \$441.06 per capita, or 9.5 per cent in real terms from \$285.33 per capita to \$312.43 per capita (see Table 5). Table 5 shows local government taxation revenue per capita increased in all jurisdictions in real terms over this period other than New South Wales, where it fell by 0.1 per cent.
39. Table 4 shows that, on a per capita basis, local government taxation revenue was the lowest for the Northern Territory at \$297; and for the states, rates revenue per capita varied from \$385 for New South Wales to \$503 for South Australia

40. NSW has the lowest per capita local government taxation of any state, about 13 per cent below the average. This may be due to the NSW Government policy, which was introduced in 1977, of restricting council rate increases to a determined level, called rate capping or rate pegging. Rate pegging requires councils to seek special approval from the NSW Minister for Local Government for annual increases in rates and charges, or in total revenue, beyond a level announced by the Minister. If rates in NSW were to match the average for other states, it would raise an extra \$220 million per annum.
41. Local governments in Victoria and South Australia have raised rates in recent years to address a backlog in renewal of infrastructure, such as local roads and buildings. South Australia was the first state to mandate long term financial and asset management planning for local government in 2005.
42. Table 4 and Figure 1 illustrate the changes in local government taxation revenue per capita, net of inflation, from 1992–93 to 2005–06. Nationally local government taxation per capita increased in real terms by 9.5 per cent during this period, but there was significant variation between jurisdictions. South Australia had the greatest real increase in taxation per capita at 29.8 per cent. The fall in per capita rates in Victoria during the mid-1990s was due to the State government's reform of local government, which included a mandatory 20 per cent rate reduction.

Table 4: Real Rates Per Capita 1992-93 to 2005-06 expressed in 1992-93 \$

	NSW	Vic	Qld	WA	SA	Tas	NT	Australia
1992-93	270.00	326.29	286.57	256.63	276.25	259.01	159.09	285.33
1993-94	271.81	337.57	290.02	259.65	279.01	271.89	159.01	290.25
1994-95	268.75	299.93	295.49	257.54	282.06	256.89	164.18	280.20
1995-96	290.69	262.90	304.68	265.49	287.53	272.22	159.77	281.99
1996-97	310.97	260.96	311.41	277.47	300.06	281.46	161.61	292.34
1997-98	302.48	246.95	284.62	277.59	289.03	284.57	172.69	280.33
1998-99	359.50	257.31	286.62	278.81	294.01	282.55	168.69	303.74
1999-00	275.95	264.09	285.18	289.55	299.99	275.57	193.67	277.40
2000-01	265.99	266.59	283.56	287.17	299.78	283.04	180.26	274.09
2001-02	267.07	272.72	288.10	293.11	313.72	296.00	197.91	279.09
2002-03	268.44	292.09	293.24	301.78	321.52	286.68	197.33	286.64
2003-04	269.46	309.99	295.49	308.54	335.79	290.52	209.98	294.04
2004-05	273.68	325.76	300.83	306.07	351.52	302.41	218.00	301.75
2005-06	269.62	357.17	313.38	317.40	358.67	300.99	218.94	312.43
Change	-0.14%	9.47%	9.35%	23.68%	29.83%	16.21%	37.62%	9.50%

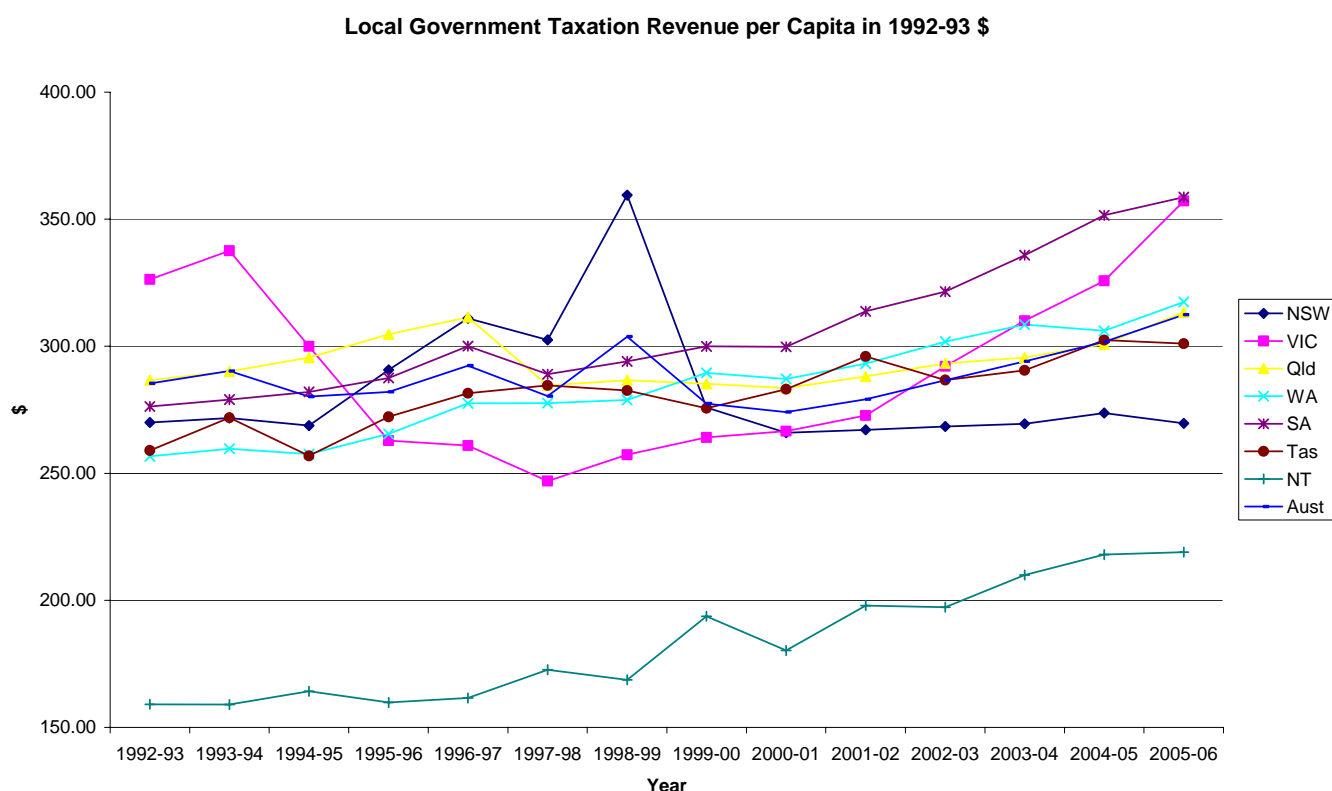
Department of Transport and Regional Services

Table 5: Local government taxation revenue per capita

	NSW	Vic	Qld	WA	SA	Tas	NT	Aust
2005-06 per capita tax revenue (\$)	384.78	495.04	446.21	455.30	503.35	423.69	296.97	441.06
1992-93 per capita tax revenue (\$)	270.00	326.29	286.57	256.63	276.25	259.01	159.09	285.33
Nominal growth in tax revenue per capita 1992-93 to 2005-06 (%)	42.5	51.7	55.7	77.4	82.2	63.6	86.7	54.6
CPI growth 1992-93 to 2005-06 (%)	42.7	38.6	42.4	43.5	40.3	40.8	35.7	41.2
2005-06 per capita tax revenue expressed in 1992-93 (\$)	269.62	357.17	313.38	317.40	358.67	300.99	218.94	312.43
Real growth in tax revenue per capita 1992-93 to 2005-06 (%)	-0.1	9.5	9.4	23.7	29.8	16.2	37.6	9.5

Source: Calculated using Australian Bureau of Statistics *Government Finance Statistics* cat no.5512.0, *Taxation Revenue* cat no.5506.0 and *Population* cat 3101.0

Figure 1



Local government taxation revenue effort as share of gross state product

43. As a proportion of gross state product, nationally local government's taxation revenue has fallen by 18.0 per cent over the period 1992-93 to 2005-06. On 2004-05 aggregate gross state product of \$946,493 million, the reduction in taxation revenue effort by local government amounts to \$1,926 million nationally, but there is great variation between jurisdictions, as Table 6 shows.
44. South Australia is the only jurisdiction where local government's taxation revenue as a share of gross state product has increased over the period 1992-93 to 2005-06. Nationally, local government taxation revenue as a share of gross state product has declined by \$1,926 million over this period, with the largest relative declines in Western Australia, Queensland and New South Wales. The resources boom has increased gross state product in Western Australia and

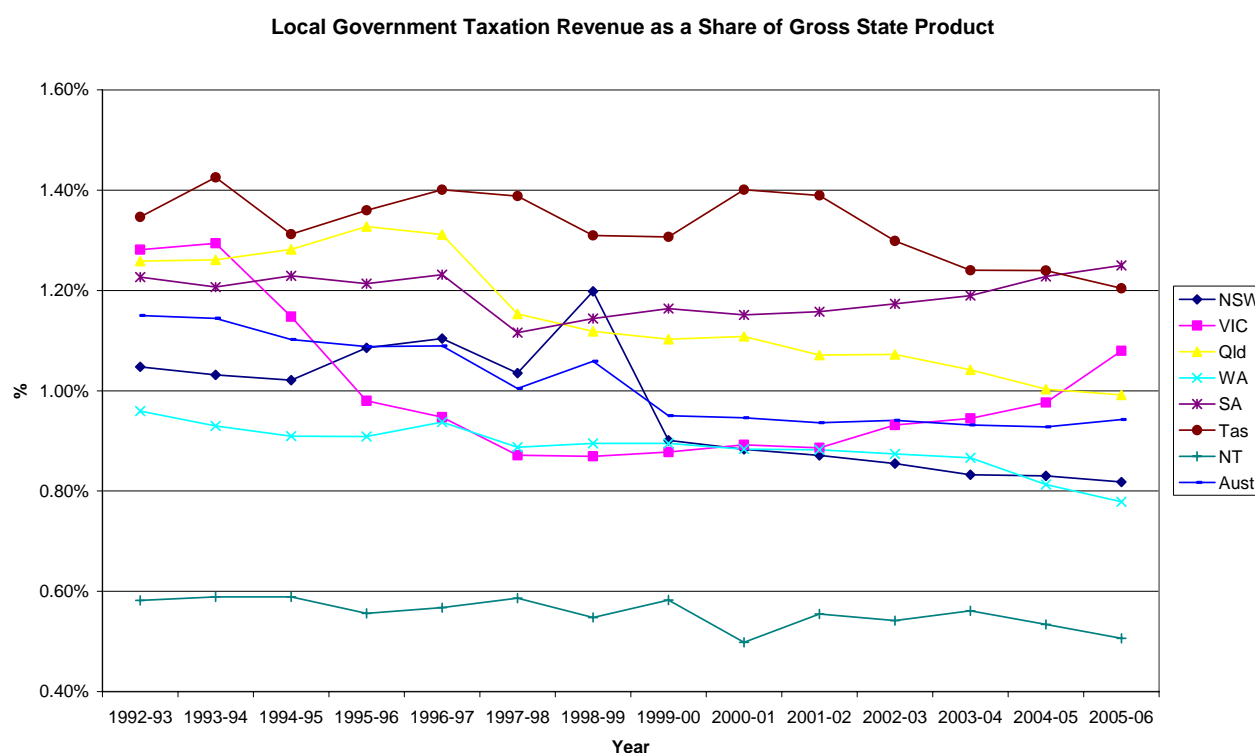
Queensland, with local government taxation revenues shrinking as a proportion of gross state product as a result.

Table 6: Local government taxation revenue as a share of gross state product

	NSW	Vic	Qld	WA	SA	Tas	NT	Aust
Tax revenue as share of 1992-93 GSP (%)	1.04783	1.28108	1.25846	0.95945	1.22675	1.34673	0.58165	1.14975
Tax revenue as share of 2005-06 GSP (%)	0.81774	1.07963	0.99171	0.65861	1.47775	1.20398	0.50654	0.94243
Change (%)	-22.0	-15.7	-21.2	-31.4	20.5	-10.6	-12.9	-18.0
2005-06 GSP (\$m)	319,541	233,320	182,211	119,190	62,798	17,193	12,240	946,493
Change in tax revenue effort as share of 2005-06 GSP (\$m)	-735	-470	-486	-216	15	-25	-9	-1926

Source: Calculated using Australian Bureau of Statistics *Government Finance Statistics* cat no.5512.0, *Taxation Revenue* cat no.5506.0 and *Australian National Accounts* cat 5220.0

Figure 2



45. Local government's principal taxation revenue source is from rates levied on properties. The states also levy property taxes such as stamp duty and land tax, principally on the capital value of property, which raise considerably more revenue than local government does from its property tax base.
46. There is a marked difference in the revenue raising efforts between South Australia and Victoria and the other states which suggests that there may be scope for higher rates in other states. If all councils were to raise rates to the same per capita level as in South Australia, they would raise in total an extra \$1 billion a year.

47. The sustainability report by the Western Australian Local Government Association observed that WA councils with operating deficits could more than halve these deficits if they increased their rating and cost recovery effort to the average WA level. In that case rate revenue would increase by around \$40 million or 6 per cent.

Income from the sale of goods and services

48. Income from the sale of goods and services is the second largest source of local government revenue. It has grown from 13.3 per cent of revenue in 1974-75 to 30.3 per cent in 2005-06. Revenue from sale of goods and services grew by 237 per cent between 1997-98 and 2005-06.
49. In Queensland and Tasmania local government derives around 40 per cent of its revenue from the sale of goods and services since councils in these States (and in rural and remote parts of New South Wales) are responsible for water and sewerage services. (The Queensland Government has announced it will take over bulk water assets in south east Queensland but leave local government with a role in retail and distribution of water.)
50. Councils in Western Australian raise almost double the revenue per capita from the sale of goods and services of South Australian councils.

Business Activities

51. Local governments operate a wide range of business activities such as caravan parks, car parks, golf courses and entertainment centres. Local government could examine the scope for it to operate its businesses on a clearer commercial basis.

LOCAL GOVERNMENT EXPENDITURE

52. Local government expenditure in 2005-06 was \$20.5 billion. Expenditure has increased from \$13.6 billion in 1998-99 – an increase of over 50 per cent in 8 years.
53. Nationally, around two-thirds of local government expenditure is on transport and communications, housing and community amenities and general public services, as Table 7 shows. Local government expenditure on transport and communications has fallen from about 50 per cent in the early 1960s to 29 per cent in 1998-99 and 22 per cent in 2005-06, suggesting that local government may not be spending enough on asset renewal. Spending on general public services has risen from 16 per cent to almost 18 per cent.

Table 7 - Total Local General Government Expenses by Purpose

<i>\$m</i>								
TOTAL EXPENSES	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
General public services	2,174	2,577	2,630	2,867	2,842	2,999	3,396	3,655
Public order and safety	263	288	312	359	486	522	497	579
Education	43	43	40	45	84	82	71	77
Health	245	261	258	265	240	254	257	257
Social security and welfare	712	773	823	900	1,114	1,170	1,230	1,283
Housing and community amenities	3,137	3,390	3,556	3,750	4,105	4,311	4,574	4,875
Recreation and culture	1,836	2,025	2,139	2,213	2,351	2,704	2,903	3,073
Fuel and energy	7	10	9	10	16	14	20	15
Agriculture, forestry and fishing	12	12	23	23	31	35	35	51
Mining, manufacturing and construction	164	150	163	176	199	243	253	281
Transport and communications	3,942	4,400	4,498	4,629	4,498	4,443	4,475	4,555
Other economic affairs	406	536	489	588	644	663	739	774
Public debt transactions	417	427	418	403	382	366	371	375
Other	250	335	439	467	551	645	655	654
TOTAL	13,608	15,226	15,796	16,695	17,542	18,449	19,475	20,505

ABS Government Finance Statistics Catalogue 5512.0

FINANCIAL ASSISTANCE TO LOCAL GOVERNMENT

Changes in Australian and State Government assistance to local government

54. Local government revenue from all sources in 1974-75 was \$1.3 billion (current prices 1974-75). In that year Australian Government assistance to local government was 10.5 per cent of revenue and State assistance was 14.8 per cent. In 2004-05, total local government revenue was \$21.4 billion. Australian Government assistance represented 9 per cent of this revenue and State assistance was about 10 per cent of local government revenue. Recent data has shown an increase in state assistance from \$1,159 million in 2003-04 to \$2,132 million in 2004-05 though the trend over recent years has not been consistent.

Australian Government Financial Assistance

55. The Australian Government provides significant financial assistance to local government through tied and untied grants programmes. In 2005-06, Australian Government assistance of about \$2,329 million represented about 10.1 per cent of total local government revenue of \$23.1 billion. This assistance was boosted by a one-off doubling of grants under the *Roads to Recovery* Programme. Total Australian Government assistance exceeded \$2,270 million in 2006-07.

Local Government Financial Assistance Grants (FAGs)

56. The Australian Government has provided Financial Assistance Grants to local government since 1974-75. The grants are currently provided under the *Local Government (Financial Assistance) Act 1995* and have a general purpose and a local road component.
57. The Act provides that the purpose of both components of the Financial Assistance Grants is to improve the financial capacity and certainty of funding for local government, and improve the efficiency, effectiveness and the capacity of local governing bodies to provide residents with an equitable level of services.
58. At the sector level, FAGs account for around 8 per cent of local government's income. However, for councils assessed as relatively more needy, the grants can be more than 50 per cent of income.
59. The general purpose grant pool is allocated between jurisdictions on a per capita basis, while the local road grant pool is allocated between jurisdictions on the basis of a formula. Both components are paid through the states and territories on condition that they are passed onto local government. The grants are untied in the hands of councils who are free to spend them according to local priorities. The grant pools are indexed annually by population growth and inflation to maintain their real per capita value. For a full description of the grant calculation and distribution methodologies see the 2004-05 Local Government National Report published by DOTARS which is available at <http://www.dotars.gov.au/local/publications/index.aspx>.
60. The intra-jurisdictional allocation of the grants is made in accordance with recommendations of the Local Government Grants Commission in each jurisdiction. The Commissions are State and Territory government bodies. The intra-jurisdictional allocation of the general purpose grants is made on the basis of horizontal equalisation to assess councils' capacity to deliver local

government services at the average standard for local government in the State. The local roads grants are distributed according to Local Government Grants Commissions assessments of road expenditure needs.

61. In 2007-08, the Australian Government will provide around \$1,763.4 million in local government FAGs to local governing bodies, an increase of 4.55 per cent on 2006-07. The grants consist of \$1,221.4 million in general purpose grants and \$542.0 million in local road grants.
62. Since 2004-05, local governments in South Australia have received a supplementary grant for local roads to compensate for South Australia's disadvantage in the distribution of the local road FAGs. Under the existing formula South Australia receives the lowest share of all jurisdictions on both a per capita and per kilometre of local road basis. The supplementary grants are distributed between councils in the same proportions as the local road FAGs. In 2007-08 the grant will be \$13.5 million and will be indexed from that year at the same rate as the FAGs.

Indigenous local governing bodies

63. Indigenous local governing bodies can be established under the mainstream local government legislation of a State or Territory, or through separate, specific legislation, or can be 'declared' to be local governing bodies by the Australian Minister for Local Government, on advice from a State or Territory Minister. Queensland, Western Australia, South Australia and the Northern Territory have Indigenous local governing bodies eligible for financial assistance grants as detailed in Table 8.

Table 8: Distribution of Indigenous councils by eligibility type and by State, June 2005

State/Territory	Established under State local government legislation	Established under separate State legislation	Declared local governing bodies	Total Indigenous local governing bodies
Queensland	2	32	0	34
Western Australia	1	0	0	1
South Australia	0	2	3	5
Northern Territory	26	1	24	51
Total	29	35	27	91

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

64. In 2006-07 the total estimated entitlement of Indigenous local governing bodies was \$29.6 million.

Australian Capital Territory

65. The ACT does not have local governing bodies and municipal services are provided directly by the ACT Government. The ACT is, however, receives FAGs from the Australian Government. The estimated amount of grants to be provided to the ACT in 2007-08 is \$36.6 million.

Other Australian Government funding for local government

66. Total direct Australian Government assistance to local government in 2006-07 was in excess of \$2,270 million, including the FAGs, \$300 million under *Roads to Recovery* Programme and around \$60 million for services to children.

67. The *Roads to Recovery* Programme has become an important revenue source for local government. The programme, which was boosted by a one-off doubling of funding in 2005-06, was renewed in the May 2007 Budget with funding of \$350 million a year to be allocated from 2009-19 to 2014-15.
68. Funding for strategically important regional roads under the AusLink Strategic Regional Programme is also of growing importance to local government.
69. Local government is also eligible to apply on a competitive basis for funding from a wide range of Australian Government programmes. In 2006-07 the AusLink Black Spot programme provided an estimated \$27 million for road safety projects nominated by local government. Under the Regional Partnerships program in 2006-07, about 39 per cent of the successful applications were from local government which received \$39.72 million, or 49 per cent of the grants. Local government can also access, on competitive basis with other applicants, a wide range of programmes outside of the DOTARS portfolio such as the Australian Water Fund.

State And Territory Financial Assistance

70. It is difficult to obtain an accurate picture of the level of financial assistance from State Governments because of the lack of consistent, comparable and timely data. ABS data is the only source which can provide an indication of State assistance to local government.
71. Based on ABS data, State assistance to local government varies year on year. In 1998-99 state and territory grants to local government amounted to \$788 million. In 2000-01 they had risen by 84 per cent to \$1,449 million, but by 2002-03 they had fallen 42 per cent to \$846 million. In 2003-04 they rose to \$1,159 million and then almost doubled to \$2,132 million in 2004-05. (See Table 9)
72. If the data is reliable, it shows that the significant year to year fluctuations in state and territory grants to local government make it difficult for councils to rely on this source of revenue in their planning considerations.

Table 9: Grants from states to local government by purpose, 2004–05 (\$m)

Purpose	NSW	Vic.	Qld	WA	SA	Tas.	NT	Total
General public services	15	17	69	8	1	1	38	149
Public order and safety	29	1	2	12	1	-	1	46
Education	10	23	1	2	-	-	1	37
Health	11	8	4	5	7	6	7	48
Social security and welfare	111	308	27	45	17	9	8	525
Housing and community amenity	86	40	118	9	13	8	71	345
Recreation and culture	52	72	48	27	17	13	7	236
Fuel and energy	3	-	1	-	3	-	1	8
Agriculture, forestry, fishing and hunting	-	-	3	1	1	-	-	5
Mining, manufacturing and construction	1	-	9	1	-	-	1	12
Transport and communications	281	230	232	204	54	36	13	1 050
Other economic affairs	9	13	28	3	2	1	6	62
Other purposes	448	274	177	106	89	27	-	1 121
Total	1 056	986	719	423	205	101	154	3 644
<i>Less Australian Government financial assistance grants^a</i>								
General purpose grants	358	263	205	105	82	26	11	1 050
Local road grants	137	98	89	72	26	25	11	458
Supplementary local road funding	-	-	-	-	4	-	-	4
Net state grants	561	625	425	246	93	50	132	2 132
Net state grants per capita	83.12	125.18	108.25	123.37	60.53	103.35	657.23	107.23

^a These grants are included in the grants paid by states to local government although the purpose does not appear to be reported consistently across states in the table. These are the amounts actually paid as they include the adjustment from the previous year.

Source: Australian Bureau of Statistics unpublished data, Department and Transport and Regional Service

Specific Grants by States

73. Some states provide significant specific purpose assistance to local government under medium term agreements, which assists local government to fund and plan these services more effectively.
74. The Western Australian Government has a five year State Road Funds to Local Government Agreement which hypothecates 27 per cent of vehicle licence fees to local government for local roads, providing councils with \$94 million in 2006-07.
75. The South Australian Government has a five-year agreement with the Local Government Association of South Australia covering the period 2006-07 to 2010-11 providing about \$16 million a year towards library services.
76. The Queensland Government has a Road Management and Investment Alliance agreement with local government to jointly manage an agreed network of roads in a more strategic and efficient way. In 2007-08, the Queensland Government will allocate \$76 million to local governing bodies for council-managed roads and bikeways under its Transport Infrastructure Development Scheme. Funds for local roads of regional significance and other council-managed roads are available generally on a 50:50 funding basis with local councils, while for access roads to Indigenous communities the state provides 100 per cent of the funds. Funding has more than doubled since 2002-03 when \$34 million was available under the scheme. In addition, \$30 million per year is allocated for roads and drainage grants to encourage expenditure by local governments on road and urban stormwater drainage infrastructure.
77. Victoria provides the highest level of assistance to local government on a per capita basis. If the financial assistance provided by Victoria (see Table 9) was matched on a per capita basis by other state governments, local government would have an additional \$363 million of revenue per annum to fund infrastructure, including local roads.

State reporting on the level of their assistance to local government

78. The South Australian state budget provides a one page statement of state specific purpose budgetary assistance to local government, which aids transparency on the level and nature of state funding. The Victoria, Queensland, Western Australia and Tasmania state budgets provide a limited range of information identifying some of the assistance they provide to local government.

FACTORS AFFECTING LOCAL GOVERNMENT REVENUE RAISING

Restrictions on Local Government Revenue Raising

79. There is a wide range of exemptions and concessions applying to rates and these affect local government's revenue raising capacity. For example, many state government commercial enterprises, such as power stations, do not pay rates to local government. In Western Australia, State Agreement Acts have restricted the capacity of local governments to raise rates on land used for mining operations. Government owned land (including land owned by the Australian Government), such as state forests and land owned by charitable and benevolent organisations such as churches, schools or hospitals may be rate exempt or attract concessions. In some cases

rate exempt organisations may make ex gratia payments to local government. Under competition policy arrangements, some state businesses make rate-equivalent payments to the state government (which are not all passed on to local government). In Tasmania, the state and local government sectors have concluded a Partnership Agreement on finances, which spells out the reciprocal taxation obligations of each party.

80. In NSW annual increases in councils' total rate revenue are capped, generally in line with the inflation rate. The recent State report for the NSW Local Government and Shires Association identifies an infrastructure backlog of over \$6.3 billion. If this estimate can be verified, it suggests councils in New South Wales may not be able to raise enough revenue from rates to address increased population, increased responsibilities, increasing service standards and the need to renew infrastructure.
81. There are restrictions on local government's capacity to impose user charges in a number of states, such as constraints on the fees and charges councils are allowed to levy under other legislation. One example is under the NSW Environmental Planning and Assessment Act.

Transfer of profitable assets from local government to states

82. In addition, at times States have required the transfer of important revenue-generating assets to the State. In the mid 1990s this was the case with electricity distribution authorities in Victoria and more recently the Queensland Government has announced that it will assume control over local government's bulk water facilities in south east Queensland and compensate local government for assets paid for from rates.

State taxes superimposed on local government's taxation base

83. Compared with local government, the states and territories raised almost twice as much in taxes on property at \$16,937 million. This includes taxes on financial and capital transactions of almost \$12,361 million as well as land taxes of almost \$3,613 million. State land taxes have grown from \$2,103 million in 2000-01 to \$3,613 million in 2005-06, up 71.8 per cent. Local government taxes on property have grown from \$6,303 million in 2000-01 to \$8,920 million in 2005-06, up 41.5 per cent.
84. State land tax in NSW has increased more rapidly than in other states, up from \$929 million in 2000-01 to \$1,717 million in 2005-06, or 84.8 per cent.
85. Recent large increases in the value of residential and farm land near towns and cities would suggest that local government could increase its revenue from this source.

Foregone revenue

86. Pensioner rate concessions are often part funded by councils through foregone revenue. The level and extent of rate concessions could be examined with a view to greater consistency between councils and greater transparency and evaluation of the level of community service obligations involved.

Poor local government reporting

87. The State sustainability reports have all concluded that current financial reporting by local government is not adequate to give an accurate picture of a council's financial position. This is

largely because councils do not have adequate asset management systems which correctly value their assets and provide for their maintenance and replacement.

88. The introduction of accrual accounting has highlighted deficiencies in council asset management. The 2005 South Australian local government sustainability inquiry revealed many councils were using their capital budgets to support their operating budgets, rather than for renewing their assets.
89. Two states have made major legislative changes to improve financial governance and asset management in local government. In South Australia, legislation was passed in December 2005 to strengthen accountability and financial governance. The *Local Government (Financial Management and Rating) Amendment Act 2005* included new obligations for councils to adopt long term financial and asset management plans and to consult with their communities regarding annual business plans in developing their annual budgets. In Victoria the *Road Management Act 2004* has required local government to implement proper management of its road assets.
90. Councils in Western Australia provide detailed information on their local road network that separately identifies maintenance, renewal, upgrade and new capital expenditure. This information is published as a trend series by the Western Australian Local Government Association in its Local Government Road Assets and Expenditure Report.
91. Apart from the developments in South Australia and Victoria, the state sustainability reports indicate that many councils in other jurisdictions are unlikely to have reliable long term financial and asset management plans in operation. For example, the sustainability report by the Local Government and Shires Association of New South Wales found that “most councils do not have the asset management systems and skills to ensure that assets are properly registered, valued, planned, acquired, operated, maintained, disposed of and renewed, let alone costed on a whole of life basis”.
92. At its meeting in October 2006, the Local Government and Planning Ministers’ Council endorsed nationally consistent frameworks for assessing financial sustainability, financial planning and reporting and asset planning and management. These are being implemented in each jurisdiction and are available at <http://www.lgpmcouncil.gov.au/publications/index.aspx>.

Local government’s viability environment

93. One option for addressing the sustainability of councils is for them to be organised into larger entities with broader revenue bases. Councils with low populations generally do not have the revenue base or economies of scale to deliver the range of services a larger organisation can provide. They can also have difficulties attracting and retaining the required personnel. The experience in Victoria suggests that a population of at least 50,000 people may be required to create a viable local government. Western Australia has 140 local governments, including 68 councils with fewer than 2000 residents.
94. Increased efficiency by local government in the provision of services can reduce costs. Local government has generally reformed the structure and performance of its larger commercial activities, such as water utilities, as a result of the National Competition Policy reforms. Local government in some states have gone through a period of significant reform. In Victoria, local government has undergone substantial reforms including amalgamations - which reduced the number of councils from 210 to 79 councils over the period from 1994 to 1997 - the

introduction of compulsory competitive tendering and changes to asset management triggered by the *Road Management Act 2004*.

95. South Australia implemented a process of voluntary structural reform which reduced the number of councils from 118 to 68 over the period from 1995 to 1998. It is also improving long term financial and asset management as a result of the South Australian sustainability report and the *Local Government (Financial Management and Rating) Amendment Act 2005*. Councils in Victoria and South Australia have raised rates significantly and a number of individual councils in each state have improved asset management practices.
96. Local government also has potential for expenditure savings through operational efficiencies. At May 2006, in Western Australia there was one council employee for every 119 residents compared with one employee for every 154 residents in South Australia. Local government employment in Western Australia rose by 16.3 per cent between February 2002 and February 2006 compared with 11.8 per cent for local government as a whole.

Current Local Government Restructuring

97. The Northern Territory Government has announced a major restructuring of local government in the Territory to apply from 1 July 2008. The 63 current local governing bodies are to be amalgamated into fewer (possibly 12-13), larger, more viable bodies centred on existing major councils. All of the Northern Territory is to be incorporated under these new councils, although, as at July 2007, the affect on this process of the Australian Government's indigenous communities initiative in the Northern Territory is still to be determined.
98. The Queensland Government has also announced a process of major restructuring of local government. A Local Government Reform Commission is due to report to the Government on new areas and boundaries by 1 August 2007.

LOCAL GOVERNMENT FINANCIAL POSITION

99. Table 10 shows a snapshot of local government short term financial position as at 30 June 2006. It shows that local government had net financial assets worth over \$1.6 billion, with assets of \$12.6 billion and liabilities of \$10.9 billion.

Table 10: Local government's financial assets and liabilities as at 30 June 2006 (\$m)

	NSW	VIC	QLD	SA	WA	TAS	NT	Total (a)
Financial Assets								
Cash and deposits	1708	680	2088	42	375	151	97	5140
Advances paid	1	2	-	-	1	2	-	6
Investments, loans and placements	3467	708	340	23	715	146	74	5474
Other non-equity assets	619	423	574	87	182	44	15	1943
Equity	-	20	-	20	-	-	-	40
<i>Total</i>	<i>5795</i>	<i>1833</i>	<i>3002</i>	<i>171</i>	<i>1273</i>	<i>342</i>	<i>186</i>	<i>12603</i>
Liabilities								
Deposits held	158	98	3	112	21	7	-	398
Advances received	22	10	-	-	9	-	1	42
Borrowing	1663	621	2981	94	289	185	7	5389
Unfunded super liabilities & other employee entitlements	910	363	459	85	119	53	12	2001
Other provisions	197	84	37	20	5	18	1	362
Other non-equity liabilities	639	432	742	149	241	65	45	2313
<i>Total</i>	<i>3589</i>	<i>1608</i>	<i>4221</i>	<i>460</i>	<i>684</i>	<i>327</i>	<i>66</i>	<i>10954</i>
Net debt	-3333	-662	555	141	-773	-107	-164	-4342
Net financial worth	2206	225	-1218	-289	590	15	120	1650

(a) Figures may not add to totals due to rounding Source: ABS Government Finance Statistics Catalogue 5512.0

100. Local government has significant long term assets, with about \$182 billion in land and fixed assets in 2004–05 (ABS, Government Finance Statistics, cat. no. 5512.0, Table 30). According to the Australian Bureau of Statistics (ABS), \$50.4 billion of this was land and \$14.8 billion was buildings. Other construction infrastructure, including local roads, was worth \$104.8 billion, net of depreciation (ABS, personal communication, 2006). ABS data do not itemise the value of local roads and bridges but, from state sources, DOTARS estimates they are worth about \$82 billion, calculated (mainly) in current replacement terms. Local government has capacity to raise additional revenue through the sale or redevelopment of its non-road assets.

CONCLUSION

101. The role of local government has broadened in recent years and this has generally been embraced by local communities. In the same period, local government rate revenue as a proportion of total council revenue has declined while local government charges for goods and services have increased as a proportion of revenue. The State sustainability reports indicate

that in many cases local governments have tended to balance their budgets by diverting funds needed for capital purposes to fund recurrent services.

102. State assistance to local government tends to vary year on year, but the long term trend is a decline in assistance from State governments. State Governments impose some restrictions on local government's revenue raising.
103. The Council of Australian Governments has agreed to discuss local government funding arrangements at a meeting in 2008. The Productivity Commission report will be an important input to that discussion.

COMPARISON OF STATE LAND VALUE ASSESSMENTS USED TO CALCULATE RATES

Rates in each state and the Northern Territory are based on a valuation of the land upon which they are charged. However, methods for assessing land value differ significantly between states. New South Wales and Queensland have a statewide requirement that rates be based on the unimproved value of the land. Victoria, however, operates on a differential system where different valuation assessments are used depending on the type or the primary use of the land. In the Northern Territory a variety of systems may be used for rate assessments and the way they are applied is at the discretion of the individual council.

Property taxes, or rates, account for 39 per cent of the total revenue of local government across Australia and are the only direct source of taxation revenue available to this sphere of government. The methods by which rates are charged vary significantly between jurisdictions. Exemptions are provided to Crown Land, including defence land and national parks in all jurisdictions. Charges for water and sewerage services for those jurisdictions where local government provide these services are excluded from the comparison.

New South Wales rates are based on the unimproved value of the land. The structure of a rate may also include a base amount or be subject to a minimum amount. The amount of income that councils can raise through certain rates and charges is limited by the state government's rate-pegging legislation. Each year the government determines a percentage by which councils can increase their income from the previous year. This limit does not apply to individual rate assessments. Mandatory concessions are also provided for eligible pensioners. The structure, rate-pegging and concessions are all designed to ameliorate the impact of increased land values.

Councils in **Victoria** can choose between three valuation systems – capital improved value, net annual value or site value. Differential rates, where different rates in the dollar are struck for separate property classes, can be applied. Councils using net annual value or site value to determine rates are limited to applying three differential rates. However, councils using capital improved value can strike a wide range of differential rates, so long as the maximum differential rate is no more than four times the level of the lowest differential. In addition, councils must justify all differentials when they use the capital improved valuation system. Generally, all rural land is assessed on a capital improved value basis and differentials may be applied.

Queensland follows a similar approach to New South Wales for rates using the unimproved value of the land as the basis for the rates. However, Queensland does not impose limits on rate increases councils can apply.

Western Australia uses gross rental value of the land, that is, the amount that could potentially be charged should it be made available for rent, as the basis for non-rural rates charges. Rural land is predominantly assessed on the unimproved value of the land. However, this can change depending on the extent of improvements or the primary use of the land.

Councils in **South Australia**, like Victorian councils, can use capital (improved) value, site (unimproved) value or annual (gross rental) value of the property. There is no differentiation for rural property, however, and 85 per cent of the state is unincorporated (that is, not included in a council area).

In **Tasmania** rates are also based on one of the three criteria used in South Australia and Victoria. However, recent agreements in Tasmania between the state government and councils means councils are now able to charge rates on selected state government-owned land. This will increase the amount of revenue local governments can realise from rates.

The **Northern Territory** allows individual councils to determine the method and extent of rate charges in the council area, although the calculation of rates is still based on the unimproved capital value, the improved capital value or the annual rental value of the land. Rates can be charged on a flat parcel rate, where all land is charged at the same rate regardless of use or value. Alternatively, a differential rate similar to that used in Victoria, or a uniform rate can also be used.

The **Australian Capital Territory** uses the unimproved land value of the property, averaged over the three previous years, to calculate rates. The calculation of rates for residential and commercial properties differs to that for rural properties. For residential and commercial properties, rates are determined as a fixed charge levied on all properties plus a rate charged on the amount that the average unimproved land value exceeds a rate-free threshold. For rural properties, a fixed charge is not applied. A differential rate applies for residential, commercial and rural properties but the same rate-free threshold applies across the three property types.