

**Fiscal Arrangements in Australian  
Local Government:  
Out of Step with Contemporary Needs  
or a Fair Approach for a Diverse System?**

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# Fiscal Arrangements in Australian Local Government: Out of Step with Contemporary Needs or a Fair Approach for a Diverse System?

## Abstract

The paper provides clear accounts of the present local public finance dynamics within and across levels of government in Australia as seen in various perspectives. By delving on key historical accounts and procession of studies conducted by various parties-in-interest, the paper raises the question of sustainability and relevance of the current system amidst the changing and diverse local governance environments in the country. Besieged by the need to be constitutionally recognized and to move from being mere administrative instruments, this paper shows that diverse local governments in Australia are torn between two opposing sides — to be *inside-out* or be *outside-in*. Concluding that the present local public finance dynamics is unfair, the paper offers a suggestive policy direction that only by holistically engaging communities can local governments attain their desired fiscal sustainability and relevance.

## Introduction

This paper examines the current system of Australia's local government financing system. It inquires into the appropriateness of the system in the 21st century. By examining Australian local government's development in historical perspective and recognizing the system's diversity, this paper will attempt to reflect on recent studies of Australian's system of local public finance.

## The historical development of Australian local government

Australia's local public finance system traces its history to the establishment of the local governments. Prior to the formation of the Australian Commonwealth in 1901, local government councils had been antecedently established to ensure the provision of basic place-based services. Adelaide City Council was the first local government founded in Australia in 1840. Two years later, City of Sydney and the Town of Melbourne followed suit. Afterwhich, State-based systems of local government subsequently developed through the 19th and middle 20th centuries. However until now, local government is not formally recognized as a level of government in the Australian Constitution. Local government's existence has clearly been dependent on state government.

More recently, Australian Local Government Association (ALGA) has been pushing for a referendum calling for constitutional recognition of local government. This is another attempt after the same initiative failed in 1988. The strategy this time is for each local council to pass a vote in support for constitutional recognition

prior to the actual referendum. Taking into consideration relative provisions of the Australian Constitution, a referendum process had been agreed upon. The process required all states to elect candidates to represent them in a constitutional convention and to pass a referendum in their state in support of federation. The legislation could then be passed in all states for the establishment of the Commonwealth of Australia. The conventions used for the establishment of the Australian nation over a hundred years ago are now being recalled to support local governments' attempt to be recognized by the Australian Constitution.

State governments established local governments purposely to attend to local infrastructures such as, roads, bridges, sewerage, and water services. In fact, many were first established as local roads boards. This was during the Australian society's attempt to manage 'the tyranny of distance' characterizing the development of Australian society and the structure of government. All of Australia's state-based systems of local government have undergone significant change since the last 1980s (Chapman et al 1997, Dollery & Marshall 1997). New Public Management (Hood 1995) pervaded all of levels of Australian government including governments. The change includes the use of the market to provide services and greater emphasis on accountability and transparency in governance. Compounding these are the introduction of accrual accounting and depreciation of local assets such as roads and bridges. These management changes lead local government to plan for long-term management and replacement of these assets. Recent state-based (and one national) studies reported that a significant number, especially smaller rural councils, are regarded as financially unsustainable. The studies contrasted their plight with that of city and urban councils. It showed that the latter have quite different issues to manage yet also requires significant resourcing.

Against this historical perspective of decentralization development, we can contrast the development of the Australian system of local public finance — a system predicated on the value of the property served by the local council, likewise, the opportunity to levy fees and charges for additional and typically non-essential services. Notwithstanding the development of Australian local government over the last 170 years, local government finance is still dependent on state government. In mid 20th century, Commonwealth Government (now referred to as the Australian Government) provided per capita based grants to local government as additional funding. What sets Australian local government financing apart from many other nations is that there is no incentive-based system of financing (such as a local goods and service tax) available to local government. While state and local governments raised this lack of incentive in the federal government general revenue sharing system, none had taken this potentially challenging political question. This is because, in reality, the great majority of local councils (a) does not have high performing local economies, and (b) would suffer immediately if their revenue sharing grant was diminished in any way to reward more economically successful places. This is a recurring theme in understanding the nature of Australian local public finance. The key issue is — states and the Federal government must ensure the social and economic viability of local communities through its' diverse local governments.

## Diversity across Australian Local Government

In 2006, approximately 167,400 people worked in local governments across the nation. Population ratio per local government employee ranges from 62 in the Northern Territory to 154 in South Australia (Commonwealth Department of Transport and Regional Services 2007). Within states, this ratio would vary considerably between urban, rural, and regional councils. One of the policy issues for both state and the Federal government is the diversity of local government across the nation. This diversity challenges and complicates attempts by central governments<sup>1</sup> to both direct — through the legislative framework — and control — through fiscal policy — how local governments must operate both politically and administratively (although the former is rarely acknowledged publicly). Central governments in Australia manage and control local government through regulation and by fiscal measures. Just how they do this is the focus of this chapter. We first outline and explore the current fiscal arrangements for Australian local government by describing the current structural arrangements of local government financing. We then show how central governments maintain fiscal control of local governments by reporting on recent studies made on these arrangements. While local government is closest to the people and has the potential to be the “*local state*,”<sup>2</sup> the reality in the Australian federation seemingly shows that the ideals of local democracy are rarely achieved with the two levels of central government dominating local affairs.

Wild River (2002, 2005), in her study of local government and environment, saw the dilemma of the local state ideal as an antinomy in the Australian federation — a “*contradiction between two laws or principles that are reasonable in themselves*.”<sup>3</sup> These contradicting principles, she posited, are the “*outside-in principle*” and the “*inside-out principle*.” *Outside-in principle* recognizes local governments as statutory agencies of state government while *Inside-out principle* recognizes local governments as independent agencies whose local interests transcend their regulatory powers by nature of their attachment to their local area (Wild Rivers 2002). As we will see in our discussion of fiscal arrangements in Australian local governments, this dilemma is most apparent. It is further complicated in recent decades when federal governments played a greater role in local government funding. Federal government found a mechanism to magnify their visibility in delivering local works and services through the local governments.

## Financing Australian Local Government

Today in Australia, there are currently 565 local councils (as they are typically referred to) covering most of the continent (except for parts of western New South Wales and South Australia where the respective state government is responsible for *unincorporated lands*). This number is down from over 800 councils two decades ago. Local government councils deliver a wide range of services. These include planning and regulatory services, construction, and management of local roads and bridges,

human development and social services, business and economic promotion and development services, among others. In 2005, local government expenditure was around \$10.43 billion representing 2.07 of gross domestic product (Commonwealth Department of Transport and Regional Services 2007).

Local government raises approximately half of its revenue from property taxes. The remainder comes from fees and charges, and through grants and revenue sharing. The latter comes from the Federal Government through the state grants commissions. The share of taxation revenue by sphere of government and source of revenue for 2005–2006 is set out in Table 1.

As the level of government that raises far more revenue than it spends, the Federal Government shares revenue with the states and local governments. The most significant single source of state government revenue is Australia's Goods and Services Tax (GST). Ten percent (10%) of these are returned to the states and territories based on horizontal fiscal equalization (an adjustment determined by the Commonwealth Grants Commission factoring the capacity of states to provide services) and per capita. Local government also benefits significantly from intergovernmental revenue sharing. Local government is dependent on the states and on the Federal Government for funding through the *Local Government (Financial Assistance) Act 1995*. Section 3 of this Act states that:

(2) *The Parliament wishes to provide financial assistance to the States for the purposes of improving:*

- *The financial capacity of local governing bodies;*
- *The capacity of local governing bodies to provide their residents with an equitable level of service;*
- *The certainty of funding for local governing bodies;*
- *The efficiency and effectiveness of local government bodies; and,*
- *The provision by local governing bodies of services to Aboriginal and Torres Strait*

Table 1 Share of taxation revenue by sphere of government and source of revenue, 2005–06

Revenue source	Federal (%)	State (%)	Local (%)	Total (%)
Taxes on income	59.14	0	0	59.14
Employers payroll taxes	0.12	4.39	0	4.38
Taxes on property	0.01	5.68	2.99	8.68
Taxes on provision of goods and services	22.76	2.72	0	25.51
Taxes on use of goods and performance of activities	0.27	2.03	0	2.30
<b>Total</b>	<b>82.31</b>	<b>14.85</b>	<b>2.99</b>	<b>100</b>

Source: Australian Bureau of Statistics, Taxation Revenue, Table 1, cat. no. 5506.0. Presented in Commonwealth Department of Transport and Regional Services (2007), p. 12.

*Islander communities.*

This revenue is regarded as untied. It is primarily based on per capita and individual local governments are not held to account how they invest these funds. Specific purpose payments (SPPs) are a more recent innovation in Australian inter-governmental revenue sharing. Both state and federal governments use this mechanism to support individual local governments in specific program areas. One of the most recent and largest SPP schemes is the Roads to Recovery program. Another is the Home and Community Care (HACC) program providing home-based services for those in need.

In 2001, the Howard Government introduced direct funding to local government of \$1.2billion from 2001 to 2005 via The Roads to Recovery program (Commonwealth Department of Transport and Regional Services and the Australian Local Government Association, 2003). Here was an opportunity for the Federal Government to make a major investment at the local level across Australia.

*The Roads to Recovery Programme was introduced as a single intervention by the Commonwealth to address the specific problem that much local government road infrastructure is about to reach the end of its economic life and its replacement is beyond the capacity of local government (p. 2).*

The program required that \$850million of the money be spent on rural and regional local roads. A strategy designed to ensure that state government focuses on funding metropolitan roads where most of their effort has traditionally been. In 2006, the Federal Government provided a similar amount of money for another five years.

All Roads to Recovery projects are required to display local signs that tell motorists the road works are made possible by Federal Government funding. Clearly, the Federal Government sees this funding of local roads via local government as an opportunity to return revenue centrally collected directly to local governments and with the appropriate political recognition.

Furthermore, both state and the federal governments now have a range of SSP programs across a myriad of policy areas — health, environment, infrastructure, economic development, just to name a few. This mechanism allows central government to focus programs through local government. These programs are based on central government criteria. It also often criticized for pork barreling. Among the ardent critics are the media and councils missing-out on such funding. Understandably, the councils receiving such kind of programs are less enthusiastic to criticize. This arrangement appears to have become institutionalized in Australian government and there seems no way around to curb local governments' dependency on this system of funding. Local governments are aware of this funding dependency. In recent decades, there have been a number of studies on state-based local government systems emphasizing on "financial sustainability". However, it proves to be a very difficult concept to define in operational terms (Dollery, Byrnes & Crase 2007).

These studies present a similar picture of local governments, being financially unsustainable (especially local governments outside of the major urban centers). Depending on who sponsors (funds) the study, we see different recommendations on how to address the issue.

### Recent reviews of Australian Local Government Financing

Since the mid 1970s, Australian local governments had undergone significant changes. Recently, legislated changes across all states and the Northern Territory 'enabled' councils to make local choices. This is accompanied by an accountability regime making it clear that local governments must spend their money efficiently and effectively. The issue of funding has always been central to these changes. It is, as Monkkonen (1995) reminds us, 'the primary concern' in the historical development of the "local state" (p. 17). The Federal (Commonwealth) Government, state governments, and local government associations have instigated several studies on local government finance. Recently, the paradigmatic perspective of the studies shifted from finance inquires to financial sustainability. However, they all address the same thing: the fiscal capacity of local governments. By providing a brief overview of these various studies and research projects, this paper will show how the tension between central governments and local government over the fair allocation of resources to local government in recent decades has been managed. Suffice to say that all studies address the same issue. Despite these, the fiscal structures of Australian local government today remain as much as it was in the mid 1970s.

#### *National Inquiry into Local Government Finance (The Self Review)*

In 1984, the then Federal Minister for Local Government, Honorable Tom Uren, established a national inquiry into local government finance. Professor Peter Self from the London School of Economics chaired the Inquiry (NILG). The terms of reference required Self and his colleagues to "consider the functioning of the PITS Act<sup>4</sup> within the context of the respective roles of the Commonwealth and the States and of the principles of local government finance (NILG 1985, p. iii)." The Fraser Government had intended that the proportion of PITS grants should increase to 2% by 1980.

The Self Review concluded "the system of Commonwealth general purpose support for local government should be continued but should be improved in important respects." The inquiry justified the recommendation by saying, to wit,

*"Our principal reasons, for reaching this conclusion, are:*

- A) *We are satisfied that there is a degree of imbalance in the general finances of local government owing to the narrowness and regressiveness of the rate base, and to the growth of human services provided by local governments. We see this latter development as likely to continue.*
- B) *There are considerable inequalities between local councils in respect of revenue raising capacity and basic expenditure needs, which weaken the effectiveness and the equity of the local government system as a whole. A principal objective*



*of general-purpose assistance should be to strengthen Australian local government by achieving greater equality between the financial capacities of local councils.*

- C) *Only the Commonwealth is adequately placed to remedy these basic problems of local government finance by virtue of its superior financial resources. Moreover, the Commonwealth can design a satisfactory equalization scheme, which can be implemented by State local government grants commissions in an independent and impartial way. The Commonwealth's detachment from the detailed supervision of local government is a positive advantage in relation to such a scheme.*
- D) *The Commonwealth has developed a legitimate interest in the general effectiveness of local government. Untied Commonwealth grants strengthen the effectiveness of local choice and the vitality of local democratic institutions. It would be a retrograde and undesirable step for the Commonwealth to withdraw from this role after a decade of innovation in its application (p. xix)."*

In these four reasons cited, we see a comprehensive strategy for effective fiscal management of Australian local governments. It addresses independence and partnership with central governments within the principle of responsibility and accountability, equity and fairness. These principles are both essential in a federation and a strong ongoing role for local government. However, one has to take into consideration that this study was made during the mid-1980s with the Hawke Labour Government facing strong budget pressures. Some cannot help to think that the Self Review was an attempt to rationalize a philosophy espoused by the Australian Labour Party prior to Whitlam coming to power in 1972.

Federal Government revenues increased in greater proportion since the establishment of the PITS Act. The real increase in funds of local government were "*15 per cent in real terms, a far higher increase in funds than local government has ever before received, can be justified in the present tight budgetary situation* (Senator Peter Walsh, Minister for Finance, Hansard, 25 March 1985)." Central governments are always concerned that local governments will use central government's grants to replace local rate increases and the setting of reasonable fees and charges. Consequently, the Finance Minister find himself reflecting these concerns in the Parliament.

Self's extensive report made several pragmatic recommendations and were adopted. Later, these recommendations characterized the intergovernmental revenue sharing to this day. These recommendations were:

- A) *The basic amount should not be less than the present size of the grant and from now, should be subject to the same real terms guarantee as applies to general revenue sharing grants to the states. xxx*
- B) *There should be regular reviews of the program, which should take account of the changing responsibilities and finances of local government, the extent of State support for local government, and Commonwealth financial policies. xxx*
- C) *The element A grant to all local councils should be continued but subject to a*

*maximum level of 30 per cent of total funds.*

- D) *The element B (equalization) grant should be allocated according to agreed guidelines. xxx*
- E) *The grants would continue to be untied. xxx*
- F) *the State local government grants commissions would continue to administer the program. xxx (pp. xix-xx)*

The NILG remains an important study on the Australian local governments' fiscal arrangements. The structure put in place by the Whitlam Government of the 1970s has remained in place. Although, appropriate adjustments had been done to address the key principle of fairness. The adjustments were largely influenced by the comprehensive work of by Professor Peter Self and his colleagues. It was not until over a decade later that, under different political circumstances, some quarters raised once again the question of intergovernmental revenue sharing.

### ***The Garnaut and Fitzgerald Review of Commonwealth-State Funding***

Towards the end of the 1990s, the revenue raising capacity across all levels of government moved even further in the Commonwealth Government's favor. The revenue raised by Australia's three levels of government varies significantly and does not reflect their expenditure needs. In their review of Commonwealth-State funding, Garnaut and Fitzgerald (2002) note that,

*"Since World War II, when the Commonwealth took control of income taxation, Australia has had a much larger mismatch between expenditure responsibilities and revenue at each level of government than any other Federation. The mismatch became bigger in the 1990s." (p. 1)*

After the introduction of Australia's Goods and Service Tax (GST) in the late 1990s, the Commonwealth's capacity to redistribute revenue increased significantly. Garnaut and Fitzgerald questioned whether the current approach amounted to equalization or distortion. Their *Review of Commonwealth-State funding* was initiated by three Labour Government states – New South Wales, Victoria, and Western Australia. All of these three state governments were, at that time, net losers under the horizontal equalization arrangements. The Howard Conservative Government was in power at this time forcing the three Labour states to fund the Review. The three state governments believed that the basis for revenue sharing was distorted. However, now that Australia has a Rudd Labour Government in power, at least in federal government level, the issue of Commonwealth State funding appears to have moved off the policy agenda. Current world economic matters preoccupy governments, thus, intergovernmental redistribution has taken a back seat in the political debate and in the media. Historically, the Australian intergovernmental financial relations discussion and debate is very much colored by the political makeup of the states and of the Federal government of the day. In addition, broader political issues being dealt with by the Federal and State governments affect the relevance of the

debate.

Garnaut and Fitzgerald's review is a comprehensive analysis of Commonwealth-State government revenue sharing. They argue that the cost of a system with both untied grants and highly variable Specific Purpose Payments (SPPs) can be reduced if there is a more consistent, ongoing approach to the funding of health, education, and indigenous community development. The Review correlates the Commonwealth-State Funding relationship to the fiscal position of governments — being a function of the politics and economic circumstances of the day. The governments' position on intergovernmental revenue sharing in the Australian Federation is also bound to change. The current world economic crisis is a case in point. In anticipation, it will affect the resource dependent states more than the others do. Their position under the horizontal equalization principles may subsequently change over the next few years if the expected decline in demand for resources reduces the federal taxation take from these states.

### *The Hawker Cost Shifting Review*

Just after the release of the Garnaut and Fitzgerald report, the Federal Minister for Local Government and a West Australian Liberal, the Honorable Wilson Tuckey, commissioned the *House of Representatives Standing Committee on Economics, Finance and Public Administration*, to inquire into the extent of cost shifting from other levels of government to local government. A report entitled *Rates and Taxes: A Fair Share for Responsible Local Government* but is more known as the Hawker Report, after the Committee Chair, Hon David Hawker, had been issued. It reveals the weakness of the fiscal state of Australian local governments.

The Hawker report became widely known as “*the cost shifting inquiry*” as its six terms of reference were prefaced with “*Cost shifting onto local government by state governments and the financial position of local government.*” It was assumed this was in fact the case and turned out to be correct. The commissioning of Howard Government of the Hawker inquiry recognized that the Commonwealth Government saw the claims being made by Garnaut and Fitzgerald. They saw the claim applies to state local government financing as much as they claimed it applied to Commonwealth state government financing.

The Hawker Inquiry was an extensive review of the financial position of Australian local government. The terms of reference included an examination of, to wit:

1. Local government's current roles and responsibilities.
2. Current funding arrangements for local government, including allocation of funding from other levels of government and utilization of alternative funding sources by local government.
3. The capacity of local government to meet existing obligations and to take on an enhanced role in developing opportunities at a regional level including opportunities for councils to work with other councils and pool funding to achieve regional outcomes.
4. Local government expenditure and the impact on local government's finan-

cial capacity as a result of changes in the powers, functions and responsibilities between state and local governments.

5. The scope for achieving a rationalization of roles and responsibilities between the levels of government, better use of resources and better quality services to local communities.
6. The findings of the Commonwealth Grants Commission Review of the Local Government (Financial Assistance) Act 1995 of June 2001, taking into account the views of interested parties as sought by the Committee.

These wide-ranging terms of reference allowed the Committee to make far-reaching recommendations regarding the structuring of intergovernmental relations. This included developing intergovernmental agreements on roles and responsibilities. It also recommends that the House of Representatives, as a precursor to a national summit on local government, pass a resolution recognizing local government as an integral part of governance in Australia. Given the demise of the Howard Liberal Government, the new Rudd Labour Government held a national local government summit in November 2008 where his new government established a new national council of local government. The council will include the Federal Government and local government representatives.

The Inquiry recommended a Federal-State intergovernmental agreement (which has not been made) to be the basis for *"requiring a commitment from State Governments to identify and provide a share of payments to local government when it is seen as having a significant role in delivery of programs under the agreement"* (House of Representatives Standing Committee on Economics, Finance and Public Administration 2003, p. xvii)."

The Committee also recommended that the Prime Minister and the Treasurer meet with State and Territory Premiers and Treasurers. The parties must recognize cost shifting as a problem, allocate revenues with new functions, address restrictions on local government revenue raising (such as rate capping), and that impact statements be developed to identify the financial impact on local government of state and Federal government legislation. These all appear quite noble and proper actions in an environment of intergovernmental cooperation. Sadly, none has been implemented to date, and appears unlikely to be so.

The Federal Government did not miss the opportunity to hold state government to account with these recommendations adding that:

*"Minister for Finance issue a direction to all Federal agencies to ensure that all renegotiated and future Federal-State agreements describe clear Federal government objectives and measurable outcomes; specify performance indicators that are directly linked to the objectives to ensure financial accountability; define the roles and responsibilities of each party to the agreement; require State governments to report on the volume of funds to be distributed to local government to perform functions; and, disclose the funding adjustments to be applied to State government in the case of cost shifting to local government. (House of Representatives Standing Committee on*

*Economics, Finance and Public Administration, 2003, p. xix).*"

None of these recommendations has been taken up. Political events have overtaken this report with the Labour now federally in power and in all but one state (WA whose Liberal Premier declared he is more interested in getting what he can for his state than worrying about party politics). In addition, the world economic crisis has clearly shifted the political and administrative focus elsewhere.

The Committee made another ten wide-ranging recommendations which if implemented would make for a far better local government system with fiscal authority and responsibility. The missing factor in the review was inputs from state governments. None chose to provide submissions or appear before the Committee. Given that local government is an instrument of State government, it is not surprising that those recommendations that involve State and Territory governments have not been implemented. This clearly shows that Australian Federation political pre-eminence is far more important than devolution and decentralization of authority and responsibility to local government by means of an appropriate fiscal regime.

### **State Local Government Association Financial Sustainability reviews**

As local governments became frustrated with the lack of response from central governments to the Hawker Inquiry, five state local government associations commissioned their own inquiries into the financial sustainability of local government in their respective states. In Queensland, this was done by the Local Government Association of Queensland with the full support of the Queensland State Government who saw this as a precursor to local government reform. Queensland State Government clearly told local governments and the LGAQ this was the case.

A prominent Australian economic consulting firm, Access Economics, drove four all of the five state-based inquiries (except Queensland). It was not surprising that these reports were similar in their approach and recommendations. Dollery, Byrnes and Crase (2007) were critical of the use of one consulting firm to do this research across three states. They cited three reasons: First, and most obviously, one firm doing all the work reduces the opportunity for the competition of ideas around the issue. Second, the comparatively uncritical acceptance of the *accounting approach* advanced by Access Economics has allowed "*ideology*" to masquerade as objective "*analysis*" although they do not specifically cite how this has been done. Finally, they are critical of Access Economics ignoring the literature on the problem of local government's non-sustainability focusing on the predictive capacity of KPIs (p. 129).

Price Waterhouse Coopers, a leading management-consulting firm, conducted the sixth inquiry on behalf of the Australian Local Government Association, the apex body of the state local government associations. Each of these inquiries is summarized below.

#### *1. Rising to the Challenge: The South Australian Financial Sustainability Review*

*Board (South Australian Local Government Association)*

2. *Are Councils Sustainable: Independent Inquiry into the Financial Sustainability of NSW Local Government (Percy Allan Report) (NSW Local Government and Shires Associations)*
3. *Systemic Sustainability Study: In Your Hands — Shaping the Future of Local Government in Western Australia (Western Australian Local Government Association)*
4. *Rising to the Challenge: Towards Financially Sustainable Local Government in South Australia*
5. *Size, Shape and Sustainability (Local Government Association of Queensland)*
6. *National Financial Sustainability Study of Local Government (known as the PriceWaterhouse Coopers study) (Australian Local Government Association — the peak body representing all of Australia's state local government associations)*

These studies on the financial position of local governments inform our broader concern regarding the fiscal position of Australian local government. The state associations of local government councilors adopted a consistent approach across each state-based system of local government along with one national integrating inquiry. They ask the broad question “*are our local governments financially sustainable?*” This signifies a measure of the strength of the national system of local government. Like good politicians everywhere, they knew the answer to the question they framed. Many local governments are not financially sustainable and these inquiries provided the comparative information, without actually naming individual councils. Importantly each state association has now put measures in place to support unsustainable councils (as have some State government local government departments) with a range of initiative enabling them to have a better understanding of individual council financial situations.

Dollery, Byrnes and Crase (2007) reviewed each of these state and national inquiries in detail to determine the financial sustainability of Australian local government. They concluded that defining financial sustainability was too difficult to answer. To them, it was “*too tough a nut to crack*” for numerous reasons. These reasons generally relate to the accounting criteria used and the diversity of local government across the nation.

What is instructive about these local government association-initiated reviews on the financial state of their local governments is that, this research was under the control of local government. Previously they had relied on Federal and State government reviews which they largely expressed dissatisfaction. The Productivity Commission, in its most recent report, addressed the question of which level of gov-

ernment should be responsible for what level of revenue raising.

***Productivity Commission Research Report: Assessing Local Government Revenue Raising Capacity***

An outcome of the Hawker Inquiry was the commissioning of an inquiry by the Productivity Commission (the Australian Government's independent research and advisory body on a range of economic, social, and environmental issues affecting the welfare of Australians). The report is titled *Assessing Local Government Revenue Raising Capacity*. The Australian Government asked the Productivity Commission to conduct a study into the following:

- The capacity of local government to raise revenue
- The impact of any state and Territory regulatory limits on the revenue raising capacity of councils
- The impacts of council revenue raising on the community (Productivity Commission 2008)

The Productivity Commission took a different approach to the state and national local government associations. The latter were focused on the financial (and fiscal) sustainability of local governments. Simply stated, the Commission defined revenue raising capacity as the aggregate after-tax income of a local community, its capacity to pay, and its preparedness to do so. The Commission reports that “*at a national level, councils raise a relatively low level of own source revenue on a per person basis. In 2005–06 the national average level of own-source revenue per person was \$977 and the average rates per person were \$439 (p. XXIV).*” This own source revenue is about 2% of GDP with the ratio of rates revenue to GDP less than 1%. Notwithstanding this relatively small amount to GDP, the Commission also reports “there is a considerable variation in revenue, as well as incomes, across councils (p. XXIV).”

The Productivity Commission showed “*fiscal capacity, as indicated by aggregate after-tax community income per resident, differs by class of local government (p. XXV) (Figure 1, panel A).*” Capital cities have the highest fiscal capacity because they are the centre of business and high land prices. While the Commission also acknowledges the basis of the variation within remote areas (highly paid mining communities contrasted with low paid indigenous communities), their analysis does not show the variation within the other broad local government classifications.

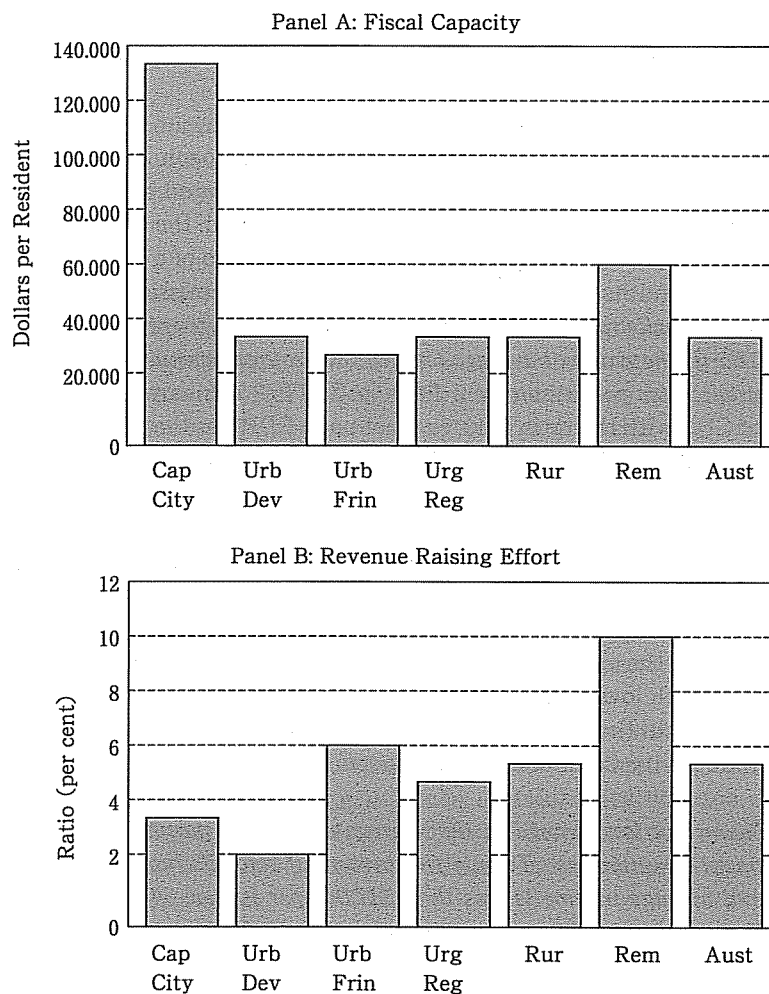
The Productivity Commission also reports that:

*“There is a large range in the aggregate after-tax income per person of local government communities. Twenty five percent of councils have communities where measured average income is less than \$17,044 per person. The top 25 per cent of councils have communities where average income is in excess of \$26,821 per person. Average community income for the median council is estimated to be about \$20,786 per person (p. XXV).”*

Conversely, the Commission reports that revenue raising effort — the ratio of

own-source revenue to fiscal capacity — differs by class of local government (Figure 1, panel B). They note that urban, developed, and capital city councils are two categories that tend to draw lightly on their communities' fiscal capacity. Remote councils and urban fringe councils in comparison draw heavily on their fiscal capacity.

With this considerable variation between fiscal capacity and revenue raising effort across Australian local governments, we have to ask how prepared are these different communities to pay for the level of services they demand? Is the variation explained by community preference to pay, or are there other factors? The Commission's framing of fiscal capacity and revenue raising effort causes local governments to ask this question about their revenue raising effort and expenditure choices. *"Have we, as a council, asked this question to our community?"* It is a strategic



Source: Productivity Commission (2008), p. XXVI

**Figure 1** Estimated fiscal capacity and revenue raising effort by class of council 2004–05



question we should now ask when discussing the fiscal capacity of individual local government councils.

The Productivity Commission reviews of the revenue raising capacity of local governments bring into perspective the dilemma of the antimony raised by Wild River. Clearly, there is no uniform strategy across Australian local government when it comes to revenue raising strategy. The variation in local revenue raising strategies across local government questions whether different revenue sources — such as more performance oriented sources (like a local goods and service tax), as is the case in North America — would mean local governments would raise more revenue from their own sources.

## Conclusion

Notwithstanding the numerous studies conducted in recent years, Australian local governments, remain as an instrument of the Australian states and the Northern Territory. Not much has changed in terms of local government's formal status in the Australian Federation. The funding arrangements are structurally much the same today as they were a decade ago before these reviews. State-based local government associations have taken the initiative in working with their member councils to improve financial planning and management to prevent diminishing of individual council's financial sustainability. Nevertheless under the national accrual accounting regime as applied to local governments, a significant proportion (greater than 25% in all states) remain financially unsustainable, thus, unable to maintain and replace their assets over the long term.

It is important to recognize that all local government associations' inquiries into the financial sustainability of local governments have been preoccupied with the "supply side." This means the local government's capacity to fund existing and future works and services. There is very little discussion of the "demand side" of local government. This refers to what communities actually need, want, and are prepared to pay for. The Productivity Commission report clearly acknowledges this side of the equation. Their report refers to a "second approach" — *"the willingness of the local community to pay for services provided by local governments (Productivity Commission, 2008, p. XXIII)."* Nowhere across the Australian local government system do we see an attempt to answer this question. There are surveys asking ratepayers how they feel about the quality of service delivery, but there are few systematic questions about what services beyond a basic level of service ratepayers are prepared to pay for. We acknowledge that this is problematic because most local governments provide basic level of services to households and varying service delivery standards would be administratively problematic.

We suggest that the long-term fiscal health of local governments will be enhanced if councils engage with communities in a comprehensive manner about the overall design and function of their communities. These include the built, economic, social, cultural, and natural environment. Changing attitudes to energy use, recycling, water consumption, economic development are, for example, contemporary

issues that all local government councils will continue to grapple with in coming years. They can do this, from the *inside-out* taking charge of community decision making, or they can wait until the *outside-in* strategy from state and federal governments come to bear on how communities respond to broader environmental, economic, and social issues. All these questions lead to a more valid attempt at sustainable community development. This is not a new idea. It is one that has been advocated in other federations over the last three decades (Honadle 1981, 2003, 2004). In the Australian context, accrual accounting was, in part, an attempt to lead local governments to the conclusion that if councils have to look after these assets, do communities require such levels of service or are there other ways of delivering these services.

On balance, the outside-in influence of state governments seems to dominate most local government decision making. Universal approaches to diverse situations are determined by capital city-based politicians and administrators often far removed from the great majority of rural and regional local governments in Australia. This is certainly not a fair approach to a diverse system of local government and is certainly out of step with the contemporary needs of Australian communities.

#### Notes

- 1 In this chapter central government in Australia refers to both state and the Federal Government. For the purposes of centre periphery discussions both state and federal governments deal with multiple local governments.
- 2 Where local democracy, responsibility and authority for service delivery go hand in hand.
- 3 Collins English Dictionary.
- 4 The Personal Income Tax Sharing ACT 1976 guaranteed local governments a fixed amount of general Federal Government revenue, initially set at 1.56%.

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