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Mr David Hawker MP  
Chair  
Standing Committee on Economics, Finance  
and Public Administration  
House of Representatives  
Parliament House  
CANBERRA ACT 2601

Dear Mr Hawker

The NSW Local Government Grants Commission submits the attached submission  
in relation to the *Inquiry Into Local Government and Cost Shifting*.

Yours sincerely



**Emeritus Professor Maurice Daly**  
**Chairperson**  
**24 June 2003**



**NEW SOUTH WALES  
LOCAL GOVERNMENT GRANTS COMMISSION**

**SUBMISSION  
TO THE  
INQUIRY INTO LOCAL GOVERNMENT  
AND COST SHIFTING**

**24 June 2003**

## **INTRODUCTION**

The New South Wales Local Government Grants Commission wishes to comment on a number of issues raised in relation to local government financial assistance grants (FAGs) in the Discussion Paper *At the Crossroads* and at public hearing held in connection with the *Inquiry Into Local Government and Cost Shifting*.

### **IN SUMMARY**

- We oppose any changes to the current interstate distribution method;
- We endorse the Commonwealth Grants Commission's support for the retention of the minimum grant entitlement;
- We believe conditional payments would undermine local government's autonomy and add an unnecessary and costly layer of administration;
- We do not support the adoption of a "centralised and simplified" SES allocation system;
- We remind the Committee that the distribution of the successful roads to recovery funding program is based States' Grants Commissions' modelling; and
- We are concerned at misleading evidence presented at the hearings.

### **AT THE CROSSROADS DISCUSSION PAPER**

We would like to make the following observations in relation to some of options proposed in the Discussion Paper *At the Crossroads*:

#### ***changes to the interstate distribution***

We are strongly opposed to the suggestion of alternatives to the current methods of interstate distribution of local government financial assistance grants. Alternative approaches would require considerable resources and data not currently available on a national basis.

The 1985 *Report of the National Inquiry into Local Government Finance* (The Self Report) identified severe data problems with alternatives to an equal per capita distribution. Little has changed since then. We consider the data problems necessary for alternative assessments are likely to be so great that there would be significant doubts about the reliability of the results.

### ***minimum grant***

While the minimum grant provisions act to prevent full horizontal equalisation being achieved, an examination of the per capita grant level between councils shows that there is a very significant weighting to those councils where need is identified as greatest.

It is our view that the minimum grant provides a "safety net" of funding to local government and should be maintained, for the following reasons:

#### ***data limitations***

We consider data quality in some significant areas of the grant determination process to be less than perfect. Accordingly, we see some level of safety net as being appropriate.

#### ***capital -v- recurrent needs***

There are significant difficulties, both practically and philosophically, in the assessment of capital needs. This is particularly the case given the untied nature and the limited level of grant funds. For these reasons we do not consider capital works in our grant formula. However, that does not mean that councils with significant infrastructure needs, and there are many on the minimum grant, should be excluded from receiving grant funds.

The safety net of the minimum grant provides, at the very least, some form of protection for those councils and a recognition by government that all councils have disabilities, irrespective of the perception sometimes held of their resident's social position. It should also be noted that the residents of minimum grant councils also pay taxes.

This safety net imposes a requirement that a council considers services in its area on a needs basis, that is, services for people who are at the lower end of the socio-economic scale or in some way disadvantaged. Accordingly, some level of minimum grant is considered appropriate.

#### ***guaranteed return***

The minimum grant provides a guarantee that all taxpayers will receive at least something back for their local communities from the tax dollars paid.

#### ***CGC findings***

We would also refer the Committee to the Commonwealth Grants Commission's Review of the *Local Government (Financial Assistance) Act 1995*, which stated:

*"We have concluded that a change in the rate of the Minimum Grant is not warranted."*

Commonwealth Grants Commission  
Review of the Operation of the Local Government  
(Financial Assistance) Act 1995, June 2001, p 15

### *conditional FAGs*

We believe it is inappropriate to make financial assistance grants conditional or to require local government to report on their expenditure.

The very notion of horizontal fiscal equalisation (relative needs) is built on a premise of addressing those very issues that affect a council's ability to perform efficiently. This is currently achieved by the States' Grants Commissions' assessments of relative disadvantage with respect to revenue raising capacity and expenditure needs in the framework of effort neutrality.

The extensive and independent calculations of the Grants Commission in NSW produce a grant figure for each council, if horizontal fiscal equalisation were to be achieved. The NSW Grants Commission focuses on recurrent expenditure needs and does not consider capital expenditure. On average the grant actually given to a council is just forty-five per cent of their calculated needs. This proportion a decade ago was sixty per cent.

To impose "conditions" would undermine councils' autonomy because they would be responding to the "conditions" rather than their own expenditure priorities. Conditional arrangements would add an unnecessary and costly layer of administration.

The untied nature of the current funding arrangements means that the efficiency of a local government body is not directly affected by the grant funds nor are those councils that operate at a more efficient level than others given a greater reward through the grant process. However, councils that operate efficiently and effectively are able to provide services at a higher standard through the application of grant funds compared to those councils that operate less efficiently. The difficulty for all Grants Commissions is to separate the inherent effect of disabilities such as remoteness, sparsity etc from what may be described as inefficiencies, some of which will arise directly from the disabilities already mentioned.

Consideration has been given in the past to the possibility of some portion of the grant being determined on an efficiency basis, however, the difficulties of measurement and assessment are significant and the difficulty of separating inherent disabilities from inefficiencies is almost impossible on the scale of assessment required for every local governing body within a State or nationally.

Any movement towards a submission based system has the inherent danger of rewarding those councils best able to present a case, a capacity which is usually aligned with having the economic capacity to allocate resources towards such submissions. There is a very likely outcome that any sort of conditional based assessment proposal, which requires councils to make submissions, will end up directing funds not to those which are most disadvantaged but to those most able to develop and present submissions. Such an outcome would be contrary to the principles of horizontal fiscal equalisation.

The NSW Local Government Act 1993 gave councils a great deal of autonomy, enabling them to order their own priorities to suit the needs of their residents. It is, therefore, quite difficult to establish benchmarks for per capita costs for providing a service because the needs of councils vary so significantly across the State and the expenditure patterns vary greatly. The impact of devolved responsibilities from the Commonwealth and State Governments has also brought an uncertain and uneven dynamic into the system.

### *centralised and simplified system*

A centralised allocation system is not practical because local government units in the different States operate under different Acts and hold different responsibilities. They have different systems of revenue raising and face different expense components because they perform different functions.

The SES model has severe technical limitations. Multivariate grouping programs, such as the Farish SES model, can only tolerate certain kinds of data. Some of the critical factors determining councils' expenditure patterns simply cannot be accommodated within such a model. For example, a range of physical determinants (climate, topography, soils, geology etc.) interact to affect core cost factors such as road and bridge construction and maintenance or environmental management.

Another severe limitation of the SES model is its dependence on ABS information. The spectrum of variables that need to be included if the SES model is to produce realistic outcomes are only gathered in the Census. This would mean that the relative position of councils would be determined only once in five years. The explosive dynamics of change in many places take place in much shorter time frames.

Another problem with using the SES approach is that it provides no differential outcomes in terms of the costs that councils face. In fact it does not deal with costs at all. Across very large systems, such as NSW, the costs to councils of providing services are dramatically different across the State. Such costs bear no necessarily sensible relationship to socio-economic status.

We do not believe that the adoption of a centralised and simplified SES allocation methodology for financial assistance grants would be able to respond adequately to the differing needs of local governing bodies across Australia.

We remind the Committee that a previous major Commonwealth inquiry in 1985, *The Report of the National Inquiry into Local Government Finance (The Self Report)*, found, amongst other things, that there are considerable inequalities between local councils in respect of revenue raising capacity and basic expenditure needs and that:

*“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.”*

National Inquiry into Local Government Finance  
(Self Report), 1985, page xix

We are of the view that the NSW distribution methodology, with its comprehensive assessment of relative expenditure needs across twenty service functions; isolation issues; and an assessment of revenue raising capacity, addresses many of the complex issues facing local government in NSW.

While we recognise the importance of socio-economic indicators – many are used in our assessment - we do not believe a centralised and simplified SES model would adequately address the extent of relative disadvantages associated with, for example, the duplication of services; flood prone properties; levee banks; contributions to urban and rural fire services; non-resident use; environmental issues; noxious plant control; and roads and bridges.

We consult regularly with local government, visiting over thirty councils annually. Our on-going visitation program means we are continually refining our methodology to reflect the ever-changing needs of local government. The flexibility of our methodology allows for special “one off” issues to be incorporated in the assessment of expenditure needs, as appropriate.

We would remind the Committee of the of the Commonwealth Grants Commission’s review, which found that:

*“There are many differences between LGGCs in the areas of expenditure and revenue covered by their assessments, the range of influences on expenditure and revenue levels assessed and the methods of measurement. Such differences are to be expected given the differences in the circumstances of LGBs both between and with the States. LGGCs require the flexibility to adopt methods that best reflect their circumstances.”*

Commonwealth Grants Commission  
Review of the Operation of Local Government  
(Financial Assistance) Act 1995, June 2001, page xii

*“Overall, we think the intentions of the Commonwealth in providing financial assistance for local government are being achieved. All LGBs are receiving some assistance and greater amounts are being delivered to relatively more disadvantaged councils.”*

Commonwealth Grants Commission  
Review of the Operation of Local Government  
(Financial Assistance) Act 1995, June 2001, page 32

*“We have concluded that the current arrangements are generally delivering outcomes consistent with the Commonwealth’s intentions.”*

Commonwealth Grants Commission  
Review of the Operation of Local Government  
(Financial Assistance) Act 1995, June 2001, page 45

We are concerned by the comments at the Sydney hearing in relation to a simplified SES model for grant allocations where Prof Steven Farish stated:

*“...simplicity and fairness are often counterpoised.”*

Local Government and Cost Shifting  
Sydney Hearing 28 April 2003  
Hansard EFPA 762

### *roads to recovery funding*

We note the many positive comments being made by local government in relation to the successful roads to recovery funding program.

We would remind the Committee that the distribution of the funds is on the basis of modelling by the States' Grants Commissions.

## **PUBLIC HEARINGS**

We support the Committee's decision to allow local government representatives the opportunity to express their views on the variety issues raised by the Discussion Paper at recent public hearings. However, we are concerned at the misleading evidence given at the hearings, particularly in relation to financial assistance grants, for example:

### *skimming off and \$ millions in savings*

Statements made at the public hearings in relation to FAGs that the State government skims off funds and that a centralised system would save \$ millions are misleading and ill informed.

That fact that such comments were made demonstrates a disturbing lack of understanding of the role of Grants Commissions and the way the funds are currently administered.

We would remind the Committee that the States' Grants Commissions operate at no cost to the Commonwealth, ensuring that every dollar of the available grants allocated by the Commonwealth Government are passed on to local government, as required by the current legislation.

### *a reduced grant for amalgamations*

Comments have been made suggesting significant grant reductions in the event of council amalgamations.

We would point out that the grants process aims to recognise and compensate councils for their relative differences in revenue capacity and expenditure needs.

Our modelling has shown that, generally, voluntary structural reform will reduce the financial burdens on councils that the Commission attempts to assess. This will result in a lessening of grant need for some functions. The changes are principally related to the assessment of issues such as duplication of services, economies of scale and isolation. The affects of these changes can vary significantly depending on the nature of the councils embarking on reform.

We are sensitive to the need for grant stability during structural reform, while at the same time recognising that as a result of such reform are likely to be reduced grants. Accordingly, we have developed an *amalgamation principle* that ensures the financial

assistance grant outcomes do not become an impediment to structural reform in local government.

Our amalgamation principle states that:

*“in the event of council amalgamations, the new council will receive grants for two years as if the councils had remained separate entities and any subsequent change may be phased in at the discretion of the Commission.”*

As a result councils that have successfully embarked on structure reform have not been disadvantaged and claims by participants at public hearings of significant grant loss are ill informed.

Our approach to structural reform issues is similar to that of other Grants Commissions.

## **CONCLUSION**

In conclusion the NSW Grants Commission is concerned that the Discussion Paper *At the Crossroads* has shifted the focus of the original Inquiry. The Discussion Paper threatens to completely dismantle the system of financial assistance grants currently in operation under the Local Government (Financial Assistance) Act 1995. This is not considered to be within the scope of the original Inquiry. In effect it would appear the rules have been changes half way through the game. Accordingly, before considering any changes to the existing local government financial assistance grant arrangements the extent of the “cost shifting” across all levels of government and across boarders must be considered.



**Emeritus Professor Maurice Daly**  
**Chairperson**  
**NSW Local Government Grants Commission**  
**24 June 2003**