



Dr Anne Twomey
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Mr Glenn Worthington
Secretary
Joint Committee on the Constitutional Reform of Local Government
Parliament House
Canberra, ACT 2600

22 December 2012

Dear Mr Worthington,

Inquiry into the Constitutional Recognition of Local Government

Please accept the following submission to the Committee's inquiry. The points made in this submission are drawn from the more detailed and referenced analysis contained in the Constitutional Reform Unit report, attached. The Report may also be accessed on the Constitutional Reform Unit's website: <http://sydney.edu.au/law/cru/index.shtml>. The report provides much background material that the Committee might find useful, including:

- a discussion of local government's place in the Commonwealth Constitution (Ch 2);
- a history of the funding of local government in Australia from the 1920s to the current day, including an analysis of the *Pape* and *Williams* cases and the current status of local government funding (Ch 3);
- an analysis of local government funding in other federations, including what lessons may be learned from overseas experience while recognising that local government's role, status and responsibilities in Australia tend to be quite different from other federations (Ch 4);
- a discussion of the efforts to achieve constitutional recognition of local government, including the 1974 and 1988 referenda and the recognition of local government in State Constitutions (Ch 5);
- an analysis of the current campaign for the constitutional recognition of local government, including the report of the Expert Panel, the arguments for and against constitutional recognition and the potential risks (Ch 6).

Part of this Report was also first published as an article: Anne Twomey, 'Always the Bridesmaid – Constitutional Recognition of Local Government' (2012) 38(2) *Monash University Law Review* 142.

Local government funding

Local government in Australia is relatively financially autonomous. Commonwealth funding makes up around 8% of local government operating revenue (in contrast to the States, which receive about 50% of their revenue from the Commonwealth). This overall figure, however, hides the fact that some local government bodies are more dependent than others upon receiving grants from the Commonwealth and State governments. PriceWaterhouseCoopers noted in a 2006 study that dependence of individual councils on grants varies from less than 2% to more than 70% of revenue. The Productivity Commission also pointed out that those councils with a high dependency on grants also cover a very small proportion of the population. It found in 2008 that 10 percent of councils were highly dependent on grants, with grants amounting to more than 58% of their total revenue, but that these councils represented about 0.4% of the total resident population of all councils.

In 2011-12, the Commonwealth provided \$2,722,866,000 to local government through grants to the States under s 96 of the Constitution. This amount was divided up between the States according to the population of each State. It was then distributed within each State on an equalisation basis, as determined by the relevant State local government grants commission, subject to the first 30% being distributed to each local government area by reference to population. In the same period, \$623,996,000 (around 23% of Commonwealth funding to local government) was paid directly to local government bodies through programs such as the Roads to Recovery program. The distribution of these grants, while coming direct from the Commonwealth, also relies in part on assessments made by the relevant State local government grants commission.

Whether there is a problem that needs to be fixed by a constitutional amendment

The primary argument for the constitutional recognition of local government seems to be the need to secure direct Commonwealth funding to local government due to doubts as to its constitutional validity. To get things into perspective, what we are dealing with is approximately 1.8% of local government revenue (i.e. 23% of 8% of local government revenue). This is still a significant amount of money and is particularly important to support the construction and repair of infrastructure in local government areas, but its relevance as a proportion of local government revenue is sometimes misrepresented in the debate.

Is this direct funding at risk of being held constitutionally invalid? Yes, much of it, in my view, is vulnerable to a constitutional challenge (see the analysis in the attached Report). Some might well be supported by a Commonwealth head of legislative power, but much of it, including the Roads to Recovery program, is probably not so supported and therefore invalid.

Is this a significant problem? No, because the same amount of money can be validly given under s 96 grants, as has been done since the 1920s. There is a perception that the grants made under the Roads to Recovery program and other 'nation-building' programs amount to 'new money' that would not be received by local government if direct funding were held to be invalid. However, if one looks at the statistics over a longer period by reference to local government funding as a proportion of GDP, the Parliamentary Research Service has found that while the financial assistance grants to local government have gone down as a proportion of GDP since 1996, the direct grants have gone up, resulting in Commonwealth funding of local government of 'about the same proportion of GDP as grants were in the late 1990s'. In other words, all that has happened is that funding to local government has shifted from general untied grants to specific purpose grants, imposing greater conditions and limitations upon the use of the money. This is not necessarily to the advantage of local government. There is certainly an argument that local government would be better off if the direct funding was found to be invalid and folded back into financial assistance grants made under s 96 of the Constitution.

Whether or not the Commonwealth would do so is a political and economic matter. Ultimately, the Commonwealth will make grants to local government in the amount that it thinks appropriate in the relevant economic conditions. This is the case regardless of whether a constitutional referendum regarding direct Commonwealth funding of local government succeeds or fails. I do not see the logic in the arguments that success in such a referendum will result in more funding or more secure funding for local government. The funding will remain insecure and vulnerable to reduction in either case, because it will remain dependent upon the will and capacity of the Commonwealth to make grants. Indeed, for the reasons discussed below, there is a reasonable likelihood that a successful referendum would result in reduced Commonwealth funding to local government.

The argument that the Commonwealth will provide more money to local government if it can do so directly, rests upon the view that the Commonwealth will behave disreputably and irresponsibly by denying local government adequate funding unless the Commonwealth can 'buy' votes and public approval by directly funding particular projects. The Expert Panel coyly referred to this as the 'political advantages' of direct funding. It is difficult, however, to argue that the Constitution must be changed in order to accommodate poor behaviour on the part of the Commonwealth Government. It is also difficult to imagine Commonwealth Ministers supporting a referendum on the ground that they will only fund local government adequately if they can get direct political advantages from doing so.

Is direct Commonwealth funding of local government more cost effective?

Is it more efficient for the Commonwealth to fund local government directly, resulting in savings being passed on to local government? The answer would

appear to be 'No'. First, there is an incorrect but persistent perception that the States 'take their cut' from Commonwealth grants to local government and that local government effectively 'pays' for the administration of the State equalisation schemes. This is not the case. Commonwealth grants to local government through financial assistance grants have to be paid in full and this is audited. Further, the cost to the States of administering the distribution of these grants is borne by the States, not local government.

If, however, the Commonwealth were to give all its local government funding directly, then it is very likely that it would first deduct the cost of administration. This is what it does in relation to the GST, deducting its costs of collecting and administering the tax before passing the rest of the proceeds onto the States. There is no reason to believe that the Commonwealth would be more generous to local government in this regard. Further, it is likely that the costs of administering the scheme at the national level would be far greater. The current distribution of Commonwealth grants direct to local government bodies, such as the Roads to Recovery program, relies upon the assessments made by State local government grants commissions. If those bodies ceased to exist (because the Commonwealth gave all its funding directly to local government, rather than through the States), then the Commonwealth would have to collect the relevant information in relation to each local government body in Australia and somehow assess relativities, despite the fact that local government bodies in different States have different functions and responsibilities and different revenue raising capacities. The cost and difficulty of doing so at the Commonwealth level would be immense. Assuming, as would appear likely, that the Commonwealth would deduct this cost from its grants, the likely outcome would be that the amounts provided to local government would go down, rather than up.

What other risks are there for local government if such a referendum were successful?

At the moment, most Commonwealth funding to local government is made by way of financial assistance grants that are passed through the States under s 96 of the Constitution. If a referendum permitted the Commonwealth to fund local government bodies directly, then the most likely outcome would be that it would do so in relation to all its local government funding. This would mean the end of financial assistance grants being given to local government through the States and the end of the State local government grants commissions that distributed those grants. Most importantly, the likely outcome would be the end of the distribution of financial assistance grants amongst the States on the basis of population (as grants would no longer be made to each State). If the Commonwealth were to provide financial assistance grants directly to local government, it would most likely do this on an equalisation basis (i.e. distributing it to local government bodies according to need, with no reference to the population of the relevant State). This would be consistent with previous recommendations of the Commonwealth Grants Commission and a parliamentary committee (see the attached Report). The consequence would be

winners and losers. The winners would be the remote and rural councils in the less populous States. The losers would be New South Wales and Victoria, and in particular councils in the most populous areas of those States. The consequence would be that a small proportion of the population would make great gains while a large proportion of the population would lose considerable funding, resulting in higher rates.

For example, when the Commonwealth Grants Commission considered the distribution of grants to local government on an equalisation basis in the 1990s, the distribution of funds to NSW would have dropped from \$243.1 million to \$74 million. Victoria would also have lost \$142.2 million in funding. Hence any move to direct funding of local government by the Commonwealth on an equalisation basis (without first distributing funds to the States on a population basis, as is presently the case) that resulted from a constitutional amendment, would be likely to have serious financial consequences for local government in New South Wales and Victoria.

The wording of the proposed amendment

The Expert Panel proposed the insertion of the italicised words in s 96 of the Constitution:

the Parliament may grant financial assistance to any State *or to any local government body formed by State or Territory Legislation* on such terms and conditions as the Parliament sees fit.

As a small drafting point, I would not give 'Legislation' a capital letter.

The provision seems to be based, in part, on s 51(xx). The reference to local government bodies having been formed by State or Territory (hereafter 'State') legislation is intended to indicate that these bodies are still creatures of the States that are established and regulated by State laws. It would make clear that local government is not a genuine third tier of government within the federation, but a subordinate level of State government. It appears that it is also intended to indicate that the Commonwealth could not establish such local government bodies.

The Expert Panel noted at p 16 of its report that there was a risk that a reference to local government in the Commonwealth Constitution 'could be held by the High Court to prohibit a state from altering the fundamental characteristics of the system of local government and the High Court could determine what those characteristics were'. This is what has occurred with respect to other constitutional terms, such as references in the Constitution to 'courts' and 'juries'. Hence the High Court might find that a fundamental characteristic of 'local government' is that it is an 'elected' body, and that this does not permit dismissal of elected councillors or the appointment of administrators. The Panel sought to avoid this problem as best it could, by linking the reference of local government



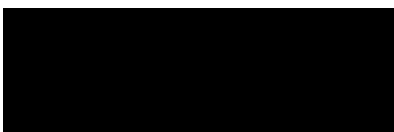
to its funding, rather than requiring each State to have a system of local government. The Panel noted at p 16:

If, in the future, the system of local government of a particular State were to be changed in such a manner that it no longer answered the constitutional concept of 'local government', the effect would be that the Commonwealth would not be able to make grants to the local councils of that State. Nothing in the existing jurisprudence of the High Court suggests that a State is obliged to create a system that complies with the constitutional expression.

While this may be true and a State could have a system of local government which did not meet the minimum requirements implied by the High Court, the effect would be that its local governments could not receive direct Commonwealth funding. There would therefore be enormous pressure on a State to ensure that its system of local government complied with any minimum characteristics identified by the High Court in order to avoid missing out on direct funding programs, such as the Roads to Recovery program. This would be particularly so if, as is likely, (a) all Commonwealth funding to local government were shifted to direct funding; and (b) the Commonwealth refused to provide funding to local government through the States where the local government system in a State did not satisfy the High Court's assessment of the minimum characteristics of local government. Accordingly, the High Court's interpretation of the term 'local government' would still be of critical importance to both States and local government bodies.

If you need any further information, please do not hesitate to contact me.

Yours sincerely,



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