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## 4 Defining revenue-raising capacity

### Key points

- The revenue-raising capacity of local governments depends in substantial measure on the ability of their communities to pay for local government services.
- A comprehensive measure of the after-tax aggregate disposable income of a community is the most appropriate indicator of its ability to pay and hence of the fiscal capacity of its local government.
- However, measures of fiscal capacity are not reliable indicators of the level of revenue that local governments do, or should, raise. The willingness of the community to pay for local government services is the principal determinant of the revenue actually raised.
- There are major challenges associated with undertaking an empirical study of the revenue-raising capacity of local governments. These arise from the diversity of councils in terms of their characteristics, systems of rates, user fees and charges, the mix of goods and services they provide, the fiscal capacity of local governments and the willingness of the community to pay.
  - The Commission has adopted a pragmatic approach to undertaking an empirical analysis of the principal factors that determine the own-source revenues actually raised by different local governments.
  - This approach enables an analysis of the potential for local governments to raise additional revenue by ‘benchmarking’ each local government’s revenue-raising effort against that of all others, adjusting for the principal factors that explain the own-source revenue raised.

The Commission has been asked to assess the revenue-raising capacity of local governments in Australia. In this chapter, the meanings that can be attached to the term ‘capacity’ in the context of this study are explored. There are two broad conceptual approaches that can be taken to defining and analysing the term *capacity to raise revenue*. The first is based on the concept of a community’s *ability to pay* for local government goods and services, also referred to as its *fiscal capacity*. The second is based on the concept of a community’s *willingness to pay* for these services.

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## 4.1 Fiscal capacity

The concept of an *individual's* ability (capacity) to pay for public services has a long-established meaning in public sector economics literature. It is often used in analysing the distribution of the burden of taxes and charges levied to fund public services (Musgrave and Musgrave 1989).

The generally accepted view is that a comprehensive measure of the income of a person (or household or business) is the best indicator of their ability to pay taxes and charges. Those with higher incomes have a greater ability to pay than others.

It is a natural extension of this concept to suggest that the aggregate income of a community is an indicator of that community's ability to pay for local government services. The higher the aggregate income of a community, the higher the ability to pay for local government services, and hence the higher the potential for its local government to raise revenue. It has become common for this indicator of a local government's potential to raise revenue — aggregate community income — to be referred to as its fiscal capacity. (Barro 2002; Bradbury and Ladd 1985; Musgrave and Musgrave 1989).

The fiscal capacities of local governments depend, to a large extent, on the underlying characteristics affecting the aggregate income of their local community. Some characteristics include population size and demographic attributes of the population, as well as their natural resource endowments and the nature and scale of their economic activity.<sup>1</sup> For example, a local government area with a higher proportion of its residents not in the labour force (such as those below and above working age, students and retirees) would have a lower aggregate community income compared with other council areas, all else being equal. Aggregate community incomes in some local government areas might be associated with the value of agricultural or mining output, or the concentration of business and industrial properties, within an area.

The fiscal capacity of a local government can be influenced by factors other than the aggregate income of its community. A council encompassing a central business district might have a fiscal capacity that exceeds the income of its local residents and businesses because non-resident workers, shoppers and visitors pay for the use of some of its facilities (for example, car parking and swimming pools). In holiday destinations, rates revenue may be raised from holiday homes owned by non-residents. Moreover, fees and charges for local services might be paid by

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<sup>1</sup> Some of these characteristics might be partly dependent on the activities undertaken by local governments. Taxing and spending policies, for example, might influence the attractiveness of the area to individuals and businesses, at the margin.

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non-residents (holiday home-owners or renters). However, for present purposes, these complications are set aside. Some are further considered in the analysis presented in chapter 5.

The measure of fiscal capacity used in this study is assumed to be independent of the level of revenue actually raised by a local government from rates, fees and charges. This is done in order to distinguish analytically between the capacity of the local government to raise revenue and its choices about how much revenue to generate through its fiscal effort (Barro 1986, 2002).

### **Income is an appropriate indicator of fiscal capacity**

Income is a more appropriate indicator of the fiscal capacity of a local government than the rateable value of land. This is recognised not only in the economics literature (Collins 1987 and Barro 2002), but also in other studies by the Commonwealth Grants Commission (CGC) (1991) and Morton Consulting Services (1996). Some of the key arguments for using income or land values as the bases for indicators of fiscal capacity are summarised in box 4.1.

Although obtaining fully comprehensive measures of income at the local government level is difficult, the arguments in support of using income as an indicator are more compelling than those in support of using property values. This includes the fact that a substantially large proportion of local governments' own-source revenue, at a national level, is from fees and charges (as illustrated in chapter 2).

Moreover, the reality is that ratepayers pay their rates and charges out of their incomes and probably think in those terms when confronted with their rates notices (Caulfield 2000). Indeed, local governments, at least implicitly, acknowledge this when they set their rates, fees and charges. Councils are required under State legislation to provide concessions to pensioners, and also voluntarily offer their own concessions to people facing hardship in paying rates. In times of rapidly rising property values, councils often decrease the rate in the dollar, so as to reduce the revenue raised to match the revenue required to fund the budget.

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**Box 4.1 Propositions for using either income or property values as bases for indicators of fiscal capacity**

In its *Report on the Interstate Distribution of General Purpose Grants for Local Government (1991)*, the Commonwealth Grants Commission presented the views of parties relating to the use of income or the value of rateable land as bases for indicators of revenue-raising capacity. The context of the discussion was to assess standardised revenue for the purpose of distributing grants to local governments. The arguments that supported income as an appropriate indicator were that:

- local government rates are set in accordance with expenditure requirements, determined through the local government budget process, and not in reference to property values
- households and businesses pay local government rates from their income. Ability to pay does not increase proportionally with increases in property values
- the increasing use of fixed charges for services, such as garbage collection, and the use of a raft of other fees and charges, is weakening the relationship between land and property values and the revenue raising of a local government. This is largely because the costs of providing such services generally do not vary in line with changes in property values
- the locational decisions of businesses are less likely to be distorted when income is used to assess revenue-raising capacity.

The propositions that supported property values as an appropriate indicator were that:

- property values reflect both the wealth and income of residents and are therefore a better indicator of ability to pay
- economic theory suggests that, in an efficient property market, at least in the long run, property values should be correlated with the expected return on holding the asset. Therefore, higher property values would imply higher returns and ability to pay
- using property values to assess ability to pay overcomes some of the practical difficulties in obtaining suitable measures of income.

*Source:* Based on CGC (1991).

Although there is likely to be a link between property values and incomes, property values are an imperfect and incomplete indicator of the incomes of residents and hence of their ability to pay rates.

A number of participants to this study support the view that the principal determinant of a council's revenue-raising capacity is the income of its community.

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The Local Government Association of Queensland (sub. 11, p. 3) stated:

It is important that the Productivity Commission recognises that growth in the overall value of property does not determine revenue-raising capacity. It is the recurrent resources available to each sector of the economy to meet the rate impost that has a significant bearing on revenue capacity.

Similarly, the Launceston Municipal Ratepayers and Residents Association (sub. 10, p. 6) commented:

This association submits that in examining the capacity of different types of councils to raise revenue, the income of the community should be a central indicator of such capacity.

All things considered, the Commission considers that the appropriate indicator of fiscal capacity for each council in the context of this study is the aggregate income of its local community. Ultimately, it is the incomes of individuals in local communities that constrain the choices they face between consuming public or private sector goods and services.

The most appropriate indicator is based on a comprehensive measure of income. This includes income from all sources, such as wages, salaries, interest, dividends, imputed income from housing ownership, and capital gains on assets (whether realised or not). It also includes all business income (such as retained earnings) that has not been paid to residents in the form of dividends (Barro 2002; Musgrave and Musgrave 1989).

People and businesses in local government areas pay taxes and charges to other spheres of government and receive income from outside the local area (including welfare and other transfer payments from the Australian and State Governments). In principle, the indicator of a community's ability to pay for local government services should be based on disposable income, net of other taxes and charges.

However, a complete quantification of a broad measure of income disaggregated down to the level of local government areas is not available in existing data collections. In practice, it is necessary to use incomplete measures of disposable income, as explained in chapter 5.

## **Comparison with State grants commission's approaches**

The approach to defining and measuring fiscal capacity in this study is different from that used by State grants commissions (SGCs) to estimate relative revenue-raising capacity (box 4.2).

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There are two key differences to note. First, the relative revenue-raising capacity of local governments estimated by SGCs is based on a State's average level of rates (and fees and charges in some cases). This definition of revenue-raising capacity is applied in order to distribute grants without discriminating against councils in relation to their actual revenue-raising effort.

In contrast, for the purpose of this study, revenue raising is examined in the context of the policy choices available to local governments.

**Box 4.2      Concept of relative revenue-raising capacity applied by the State grants commissions**

The concept of fiscal capacity adopted in this study differs from the concept of relative revenue-raising capacity applied by the State grants commissions. Although the precise methodology applied by each of the Commissions differs across jurisdictions, the relative capacity to raise revenue is assessed for each council relative to a State average for all councils. This approach is employed because the policy for distributing Australian Government General Purpose Grants explicitly requires that grants be allocated on an effort neutral basis and should not discriminate between local governments on the basis of their policy choices, which affect both revenue raising and expenditure.

In New South Wales, for example, the NSW Local Government Grants Commission determines each council's relative revenue-raising capacity by multiplying the difference between the state average value per property and the council's actual value per property by the state average rate-in-the-dollar and the number of properties. Councils with low values per property relative to the State's average are assessed as having lower revenue-raising capacity.

In the case of Victoria, standardised revenue for each council is determined as standardised rates revenue plus standardised fees and charges revenue, reflecting the fact that councils also raise own-source revenue from fees and charges. Standardised rates revenue is calculated for each council by multiplying its valuation base (on a capital improved value basis) by the average rate across all Victorian councils, and, where applicable, adding payments received by the council in lieu of rates. In the calculation of standardised fees and charges revenue for each council, for each of nine functional areas, the relevant driver (such as population) is multiplied by the state median revenue from user fees and charges. For some functions, this is then modified by a series of revenue adjustors to take account of differences between councils based on characteristics which affect their capacity to generate revenue from fees and charges. The revenue-raising capacity from fees and charges is assessed on an effort neutral basis, using the State's average fee level per unit (usually per person).

*Source:* NSW LGGC (2007); VGC (2006).

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The second difference is in the choice of base used to calculate relative revenue-raising capacity and to measure fiscal effort.<sup>2</sup> In the case of the SGCs, the bases are the rateable value of land (and population, in some cases where non-rates revenue-raising capacity is assessed). This practice might stem from the fact that local governments can only tax rateable land, not the incomes of their ratepayers directly. Moreover, local governments do not have ready access to data on the incomes of individual residents and might be somewhat limited in the degree to which they are permitted to apply differential rates in the dollar. In this study, fiscal capacity is measured by a community's disposable (after income tax) aggregate income.

### **Evaluating observed revenue-raising effort**

As pointed out in chapter 2, the actual revenue raised by local governments is small relative to any indicator of the ability of local communities to pay for local government services. The average revenue-raising effort, measured by dividing actual revenue raised by fiscal capacity (income), is relatively low. At a national level, the own-source revenue raised by local governments was about \$977 per person in 2005-06, representing a share of GDP per person of about 2.1 per cent and a share of aggregate disposable household income per person of about 3.3 per cent. The share of rates revenue of GDP was about 0.9 per cent.

Given the relatively low value of the indicator of effort at the national level, a question arises as to the usefulness, in practice, of interpreting fiscal capacity as an indicator of the potential for local governments to raise revenue.<sup>3</sup> A pertinent issue for this study is to what extent it might be possible for local governments to raise additional revenue from their own sources, if they so choose. It might be possible for local governments to increase revenue-raising effort from relatively low levels. However, it is unrealistic to suppose that councils could, or should, increase revenue-raising effort to levels approaching fiscal capacity.

Indicators of fiscal capacity do not represent the actual revenue a local government does, or should, raise, taking into account the community's willingness to pay (discussed in the next section) or its expenditure requirements. It is important to note that an observed low level of revenue-raising effort for a council in a high income area does not necessarily indicate that it should, for example, raise its rates. Nor does a high measure of revenue-raising effort imply that rates should

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<sup>2</sup> Fiscal effort is defined as the ratio of revenue raised to some base measure.

<sup>3</sup> The concept of ability to pay is relevant to the consideration of the impacts of revenue raising on 'individuals, businesses and organisations', where equity issues are important. This is explored in chapter 7.

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necessarily be lowered. As noted by Teera and Hudson in considering revenue-raising effort at a national level (2004, p. 797):

... such decisions should emerge from careful consideration of expenditure needs, alternative sources of finance, the effects of the particular taxes that would be changed, administrative capacity, and the political acceptability of the program.

## 4.2 Willingness to pay

The second, rather different, concept of the capacity of a local government to raise revenue focuses on the willingness of a community to pay for local government goods and services, rather than its ability to do so. The two concepts are not entirely unrelated. Communities with higher incomes might have a higher demand, and hence willingness to pay, for at least some local government services. However, the increase in demand might be less than proportional to the increase in incomes. For example, ratepayers might choose to construct their own backyard swimming pool as their disposable income rises, rather than use the community swimming pool provided by the council. In addition, as a council endeavours to expand the range and quality of its services, it might find that many of its ratepayers are unwilling to pay for them through higher rates or user fees. This is an indication that they prefer to devote their remaining disposable incomes to private consumption rather than to additional services offered by the council.

In the situation where a council applies user fees and charges for services for which the user has discretion over consumption, the willingness to pay of individuals is revealed by the choices they make. The aggregate demand curves for such goods and services reflect the quantities that a council can sell at different prices. The price represents the marginal willingness of members of the local community to pay for the various quantities supplied by the council. This demand curve can be estimated from observed outcomes using knowledge about the key factors determining demand, which include:

- the income of the local community (ability to pay)
- the preferences of the local community for the consumption bundle of goods and services offered by the council, on a user pays basis, and all other private goods
- the prices paid for goods and services offered by councils relative to the prices paid for all other private goods and services.

However, for local government services that are paid for through rates, rather than directly through fees and charges, measuring the willingness of a community to pay is not so easily achieved.

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## **Willingness to pay and public goods and services**

There are some goods and services provided by local governments — so-called public goods and services — that private sector markets are not able to provide, or are not able to do so at optimal levels. Examples include the provision of local roads and parks and gardens. Individuals benefit from the provision of public goods whether they pay for them or not. Consequently, individuals have little incentive to reveal their willingness to pay and, in fact, have incentives to understate their true preferences.

Local governments use rates (their taxing power) to recover the costs of providing public goods and services and political processes are relied upon to signal the willingness to pay of the community. Options for signalling preferences by residents include voting and (potentially) moving, forming pressure groups, writing letters, complaining to council, responding to community or user surveys and lobbying the Australian and State Governments (Dollery, Crase and Johnson 2006).

The idea that resident-voters might reveal their preferences for local government services by ‘voting with their feet’ (moving) was originally proposed by Tiebout (1956). There are a number of assumptions necessary for this hypothesis to hold. Nonetheless, it suggests that the level of local government services and rates might influence property values and therefore affect residential and business location decisions across councils (Bailey 1999). It is likely that this hypothesis is more relevant to countries such as the United States, where local governments have responsibility for services such as education, police and fire services that more significantly affect property values in an area.

Conceptually, the observed revenue-raising effort of different local governments can be seen as being determined by councillors on behalf of their ratepayers. This may involve them choosing from a menu of options, offered to them by council managers, for various levels and mixes of services and associated expenditure, and the prices (rates, fees and charges) required to recover the expenditure. The outcome of this process can be thought of as being a sort of equilibrium arising from the interaction of demand of the community and the supply of services by the council.

The value people and businesses place on consuming public goods, their willingness to pay, is driven by the same factors that drive their demands for private goods and services — incomes (ability to pay), the preferences for public and private goods and services, and their relative costs.

In practice, the level of revenue that a local government can raise from its community is likely to be dependent on what the community wants the council to

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provide. Some participants to this study have made this point. As noted by the City of Boroondara (sub. 24, p. 6):

... The total required rates revenue is determined by the individual local government's assessment of the required operating and capital expenditure required to adequately deliver its stated objectives and to meet identified community need. ... It is not the size of the tax base that matters but the willingness of the local government to increase its tax collected measured against the capacity of the community to pay.

The capacity of local governments to raise rates revenue can be constrained by the ability and willingness of ratepayers to pay in the lowest income group. This is because, within ratepayer classes, such as residential, local governments are required to apply a uniform rate structure across all ratepayers. This can reduce the scope for councils to discriminate between ratepayers with different incomes (where income information is available to councils), thus lowering the overall potential to raise revenue from rates. However, local governments have a variety of instruments they can use to at least partially reduce this apparent constraint. They can give additional concessions or rebates to pensioners to facilitate a higher rate-in-the-dollar on higher income residents. They can also apply a minimum rate to some and a higher rate-in-the-dollar to others. In some States, relatively flexible differential rating provisions might mitigate, to some extent, constraints that arise from uniform rating structures.

The NT Government (sub. 46, p. 3) noted that factors affecting revenue raising are likely to include:

- barriers or constraints from legislation
- human and physical resources available to local governments
- the capacities and willingness of residents, organisations and businesses to pay
- the benefits derived from delivery of a service.

The willingness of local communities to pay and other factors are likely to constrain the level of revenue raised by councils (and expenditure) to well below that implied by indicators of fiscal capacity. Indeed, it is likely to be these factors that explain the observed modest level of revenue-raising effort by councils, noted earlier.

## **Interpretation of observed levels of rates revenue**

There is an issue in interpreting the observed outcomes of local government revenue raising and provision of goods and services. This is the extent to which the outcomes reflect the willingness of the community to pay for its public goods and services. The key question is whether or not institutional arrangements and political considerations lead to outcomes that fully reflect community preferences.

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There are a number of mechanisms put forward to support the proposition that local governments are guided towards effectively meeting the demands of their local communities. First, there is the theoretical concept of competition between local governments arising from the potential for resident-voters to move between councils (Dollery, Crase and Johnson 2006). Competition between councils can drive councils towards offering rates–service bundles that better meet the demands of their local communities, particularly where there is a large number of competing local governments in the same metropolitan area (Bailey 1999).

A second mechanism put forward is the ability of the residents of a council to signal their preferences through democratic and administrative mechanisms, as mentioned previously. The democratic, governance and managerial processes of councils help shape their expenditure and revenue decisions. Being smaller in size than other levels of government, local governments are said to be ‘closer’ to the people in their communities. This can improve the scope for resident-voters to reveal their preferences by shortening communication channels and promoting the expression of voice by residents. This might be facilitated by councils:

- providing opportunities for users of public services to participate in decision making
- increasing consultation (with community groups and local organisations)
- establishing complaints procedures (Bailey 1999).

It is recognised that the governance or administrative arrangements required to achieve the optimal mix of rates and service provision vary across different types of councils. For example, Local Government Managers Australia (sub. 61, p. 14) submitted:

... where special remote community circumstances exist due to large area/remoteness/low population ... separate administrative, governance and financial arrangements and systems should be applied that are specifically designed for the democratic rights and service needs of such remote areas/communities.

There is evidence of local governments using a number of means to identify and respond to the demands of their communities. For example, the Best Value Policy, introduced in Victoria in 1999, aims to ensure that councils are accountable and responsive to the needs of local communities. The policy incorporates a number of principles, including that local governments measure and report on their performance against objectives set by the council in consultation with its community (PwC 2006).

In contrast to these mechanisms which help local government meet the preferences of their communities, there is also literature that points to the potential weaknesses of local government political processes, which suggests that they might not achieve

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fully efficient outcomes (Byrnes and Dollery 2002). Some of the shortcomings include:

- voter apathy (whereby voters do not take an active and informed interest in the activities and operations of local government)
- asymmetric information between ratepayers and users of council services, councillors, management and staff about the costs and benefits of goods and services provided by councils
- councillor ‘capture’ (whereby council decisions are swayed by groups with vested interests)
- political entrepreneurship by councillors and management who use resources in an inefficient way to attract the attention of voters (whereby holding office is seen as a means of promoting a career in politics) (Dollery, Crase and Byrnes 2006).

Another shortcoming might include a lack of management skills of elected councillors, managers and staff — those who are inexperienced or do not possess the skills appropriate to the financial management of a council.

Some participants to this study have suggested that they do not consider that councils effectively assess community preferences regarding services. The Vacluse Progress Association (sub. 7, p. 2) stated:

The assessment of community needs by councils is theoretically the avenue through which new or different services appear on council menus. In Woollahra, we have observed a consistent thread of inquiry in community surveys undertaken for and by the Council, in which respondents are invited to nominate things/services they want. While the responses are often of interest, they are generally made in a financial vacuum: the surveys do not typically postulate a user charge, or a rate increment or other indicator of cost/funding, and so the responses by participants are simply wish lists. Nevertheless, such outcomes are frequently presented to and by the Council as needs and adopted by the Council, with resultant pressure on council financial resources.

Similarly, the Launceston Municipal Ratepayers’ and Residents’ Association (sub. 10, pp. 17–18) suggested that there is not always a link between the services offered and the community’s willingness to pay. It stated:

LCC [Launceston City Council] goes through the motions of ‘community consultation’ and surveys community satisfaction with council initiatives. The instruments used to poll the community are often designed to come up with a predetermined answer. ... The nature and structure of the questions is such that council can choose how to interpret results to support its argument for increased expenditure. Either ‘the community is satisfied, we can spend more’, or ‘the community is unsatisfied, we must spend more’. In the Community Survey, there is no attempt to temper the community’s wants with a financial aspect, no user charge, or a possible rate increment is mentioned.

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A number of principles to guide revenue raising and council decision making that can help the political process to achieve more efficient outcomes based on the willingness to pay of the community are discussed in chapter 8.

### **4.3 Comparisons of the relative potential to raise revenue**

A key issue for this study is to identify the principal factors that explain the revenue raised by different local governments and to assess the extent to which local governments can raise additional revenue. The Commission cannot tell whether observed revenue-raising levels reflect the true underlying preferences of communities or are distorted by features inherent in political decision-making processes. As a consequence, it has no alternative but to presume that the observed revenue-raising efforts of local governments at least approximate the underlying preferences of their communities.

Clearly, ultimately the observed revenue-raising efforts of local governments are driven by the demands of their communities for local government services. However, there are reasons why it is difficult to estimate directly the extent to which various characteristics of communities ‘explain’ differences in observed revenue-raising efforts. Among other things, this is because of:

- the difficulty in linking the rates paid by local residents to the services they use, which means there is no observable price for each of the services used
- the substantial variation in the mixes and levels of goods and services provided by councils
- the complexity and variation across councils in the system of rates, and of user fees and charges, levied by councils
- the limitations of the data available.

Because of these difficulties the Commission has adopted a pragmatic approach to attempting to estimate the extent to which various factors explain the revenue raised by different local governments. The approach also provides a basis for assessing the extent to which local governments might have the capacity to raise additional revenue. This involves undertaking a comparative analysis of relative revenue raised by councils. This type of comparative analysis has been widely applied to study the relative tax performance of countries.<sup>4</sup> The idea is that the revenue raising (and expenditure decisions) of local governments reflect a number of factors that

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<sup>4</sup> See Davoodi and Grigorian (2007), Teera and Hudson (2004), Bird, Martinez-Vazquez and Torgler (2004), Piancastelli (2001) and Leuthold (1991).

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tend to be beyond the control of local governments. Examples of these factors include:

- the income of the local community
- the geographical location, or type of, local government (for example, whether the council is classified as capital city, urban, rural, or remote)
- legislative frameworks (for example, rate pegging is practised in New South Wales)
- the relative costs incurred by councils which, among other things, is influenced by the delivery of certain services (for example, some councils are required to provide water and sewerage services in Queensland, Tasmania and in parts of New South Wales)
- the demographic and other social attributes of the local community (for example, the age distribution or ethnic composition of the local community)
- other economic attributes of the local economy, such as:
  - the economic base of the local economy (for example, capital city councils have higher observed levels of revenue per person because they generally have small resident populations and a significant proportion of their revenue is sourced from rates and fees paid by businesses and from non-residents who work, shop or visit in the city)
  - the rate of economic growth of the region and the level of grants received from other spheres of government.

These factors are likely to influence the expenditure on services provided by local governments and their ability to raise revenue from their local communities. To illustrate, the South Australian Centre for Economic Studies (2002, p. 20) commented:

In inner metropolitan areas which are experiencing urban regeneration and an influx of younger, higher income households, there is probably a greater willingness to pay for enhanced public services.

Statistical analysis, such as regression techniques, can be applied to determine the factors that best explain variations in revenue raised between councils. Such an approach can also be extended to develop indices of the potential to raise additional revenue. These indices could be derived by comparing the revenue raised by councils with similar attributes, that is, ‘controlling’ for the identified factors affecting revenue raised. If, after allowing for these factors, a council raises less revenue than the hypothetical benchmark, this evidence can be taken to be an indication that there is potential for a council to raise additional revenue.

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This type of index could be developed by applying stochastic frontier techniques. An indication of the potential to raise additional revenue does not mean that councils *should* raise additional revenue.

The analysis of revenue-raising capacity in this study includes approaches based on both the indicator of fiscal capacity and comparisons of the potential to raise revenue. The analysis is set out in chapter 5 and appendix C.