



Australian Government
Productivity Commission

Assessing
Local Government
Revenue Raising Capacity

Productivity Commission
Research Report

April 2008

© COMMONWEALTH OF AUSTRALIA 2008

ISBN 978-1-74037-249-7

This work is subject to copyright. Apart from any use as permitted under the *Copyright Act 1968*, the work may be reproduced in whole or in part for study or training purposes, subject to the inclusion of an acknowledgment of the source. Reproduction for commercial use or sale requires prior written permission from the Attorney-General's Department. Requests and inquiries concerning reproduction and rights should be addressed to the Commonwealth Copyright Administration, Attorney-General's Department, Robert Garran Offices, National Circuit, Canberra ACT 2600.

This publication is available in hard copy or PDF format from the Productivity Commission website at www.pc.gov.au. If you require part or all of this publication in a different format, please contact Media and Publications (see below).

Publications Inquiries:

Media and Publications
Productivity Commission
Locked Bag 2 Collins Street East
Melbourne VIC 8003

Tel: (03) 9653 2244
Fax: (03) 9653 2303
Email: maps@pc.gov.au

General Inquiries:

Tel: (03) 9653 2100 or (02) 6240 3200

An appropriate citation for this paper is:

Productivity Commission 2008, *Assessing Local Government Revenue Raising Capacity*, Research Report, Canberra.

The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by consideration for the wellbeing of the community as a whole.

Information on the Productivity Commission, its publications and its current work program can be found on the World Wide Web at www.pc.gov.au or by contacting Media and Publications on (03) 9653 2244.

Terms of reference

ASSESSING LOCAL GOVERNMENT REVENUE RAISING CAPACITY

Productivity Commission Act 1998

The Productivity Commission is requested to undertake a research study assessing local government revenue.

In undertaking the study the Commission is to examine the capacity of local government to raise revenue including:

- the capacity of different types of councils (eg capital city, metropolitan, regional, rural, remote and indigenous) to raise revenue and the factors contributing to capacity and variability in capacity over time;
- the impacts on individuals, organisations and businesses of the various taxes, user charges and other revenue sources available to local government; and
- the impact of any State regulatory limits on the revenue raising capacity of councils.

In undertaking the study the Commission is not to investigate the scope for local governments to borrow.

The Commission is required to provide both a draft and a final report, with the final report due within twelve months of receipt of this reference.

The report is to be published.

PETER COSTELLO

Received 5 April 2007

Foreword

Local governments play an important role in Australian society through their delivery of goods and services, and their regulation and planning activities. There is considerable diversity among local governments in the services they deliver and in the revenue they raise, though rates are their only tax instrument. The revenue raised by local governments is clearly central to their financial sustainability and ability to serve their local communities.

In this study, the Commission has been asked by the Australian Government to examine the capacity of different types of councils to raise revenue and the factors contributing to that, as well as the impacts of any regulatory limits on their revenue-raising capacity.

In conducting its research, the Commission has drawn on information from submissions, consultations with all spheres of government and other relevant organisations and research groups, as well as an array of studies on the local government sector. The Commission is grateful to the many people who have taken the time to contribute to this study, including those who provided feedback on the draft report.

The study was overseen by Commissioner Judith Sloan and Associate Commissioner Cliff Walsh, with a research team led by John Salerian in the Melbourne office.

Gary Banks AO
Chairman
April 2008

Contents

Terms of reference	III
Foreword	IV
Contents	V
Acknowledgments	XIII
Abbreviations	XIV
Overview	XIX
Findings	XXXVI
1 About this study	1
1.1 What has the Commission been asked to do?	1
1.2 How has the Commission approached its task?	2
1.3 Guide to the report	5
2 Local government in Australia	7
2.1 An introduction to local government	8
2.2 Roles and functions of local governments	13
2.3 Revenue sources of local government	20
3 Revenue and expenditure across local governments	33
3.1 Sources of local government data and their limitations	34
3.2 Revenue raised across local governments	36
3.3 Composition of own-source revenue	38
3.4 Expenditure of local governments	45
4 Defining revenue-raising capacity	51
4.1 Fiscal capacity	52
4.2 Willingness to pay	58
4.3 Comparisons of the relative potential to raise revenue	63

5	Comparisons of revenue-raising capacity	67
5.1	Fiscal capacity	69
5.2	Revenue-raising effort	74
5.3	Factors affecting revenue raised by local governments	77
5.4	Analytical results	81
5.5	The scope to raise additional own-source revenue	84
5.6	Financial impacts of increased revenue raising	89
5.7	Policy implications	93
6	The effects of legislative and regulatory factors	95
6.1	Constraints on rates	97
6.2	Constraints on fees, charges and contributions	117
7	Impacts on individuals and businesses	135
7.1	Issues about assessing the impacts	136
7.2	Previous studies of the distributional impacts of rates	145
7.3	Indicators of the impacts	148
7.4	Total rates incidence	151
7.5	Residential rates incidence	155
7.6	Business rates incidence	159
7.7	Impact of fees and charges	160
8	Principles for revenue raising	165
8.1	Principles to guide effective revenue raising	167
8.2	Application of the principles	184
A	Submissions, visits and roundtables	189
A.1	Consultations	195
B	Local government revenue-raising powers	197
B.1	Rates and property charges	197
B.2	Fees and charges	203
B.3	Other revenue	213
B.4	Borrowings	213
B.5	Defining local governing bodies	214
C	Data and modelling	217
C.1	Data sources	217

C.2	Assembling the data set	219
C.3	Estimating the income of local government areas	223
C.4	Approach to estimating the factors affecting revenue and the relative potential to increase revenue	228
C.5	Factors affecting revenue raised	242
C.6	Relative potential to increase revenue	244
D	Australian Classification of Local Governments	253
E	Effective property rates	255
E.1	Indicators of effective property rates	255
E.2	Effective property rates	256
F	Indigenous local governing bodies	261
F.1	Indigenous Australians and local governing bodies	261
F.2	Revenue raising in ILGBs	264
F.3	Factors affecting revenue-raising capacity	268
F.4	Local governing bodies — case studies	278
G	Residential rates incidence in the City of Charles Sturt	293
G.1	Data sources	293
G.2	Estimates of residential rates incidence	294
H	Referee reports on modelling	297
H.1	Report from Peter Abelson	297
H.2	Report from Joe Hirschberg	300
	References	305

BOXES

1	Participants' views	XXIV
2	Factors affecting own-source revenue per person raised by councils	XXVII
2.1	Roles of local government	14
2.2	National principles for allocation of financial assistance grants	24
4.1	Propositions for using either income or property values as bases for indicators of fiscal capacity	54
4.2	Concept of relative revenue-raising capacity applied by the State grants commissions	56

6.1	Why regulate local government revenue raising?	96
6.2	Rates revenue — some efficiency and distributional issues	98
6.3	Rate pegging in New South Wales	112
6.4	Some efficiency aspects of fees and charges	118
6.5	Examples of statutory fees and charges	125
7.1	Rates incidence within and between councils	141
8.1	Cost definitions	172
8.2	Guidelines for attributing costs	176
8.3	Rating strategies of Queensland councils	179
8.4	Local government sector initiatives	186
8.5	Assistance for local governments	187
B.1	National Competition Policy and local government	204
D.1	Australian Classification of Local Governments	253

FIGURES

1	Local government expenditure by function	XX
2	Sources of local government revenue	XXII
3	Estimated fiscal capacity and revenue-raising effort by class of council	XXVI
4	Total rates incidence by class of council	XXXII
2.1	Local government expenditure by function	19
2.2	Local government expenditure by State	20
2.3	Sources of local government revenue in Australia	22
2.4	National trends in real local government revenue	26
2.5	Australian taxation revenue, all levels of government	27
5.1	Own-source revenue versus fiscal capacity	75
5.2	Estimates of each local government's own-source revenue relative to its potential own-source revenue, by income	86
6.1	Growth in real council own-source revenue	101
6.2	Residential property valuations and rate in the dollar	102
6.3	Real rates revenue per person	116
6.4	Level of restriction	124
6.5	Local government developer charges and contributions per lot	130
6.6	Developer contributions revenue per new dwelling commenced	133
7.1	Total rates incidence and distribution in Australia	152

7.2	Total rates incidence by broad ACLG classes — Australia	154
7.3	Household rates incidence	156
7.4	Residential rates incidence and distribution in Australia	158
7.5	Business rates incidence and distribution in Australia	159
7.6	Impact of fees and charges in Australia	162
7.7	Impact of fees and charges by broad ACLG classes in Australia	164
8.1	Local government decision-making process	167
C.1	Scope for raising additional revenue	232
C.2	Scope for increased revenue raising	234
C.3	Estimates of the relative potential to increase own-source revenue, by aggregate income	245
E.1	Total effective property rates in Australia	256
E.2	Residential effective property rates in Australia	258
E.3	Effective business and rural property rates in Australia	259
F.1	Revenue of LGBs, by Indigenous status and source	266
G.1	Residential rates incidence — City of Charles Sturt	294
G.2	Residential rates per property and income — City of Charles Sturt	295

TABLES

1	Local government services	XX
2	Revenue raised by local governing bodies	XXII
3	Distribution of the estimated indices of relative potential to raise revenue, by class of local government	XXIX
4	Impact of hypothetical increases in revenue raised on aggregate cost recovery (from own-source revenue) and revenue-raising effort, by class of council	XXX
2.1	Selected characteristics of local governing bodies by jurisdiction	11
2.2	Local government functions and services	15
2.3	Grants to local government by function	25
2.4	National trends in real local government revenue	26
2.5	Revenue, GDP and personal income, all levels of government	28
2.6	Trends in own-source revenue	29
2.7	Local government revenue sources by State	30
2.8	Local government revenue, state output, and personal income	31
3.1	Revenue by councils	37

3.2	Own-source revenue by councils	39
3.3	Own-source revenue of councils by ACLG class	40
3.4	Rates revenue of councils by ACLG class	41
3.5	Sales of goods and services revenue of councils by ACLG class	42
3.6	Other revenue of councils by ACLG class	43
3.7	Grants revenue of councils by ACLG class	44
3.8	Expenditure by councils	45
3.9	Total expenditure of councils by ACLG class	47
3.10	Local government expenditure by function and ACLG class	48
5.1	Distribution of the average fiscal capacity of local governments	72
5.2	Distribution of average fiscal capacity, by class of local government	73
5.3	Distribution of revenue-raising effort	76
5.4	Regression results of the stochastic frontier analysis	82
5.5	Distribution of each local government's own-source revenue relative to its potential own-source revenue, by class of local government	87
5.6	Estimates of the average potential to increase in total revenue, by class of local government	88
5.7	Distribution of the ratio of cost recovery from own-source revenue, by class of local government	90
5.8	Effect of a hypothetical increase in own-source revenue raised on revenue-raising effort, by class of local government	91
5.9	Impact of a hypothetical increase in own-source revenue on cost recovery from own-source revenue, by class of local government	92
6.1	Property valuation methods permitted to be applied	99
6.2	Applications to exceed the NSW rate peg	115
7.1	Incidence of state and local taxes in the United States	146
7.2	Incidence of local property taxes in the US State of Minnesota	146
7.3	Incidence of council rates in the United Kingdom	147
7.4	Total rates incidence and rates per person — State comparison	155
7.5	Income elasticity of rates	157
7.6	Impact of fees and charges — State comparison	163
A.1	List of submissions	189
A.2	List of visits	191
A.3	Attendees at the roundtables	192
B.1	Local government rates and property charges	198
B.2	Rate exemptions	201

B.3	Rates (and other) concessions	203
B.4	Statutory setting of fees and charges	205
B.5	Local governing bodies by State, 2006	215
C.1	Summary of selected statistics of initial pooled data	221
C.2	The observations and local governments in the final data set	223
C.3	Distribution of the fiscal capacity of local governments	227
C.4	Distribution of the fiscal capacity, by class of local government	228
C.5	Summary of variables	239
C.6	Results of the stochastic frontier regression analysis	243
C.7	Distribution of the estimated indices of each local government's own-source revenue relative to its potential own-source revenue, by class of local government	246
C.8	Distribution of the ratio of cost recovery from own-source revenue	247
C.9	Effect of a hypothetical increase in own-source revenue on total revenue per person, by class of council	248
C.10	Effect of a hypothetical increase in own-source revenue on revenue-raising effort, by class of local government	249
C.11	Effect of a hypothetical increase in own-source revenue on cost recovery from own-source revenue, by class of local government	249
C.12	Estimates of the proportion of local governments that are grant dependent, by class of local government	250
C.13	Sensitivity tests: local government's own-source revenue relative to its potential own-source revenue	251
C.14	Sensitivity tests of the effect of a hypothetical increase in own-source revenue on cost recovery from own-source revenue, by class of local government	252
C.15	Sensitivity tests of the effect of a hypothetical increase in own-source revenue on the proportion of councils not recovering their costs, by class of local government	252
F.1	ILGBs by type and State, by legislative or administrative arrangement	262
F.2	LGBs by type and State, by Indigenous population	262
F.3	Characteristics of populations residing in LGBs	263
F.4	Number of LGBs by the proportion of Indigenous people	264
F.5	Total revenue, averages by revenue category	265
F.6	Grants to expenditure and own-source revenue to total revenue, by Indigenous status	267

F.7	Financial assistance grants, by Indigenous status	267
F.8	Indigenous owned or controlled land by State	268
F.9	Income and revenue-raising effort	274
F.10	Economic and demographic profiles of the case study LGBs	278
F.11	Revenue and expenditure profile of case study LGBs	279
F.12	Indicators of revenue-raising effort and fiscal capacity	280
G.1	City of Charles Sturt — Residential rates and personal income	296

Acknowledgments

The Commission would like to thank all those who assisted with this study. In particular, the Commission thanks the independent reference panel — Dr Peter Abelson (Managing Director of Applied Economics) and Associate Professor Joe Hirschberg (Department of Economics, University of Melbourne). Finally, the Commission is grateful to the Department of Infrastructure, Transport, Regional Development and Local Government and the Grants Commissions in each state and territory for providing detailed data on local governments.

Abbreviations and explanations

Abbreviations

ACLG	Australian Classification of Local Government
ALGA	Australian Local Government Association
ARTI	Aggregate Real Taxable Income
ATO	Australian Tax Office
BTRE	Bureau of Transport and Regional Economics
CGC	Commonwealth Grants Commission
COAG	Council of Australian Governments
DOTARS	Department of Transport and Regional Economics
FOI	Freedom of Information
GDP	Gross domestic product
HES	Household Expenditure Survey
IAC	Industries Assistance Commission
IC	Industry Commission
LGANT	Local Government Association of the Northern Territory
LGAQ	Local Government Association of Queensland
LGGC	Local Government Grants Commission
LGMA	Local Government Managers Association
LGSANSW	Local Government and Shires Association of New South Wales
MAV	Municipal Association of Victoria
OECD	Organisation for Economic Cooperation Development
PC	Productivity Commission
ROCs	Regional Organisations of Councils

SFA	Stochastic frontier analysis
WALGA	Western Australian Local Government Association