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# 1 About this study

## 1.1 What has the Commission been asked to do?

The origins of this study stem from the response of the Australian Government to a report in 2003 by the House of Representatives Standing Committee on Economics, Finance and Public Administration (SCEFPA), *Rates and Taxes: A Fair Share for Responsible Local Government* (commonly referred to as the Hawker Report). Recommendation 17 of that report was for the Council of Australian Governments to host a summit on inter-governmental relations. Two of the proposed purposes of the summit were:

To review the revenue raising capacity of councils with consideration of financial penalties for States and Territories which fail to adequately support or deliberately suppress that capacity.

To determine processes to develop a fully responsible financial role for local government free from policies that arbitrarily limit the revenue raising capacity from their normal sources. (SCEFPA 2003, p. 114)

The Australian Government's response was:

The Australian Government does not support the recommendation for a summit on inter-governmental relations at this time and believes that many of the issues identified in this recommendation will be considered by the Local Government and Planning Ministers' Council in the development of an inter-governmental agreement.

The Government does agree with the Committee on the importance of local government authorities having the capacity to raise revenue from their own sources and will ask the Productivity Commission to examine this issue. (Australian Government 2005, p. 15)

As a consequence, the Australian Government asked the Productivity Commission to conduct a study into the capacity of local governments to raise revenue and to examine the impacts of their revenue raising on the community. Specifically, the Commission has been asked to examine:

- the capacity of different types of councils (for example, 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,

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user charges and other revenue sources available to local government

- the impact of any State and Territory regulatory limits on the revenue-raising capacity of councils.

The full terms of reference for this study are reprinted at the beginning of this report.

## **1.2 How has the Commission approached its task?**

Local governments are the focus of this study. There are a range of bodies that undertake the functions generally ascribed to local governments. In the majority of cases, local governments are statutory bodies constituted under State and Territory Local Government Acts (table B.3). They are governed by councillors who are elected by eligible voters.

There are also a smaller number of other entities recognised as local governing bodies. Some local governing bodies (such as trusts and boards) are established under separate State and Territory legislation. Some are declared to be local governing bodies by the Australian Government Minister for Local Government under the *Local Government (Financial Assistance) Act 1995* (Cwlth) (LGFA 1995) (such as Indigenous community councils).

For the purpose of this study, the Commission has treated as local governments all of those bodies that receive funding under the LGFA 1995. In 2005-06, there were 663 local governments and 37 declared bodies (DOTARS 2007). Recent amalgamations in Queensland, and proposed amalgamations in the Northern Territory, will significantly reduce the number of councils during 2008.

### **Some issues relating to the scope of the study**

The terms of reference specify that the Commission is to ‘examine the capacity of local governments to raise revenue’. The Commission has interpreted this to mean an assessment limited to local governments’ *own-source revenue*. These are revenue sources which local governments have the power to collect on their own account. This interpretation was explicit in the Treasurer’s press release announcing the study.

The Commission considers own-source revenue to include revenue from property rates, sales of goods and services (such as user fees), interest income and other income (such as developer contributions and fines). It does not include ‘grants and subsidies’ from other spheres of government.

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The *revenue-raising capacity* of local governments is also assessed by State and Territory grants commissions. They are required to distribute Australian government general purpose grants in accordance with a set of principles outlined in the LGFA 1995. The approach of the State and Territory grants commissions to measuring capacity differs from that taken in this study, reflecting differences in their objectives and those of this study.

The terms of reference specify that ‘In undertaking the study the Commission is not to investigate the scope for local governments to borrow’. The Commission has interpreted this to mean that it should not report on, or imply borrowing targets or rules of thumb about borrowing targets for local governments. However, borrowing could be a factor affecting revenue raising across councils, in terms of the structure and the level of rates, and fees and charges, over time. This is particularly relevant to infrastructure services. Consequently, a broad consideration of borrowing is considered relevant to this study.

The regulatory limits imposed by State and Territory Governments on revenue raising by local governments, referred to in the terms of reference, are taken to mean the limits imposed through local government legislation, regulation and ministerial direction. It is not taken to mean Australian or State constitutional restrictions on the powers of local governing bodies to raise taxes more generally, such as through income taxes and goods and services taxes.

Finally, a number of participants to this study have urged the Commission to consider the need for other spheres of government to grant local governments access to a *growth tax*, such as a specified share of income tax or the goods and services tax revenue. The Commission considers this important policy issue to be outside the terms of reference for this study.

### **Some matters of terminology**

As described above, most local governments are established under State local government acts or other State legislation, in accordance with constitutional powers of the States. Although the Northern Territory does not have a constitutional act, a system of local government is provided for by the *Northern Territory Self-Government Act 1978* and the *Local Government Act 1993*. The Commonwealth Parliament also legislated self-government in the ACT, which is responsible for both Territory and local government functions.

Throughout this report, financial indicators for the ACT are omitted because it is not possible to separate data for its Territory functions from its local government functions. For the sake of brevity, the Commission uses the terms *States* and

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*jurisdictions* to refer to the six States and the Northern Territory.

The terms *local governments* and *councils* are used interchangeably throughout this report to refer to all local governing bodies, as defined previously.

Prior to the Commission commencing this study, separate financial sustainability reports were undertaken at the request of the State local government associations in New South Wales, Victoria, South Australia, Western Australia and Tasmania.<sup>1</sup> In addition, PricewaterhouseCoopers (2006) published a report, commissioned by the Australian Local Government Association. In this study, these reports are collectively referred to as the *financial sustainability reports*.

## **Opportunities for public participation**

The Commission encouraged broad public participation in this study. Soon after the terms of reference were received, advertisements were placed in national newspapers. The first circular was sent to over 400 individuals and organisations considered likely to have an interest in this study. Prior to releasing the issues paper, Commissioners and staff held informal discussions with relevant agencies in the Australian, State and Territory Governments. The Commission also had discussions with local government associations as well as with some industry associations. An issues paper was released in May 2007 to assist participants to prepare their initial submissions. Sixty five submissions were received in response to the issues paper.

Three roundtables were held prior to the release of the draft report. The first, held in Melbourne, provided a forum for the Commission to explore its approach to the study with academics and others with substantial experience and knowledge about local government. The second and third roundtables were held in Perth and Tamworth, respectively. These provided an opportunity for councillors, local government managers, business and ratepayer representatives to discuss the key issues relevant to the study.

Following the release of the draft report on 18 December 2007, further roundtable discussions were held in Melbourne on 27 and 28 February 2008. These roundtables provided local government associations from around Australia, and some individual councils and government departments, with an opportunity to provide feedback on the draft report. The Commission received 31 submissions in response to the draft

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<sup>1</sup> Access Economics has prepared reports for the local government associations of Western Australia (2006), South Australia (2005) and Tasmania (2007). In New South Wales, the local government, and shires, associations commissioned the *Independent Inquiry into the Financial Sustainability of NSW Local Government* (2006). The Municipal Association of Victoria produced the *Trends in Local Government Finance* report (Harvey-Beavis 2007).

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report.

Details of all individuals and organisations visited, roundtable attendees and submissions received are provided in appendix A. The Commission is grateful to those who participated in roundtables, hosted visits and discussions, and made submissions.

The Commission appointed two independent referees to review and report on the empirical analysis undertaken in this study. The referees were Professor Peter Abelson (Managing Director of Applied Economics) and Associate Professor Joe Hirschberg (Department of Economics, University of Melbourne). Their reports are presented in appendix H.

### **1.3 Guide to the report**

This report consists of eight chapters, including this introductory chapter. In chapter 2, an overview of local government is presented, with reference to the institutional arrangements, revenue-raising powers, roles and functions, and the sources of revenue available to local governments. The overview focuses on information at the national and state levels. However, there is a great deal of diversity among local governments. In chapter 3, the extent of diversity among local governments in relation to revenue raising and expenditure is explored.

A key task for this study is to assess the revenue-raising capacity of local governments. The framework applied to achieve this task is set out in chapter 4. An empirical assessment of the revenue-raising capacity of the various types of councils, the factors that explain the own-source revenue raised by local governments and the scope for councils to raise additional own-source revenue is presented in chapter 5.

Another key task for this study is to assess the impacts of any State regulatory limits on the revenue raising of councils. This assessment is set out in chapter 6. An assessment of the impacts of local government revenue raising measures on individuals, organisations and businesses is reported in chapter 7.

The key focus in the terms of reference is the capacity of local governments to raise revenue. However, under its general policy guidelines and operating principles, set out in the *Productivity Commission Act 1998*, the Commission is required to have an overarching concern for the community as a whole. In the current context, this requires taking a broader perspective than just focussing on the capacity of local governments to raise revenue. The assessment of revenue-raising capacity does not provide insight into how much revenue *should* be raised by local governments.

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Although the Commission has not sought to answer this question, it has set out a framework (chapter 8) that can guide local governments towards raising revenue in ways that maximises the net well-being of their communities, taking into account the benefits and costs of providing services.

The chapters are supplemented by a number of appendices. Appendix A lists the individuals and organisations that have participated in this study. Appendix B supplements chapters 2 and 6, providing additional details about the revenue-raising powers of local governments. Details about the data used and the modelling undertaken to assess the revenue-raising capacity of local governments are reported in appendix C. The Australian Classification of Local Governments' structure is outlined in appendix D. The impacts of local government rates are assessed using property values in appendix E. Three case studies of Indigenous councils are presented in appendix F. A short case study on the impacts of residential rates in the City of Charles Sturt is presented in appendix G. The referees' reports are presented in appendix H.