UNFINISHED BUSINESS?

A DECADE OF INQUIRIES INTO AUSTRALIAN LOCAL GOVERNMENT

Working Paper No. 4
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ACELG
Australian Centre of Excellence for Local Government

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Preface

One of the most important objectives of the Australian Centre of Excellence for Local Government (ACELG) is to support informed debate on key policy issues. We recognise that many local government organisations are not always able to undertake sufficient background research to underpin develop sound, evidence-based policy. Local government operates on so many fronts that it is often impossible to keep abreast of all the issues that affect councils and their communities.

ACELG's working paper series aims to help overcome this deficit. ACELG will never be able to provide off-the-shelf solutions to all the issues and problems that might face local government, but we will aim to clear away some of the misconceptions and myths which can arise without research evidence, and offer insights into the ways in which problems can be effectively addressed.

In that spirit, this paper looks at the findings, recommendations and outcomes of nine major national and state inquiries into local government over the period 2001-08. It explores three key questions. First, what have been the major themes and ideas to emerge? Second, to what extent have the principal findings and recommendations been implemented? Third, how much unfinished business remains to be transacted in order to place Australian local government on a sounder footing?

The paper notes that, over time, a significant number of the inquiry recommendations have been reflected in policy and legislative change. However, the patchy nature of responses to the inquiries, and evident differences of opinion between state and local governments on priorities for further reform, point to two underlying issues that slow the process of change:

- State governments tend not to respond to inquiry recommendations unless they initiate and control the agenda themselves.
- Despite commissioning several of the inquiries, local government itself has mostly failed to assemble and prosecute packages of reforms that are acceptable to councils generally, and that also appeal to other key stakeholders – especially state governments.

The federal government has also been somewhat slow to act in those more limited areas for which it has responsibility, notably repeated findings that the system of distributing general-purpose financial assistance grants to local councils ('FAGs') should be re-examined. However, a review has recently been announced, and together with a review of the inter-government agreement on 'cost-shifting' and the upcoming national Tax Forum, could lead to significant change.

We regularly seek input from local government practitioners and other stakeholders regarding the list of policy areas that should be researched, and welcome suggestions for future working papers. Please contact our Research Program Manager stefanie.pillora@acelg.org.au.

Graham Sansom
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1. Introduction and Summary

1.1 Scope of this Report

Australian local government accounts for around $24 billion in public expenditure and over $10 billion in taxation, employs in excess of 170,000 people across seven different state and territory systems, and provides an essential range of local services vital to national wellbeing (Commonwealth of Australia 2010). However, local government has received relatively little scholarly analysis. This is regrettable for various reasons, not least because local government faces numerous problems that urgently require attention.

At least three factors have combined to place contemporary Australian local government in a vulnerable position:

- Over several decades there has been steady expansion in the range of local government's functions that has outstripped growth in revenue. Local government revenues have grown more slowly than those of state and federal governments.
- Intensifying financial pressures mean that the status quo in terms of levels of income and patterns of expenditure cannot be sustained indefinitely. Various studies have shown that in many cases service provision has only been maintained at the cost of steadily deteriorating physical infrastructure.
- There is particular concern over the operational and financial viability of small (in population) municipalities, particularly those in rural and remote locations, but also some smaller urban councils.

Given these factors it is not surprising that the past decade has witnessed a host of national and state inquiries into the current status and future prospects of local government. These include:

Nine Major Inquiries

- Commonwealth Grants Commission *Review of the Operation of Local Government (Financial Assistance) Act 1995* (2001)
- House of Representatives Standing Committee on Economics, Finance and Public Administration ('Hawker' report) *Rates and Taxes: A Fair Share for Responsible Local Government* (2003)
- South Australian Financial Sustainability Review Board (2005)
- Independent Inquiry into the Financial Sustainability of NSW Local Government ('Allan' report, 2006)
- Western Australian Local Government Association *Systemic Sustainability Study* (2006)
- PriceWaterhouseCoopers *National Financial Sustainability Study of Local Government* (2006)
- Local Government Association of Tasmania *Review of the Financial Sustainability of Local Government in Tasmania* (2007)
- Queensland Local Government Reform Commission (2007)
- Productivity Commission *Assessing Local Government Revenue Raising Capacity* (2008).

It may be noted that the list above does not include the NSW Independent Pricing and Regulatory Tribunal's 2009 report Revenue Framework for Local Government, which followed a review of the state's arrangements for constraining increases in council rates and charges (headlined by 'rate-pegging'). This is because IPART's work was very tightly focused and its recommendations were confined to setting out an ongoing framework to regulate rate revenue.

Since the turn of the century there has been no major inquiry into the future of local government in Victoria. This is perhaps explained in part by the sweeping nature of reforms implemented in the 1990s. However, the Municipal Association of Victoria (MAV) has produced a valuable series of reports on Trends in Local Government Finance, the most recent in March 2010. Section 2.10 provides a brief overview of MAV's work.

The inquiry reports represent a wealth of research into contemporary Australian local government. This paper examines their findings, the common issues raised, patterns of policy recommendations, and recurring unresolved matters. It then attempts to draw some general conclusions on the implications for local government policy makers and practitioners alike. Given the immense volume of material presented in the reports, as well as the wide spectrum of matters canvassed by them, any integrative analysis of the contents of the documents must necessarily be selective, but we hope this paper correctly identifies the key elements.

The paper is divided into three parts. Following this Introduction and Summary, Section 2 provides an overview of each inquiry, identifying key themes, findings and recommendations. Section 3 then provides a comparative analysis in terms of how the reports bear on various types of reform in local government (financial, functional, jurisdictional, organisational/management and structural); and outlines some general conclusions in terms of implementation (or lack of it) and the continuing agenda of 'unfinished business'.

1.2 Principal Findings

A summary of the content and findings of the inquiries is presented in the table on page 36. Clearly, the first decade of the 21st century saw an overwhelming pre-occupation with local government's financial health, especially the precarious position of small rural and remote councils, but also broader weaknesses in asset and financial management.

The inquiries reveal a broad consensus around the major issues facing Australian local government and, to a lesser extent, actions needed to address those challenges. This consensus centred on the following policy prescriptions:

Key Policy Issues

- Local government's role and functions have expanded considerably over recent decades, and there is now a mismatch between expenditure demands and current levels of revenue, especially own-source revenues
- This mismatch manifests itself particularly in inadequate infrastructure maintenance and renewal
- More could be done by councils themselves to increase own source revenues and to improve financial governance and asset and financial management
- Local government's performance in long term strategic, asset, financial and workforce planning needs to improve considerably
- Many smaller councils struggle with lack of scale in their operations
- Greatly expanded regional cooperation and resource sharing may offer an alternative to amalgamations as a means of enabling councils to improve their efficiency and effectiveness
- Neither amalgamation nor resource sharing will ensure the sustainability of thinly populated and often geographically very large rural and remote councils: increased external support appears essential
- State governments should avoid cost-shifting on to local government, reduce compliance costs, and remove unwarranted restrictions on local government revenue-raising
- The federal government should review various aspects of the system of financial assistance grants, including the annual escalation factor
- State, and to a lesser extent federal, government relations with local government need to be enhanced through a variety of inter-government agreements.

The report of the Queensland Local Government Reform Commission was in some ways the 'odd man out'. In part this was because it began with terms of reference that sought a reduction in the number of councils. However, the Commission's analysis focused on the need for local government to do more in order to meet the varied challenges of state development. It thus sought more robust local governments with a capacity for innovation and creativity and to deal with sometimes unexpected change or shocks. Its recommendations for sweeping amalgamations flowed from that analysis.

With the exception of the Queensland inquiry, it is fair to say that follow-up has often been slow to occur and many specific recommendations have not been implemented. However, in general terms the inquiries can be linked to a considerable number of subsequent policy initiatives:

Responses to the Inquiries

- Increased federal funding for local roads in South Australia (since 2005)
- Concerted action in South Australia since 2005 to improve financial management and other aspects of local government practice, including promotion of shared services, led in many cases by the Local Government Association (which recently launched a new 'Local Excellence' program)
- Various initiatives by other local government associations to help improve council performance
- The 'Inter-Governmental Agreement establishing Principles Guiding Inter-Governmental Relations on Local Government Matters' (cost-shifting) signed in 2006, and subsequent subsidiary agreements in most states
- Federal funding for community infrastructure provided as part of the stimulus response to the Global Financial Crisis of 2008
- Amalgamations in Queensland (2008).
- A review of rate-pegging in NSW by the state's Independent Pricing and Regulatory Tribunal in 2009 (leading to modification of the process but not abolition of the system)
- Introduction in 2009 of the Integrated Planning and Reporting Framework in NSW to improve strategic, asset, financial and workforce planning; and similar planning frameworks in several other states
- Federal funding of programs to improve asset and financial management, and collection of consistent national data, through the Local Government Reform Fund (launched in 2009)

The patchy nature of responses to the inquiries, and evident differences of opinion between state and local governments on priorities for further reform, point to two underlying issues that slow the process of change:

- State governments tend not to respond to inquiry recommendations unless they initiate and control the agenda themselves – this would seem to indicate significant differences in perspective from, and failure in the 'conversation' with, local government organisations.

- Whilst there are several instances of local government collectively taking reform initiatives, notably in South Australia and Victoria, many councils appear reluctant to embrace necessary change unless and until it is sanctioned or enforced by states – suggesting a culture of compliance rather than innovation. There also seems to be a continuing widespread view within local government that its financial problems should be addressed through additional external – especially federal – funding, rather than a focus on opportunities to increase own-source revenues. Local government could do more to control its own destiny, and take the lead more often.

Against that background, the following agenda of 'unfinished business' demands further attention:

'Unfinished Business'

- **Ongoing concerted efforts to expand local government's own-source revenues** from rates, fees and charges. This would also be consistent with the findings of the 'Henry' tax review (Henry et al 2009).

- **A review of the system of federal financial assistance grants** (FAGs), including the annual escalation factor, which gives more weight to the differing fiscal capacities and revenue-raising efforts of councils, and which recognises that the quantum of assistance is unlikely to reach a level sufficient to achieve full equalisation.

- **Detailed examination of the special needs and problems faced by small (in population) rural-remote councils**, including their likely sustainability into the longer term and the appropriateness of current legislative concepts and frameworks.

- **Full implementation of recent moves towards improved long-term strategic, asset, financial and workforce planning**, including increased efforts to improve the quality and reliability of data, and expanded programs to improve the understanding and skills of both managers and elected members.

- **Related measures to improve the quality and consistency of financial governance**, applying principles such as those outlined by the Productivity Commission (2008) and some form of performance auditing against agreed key indicators.

- **Expanded and strengthened regional collaboration and resource sharing** (shared services), based on the establishment of robust and well resourced regional entities, amounting in some instances to fully-fledged 'regional councils'.

- **Further examination of the potential for council amalgamations in specific regions and circumstances** in order to enhance local government's capacity to address emerging challenges and to become more resilient in the face of profound and/or unexpected changes in its operating environment.

- **A new or revised inter-government agreement** to establish a clearer consensus on the evolving responsibilities of local government and the role it may reasonably be expected to play in the broader system of government.

2. Summary of Inquiries

This section summarises the scope, findings and recommendations of each inquiry. The inquiries are considered in chronological order.

2.1 Commonwealth Grants Commission 2001

The genesis of contemporary concern with Australian local government sustainability can be traced to the Commonwealth Grants Commission's (CGC 2001) *Review of the Operation of Local Government (Financial Assistance) Act 1995.* In June 2000, the CGC was requested to review the effectiveness of the Act, under which the Commonwealth provides general purpose Financial Assistance Grants (FAGs) through the states to local government. The CGC presented its final report on 30 June 2001.

The CGC was requested to review the FAGs arrangements and the appropriateness of the National Principles set out in the *Local Government (Financial Assistance) Act 1995.* In particular, it was tasked to examine (among other things):

- the effectiveness of the arrangements under the Act in relation to ensuring that the allocation of funds for local government purposes is made on a full horizontal equalisation basis
- the impact of the Act on the raising of revenue by local governing bodies and on the assistance provided by the States to local governing bodies (LGBs)
- the implications of any changes in the functions or responsibilities of LGBs.

However, the CGC was precluded from considering the adequacy of the quantum of federal funding, as well as the distribution of funds between the states (both then and now a simple per capita allocation with no consideration given to relative needs).

The CGC noted that the Act aims to provide financial assistance for local government to meet three underlying intentions:

- to provide all LGBs with at least a minimum level of assistance
- to provide funding to contribute to the costs faced by LGBs in maintaining their local roads
- to provide relatively greater financial assistance to those LGBs which are relatively more disadvantaged compared with other LGBs because they face greater costs in providing services or because their ability to raise revenue is more limited.

It found that in broad terms, the current arrangements have led to a distribution of funds in line with these intentions (CGC 2001: ix), and recommended continuation of the Commonwealth funding arrangements, albeit with some important modifications to terminology and methodology, and especially improvements in the transparency, monitoring and reporting of the way state local government grants commissions go about their task of dividing Commonwealth funds amongst LGBs.

Equally importantly, however, the CGC's review explored the changes that had occurred in local government responsibilities and patterns of revenue and expenditure over the preceding four decades, and discussed the implications for the sector's future financial health. Its analysis pointed to a significant expansion of local government functions and a marked change in the composition of services being provided, with increasing provision of services for people at the expense of traditional property-based services (roads and local physical infrastructure). The CGC observed that some of these changes are the result of the changing priorities of local government, whilst others are imposed on them by other spheres of government (ibid: xiv).

Based on submissions received, the CGC (ibid: 52-53) identified five main reasons for the increase in local government's responsibilities:

- *devolution* — where another sphere of government gives local government responsibility for new functions
- *'raising the bar'* — where another sphere of government, through legislative or other changes, increases the complexity of or standard at which a local government service must be provided, and hence increases its cost
- *cost shifting* — where local government agrees to provide a service on behalf of another sphere of government but funding is subsequently reduced or stopped, and local government is unable to withdraw because of community demand for the service; or where, for whatever reason, another sphere of government ceases to provide a service and local government steps in
- *increased community expectations* — where the community demands improvements in existing local government services
- *policy choice* — where individual LGBs choose to expand their service provision.

In terms of expenditure patterns, the CGC (ibid: 53) found several substantial shifts:

- a decline in the relative importance of road expenditure (although it remained the largest function, its level of importance had declined from about half of total expenditure in the 1960s to a little more than a quarter in the 1990s)
- an increase in the relative importance of Recreation and Culture, and Housing and Community Amenities (each approaching 20% of total by the 1990s)
- an expansion of Education, Health, Welfare and Public Safety services (from 4% of total expenditure in 1961–62 to about 12% in 1997–98).

On the revenue side, the CGC found that rates and state assistance had declined in relative importance, whilst the proportion of revenue derived from user charges had increased. It noted that LGBs capacity to raise revenue from user charges varies considerably (ibid: 50&53).

The CGC's report can fairly be described as a landmark in the analysis of the financial sustainability of Australian local government. It identified shifts in the pattern of revenue and expenditure that implied increasing fiscal problems. In particular, it highlighted the limited capacity of LGBs that were already heavily dependent on grants to undertake additional functions, noting that:

> Their low revenue capacity means that these LGBs might not raise sufficient revenue from the new source to enable them to provide the function. In the extreme, devolving functions can place at risk the financial viability of some LGBs (ibid: 55).

The CGC thus set the scene for further exploration of these issues, and its findings became a central point of reference for the subsequent House of Representatives inquiry into cost-shifting.

2.2 'Hawker' Committee 2003

In May 2002, the Commonwealth requested the House of Representatives Standing Committee on Economics, Finance and Public Administration (SCEFPA), chaired by David Hawker MP, to inquire into local government's financial capacity and 'cost-shifting' to local government by the states. This reflected mounting concerns across local government that in various ways both state and federal governments were forcing or urging councils to increase service delivery without providing necessary financial support.

The Committee was to examine among other things:

- local government's current roles, responsibilities and funding arrangements
- the scope for achieving a rationalisation of roles and responsibilities between the levels of government, better use of resources and better quality services to local communities
- the capacity of local government to meet existing obligations and to take on an enhanced role in developing opportunities at a regional level
- the findings of the Commonwealth Grants Commission Review of the *Local Government (Financial Assistance) Act 1995* of June 2001.

Importantly, the inquiry was required to be conducted on the basis that the outcomes would be budget neutral for the Commonwealth.

The Committee had to base its findings primarily on submissions since it had limited independent research capacity. Consequently, its report offered no definitive assessment of the magnitude and scope of cost-shifting, relying instead on estimates from interested parties. The Australian Local Government Association suggested a figure in the range $0.5-1.1bn per annum.

Although instituted to examine cost-shifting, the inquiry considered virtually the entire spectrum of local government activity. Its final report, *Rates and Taxes: A Fair Share for Responsible Local Government*, consisted of six substantive chapters dealing with the roles and responsibilities of local government; cost-shifting; local infrastructure; capacity building, including performance monitoring and structural reform; the system of federal Financial Assistance Grants (FAGs); and the need for a 'summit' on inter-government relations.

Key findings may be summarised as follows (Sansom 2004: 28-29):

- Local government's responsibilities have increased dramatically over recent decades, but revenues have lagged.
- Cost shifting is widespread and exacerbated by councils themselves taking on even more functions to satisfy community expectations.
- Overall, local government is in good shape financially, with historically low levels of debt, but many councils in rural and remote regions have very limited resources and are highly dependent on grants. Also, most councils are under-funding infrastructure maintenance and renewal.

- States have imposed unwarranted revenue limitations on councils through rate-capping or controls on fees and charges. Some also levy councils to help fund state services, such as fire brigades.
- Local government does not always receive its fair share of Commonwealth special purpose payments made to and through the states - or states offset federal grants by reducing their assistance to councils.
- Some state and federal government agencies and business enterprises do not pay council rates.
- Some councils are guilty of poor financial management: not increasing rates when they could and should; investment in non-essential infrastructure and assets that are very costly to maintain; not saying 'no' when functions could be left to the states or Commonwealth.
- Intergovernment relations are often poor. Roles and responsibilities are commonly unclear and the costs of duplication and coordination are excessive.

The report reiterated a number of issues raised by the Commonwealth Grants Commission (2001), including the increasing financial distress in Australian local government. It found not only increasing diversity across local government service provision, but also an ‘expansion of the roles beyond those traditionally delivered by the local sector’ (SCEFPA 2003: 9). This shift in service delivery had two main characteristics: (i) local authorities had assumed responsibility for many more social services and (ii) they had become more active in regulation, especially in ‘development and planning, public health and environmental management’.

The Committee (ibid: 7-8) observed that constitutional responsibility for local government fell to the states and territories which provided the legal framework for council operations. State and territory legislation imposed ‘few limitations on what services local government can provide’ and gave local government wide-ranging powers to carry out ‘almost all functions’. Thus, ‘to a significant extent, what individual councils do is a function of their own policy choices’. However, major differences in the responsibilities of local government existed between different state jurisdictions.

Chapter 5 assessed amalgamation and regional cooperation and resource sharing. The Committee (ibid: 84) identified two kinds of efficiencies gained by amalgamations:

- In general, large councils had a ‘more secure and adequate financial base, are better able to plan and contribute to economic development, are more effective community advocates, and interact more effectively with government and business’. In addition, ‘structural reform can deliver economies of scale and can enable councils to employ a wider range of professionals so they can offer a wider range and usually higher quality of services’.
- Amalgamations yielded savings as evidenced in the South Australian and Victorian amalgamation episodes, Western Australian projections that structural reform of small councils could produce ‘notional annual savings’ of a total of $74.4 million or 5.2 per cent of total municipal expenditure, and sizeable ‘savings projections’ from five NSW mergers.

However, the Committee (ibid: 86-87) also discussed why amalgamations may not work:

- Amalgamations may not be viable in the case of small remote councils or large (geographically) councils in sparsely settled areas – in such cases mentoring with a larger, more prosperous council or regional cooperation may be superior.

- Continued cost-shifting by state governments could diminish the efficiency enhancing effects of amalgamation.

Overall, the Committee concluded (ibid: 90) that 'in some circumstances amalgamations of local government bodies is the most direct way of achieving a more efficient and cost effective local government sector. If this is the case, further amalgamations should be considered.'

The Committee made 18 separate recommendations. These included (Sansom 2004: 29-30):

- The need for inter-government agreements on roles, responsibilities and associated funding measures; to tackle cost-shifting; and to address arbitrary State restrictions on local government revenue.
- Greater local government participation in formulating and implementing federal-state agreements that affect councils.
- Local government impact statements to identify additional financial pressures that may flow from Commonwealth and state legislation.
- Ensuring that Commonwealth funds intended to pass through the states to local government reach their target, and are not offset by states cost shifting or reducing their own expenditure.
- Payment of council rates by state and federal government agencies and businesses.
- All councils to audit their infrastructure, with data to be used as an input to calculation of future Financial Assistance Grants.
- A new methodology for the distribution of FAGs, including abolishing the minimum grant guarantee for better resourced councils.
- Investigation by the Commonwealth Grants Commission of the potential benefits of greater regional cooperation between councils and amalgamation of councils where appropriate.
- Continued federal-local partnerships in program delivery, including with regional organisations of councils that have demonstrated capacity in regional planning and service delivery.
- A national capacity building agency for local government along the lines of the UK Improvement and Development Agency, with a strong focus on financial management.
- A Council of Australian Governments (COAG) Summit on Inter-governmental Relations to review progress and promote further steps.

Although the Committee's report was bi-partisan, the Commonwealth government's response was at best lukewarm (Sansom 2005). The only tangible policy change flowing from the report was the 'Inter-Governmental Agreement establishing Principles Guiding Inter-Governmental Relations on Local Government Matters' signed by the Commonwealth, all states and territories, and the Australian Local Government Association in April 2006. This sought to:

- encourage the conduct of positive and productive relations between the three spheres of government in a spirit of respect with an emphasis on partnership and cooperation
- provide an overarching framework from which further agreements covering specific services and functions should be developed.

The evident intent from a local government perspective was to mitigate cost shifting by requiring greater consultation on changes in roles and responsibilities. The Agreement is shortly to be reviewed.

Another significant element of the Commonwealth's response was the later reference to the Productivity Commission to assess local government's revenue raising capacity (see below).

2.3 South Australian Financial Sustainability Review Board 2005

The South Australian Financial Sustainability Review Board (FSRB) inquiry into the long-term financial performance of South Australian local government was commissioned by the state's Local Government Association (LGA) and commenced in February 2005. The financial analysis was conducted for the Board by Access Economics, using accounting measures of performance. The FSRB produced a *Discussion Paper* in March 2005, followed by an *Interim Report* in May 2005. The approach adopted in South Australia became a model for similar inquiries in several other states.

The FSRB (2005a) investigation considered three main questions:

- Does council expenditure on service provision and local infrastructure meet current and future revenue flows?
- What is the optimal method of remedying any 'mismatch' between expenditure and revenue?
- Should grants from state and federal government be directed at reducing the financial mismatch?

In addition, the FSRB considered the problem of defining 'financial sustainability' to assess long-term solvency. It argued that no universal agreement existed on the meaning of financial sustainability in Australian local government, and proposed the following definition (ibid: 15):

> A council's long-term financial performance and position is sustainable where:
>
> (i) continuation of the council's present spending and funding policies;
> (ii) likely developments in the council's revenue-raising capacity and in the demand for and costs of its services and infrastructure; and
> (iii) normal financial risks and financial shocks altogether are unlikely to necessitate substantial increases in council rates (or, alternatively, disruptive service cuts).

On this basis the FSRB (ibid: Finding 6.4) found that 33 South Australian councils were either 'unsustainable' or 'vulnerable' under existing policy settings and at current service levels. This number included 30% of metropolitan councils and 40% of country councils, accounting for about 50% of the state's population.

The Board was particularly concerned that most councils had significant operating deficits once depreciation was taken into account. It suggested that operating deficits and their frequent co-existence with substantial infrastructure renewal/replacement backlogs reflected (ibid: 4):

- relatively low (and falling) levels of Commonwealth and State government funding
- cost pressures on councils as a result of the increasing cost of complying with escalating regulations and real or apparent cost shifting primarily by the State government
- a State-government freeze on council rates revenue in the late 1990s
- ratepayer pressure for rates increases below those necessary to fund increasing service levels

- past policies responsible for service levels and standards in excess of those which could be sustainably funded by councils themselves
- deficiencies evident in asset management practices and associated depreciation and asset valuation policies
- a widespread reluctance to borrow even when it is prudent to do so.

Importantly, the FSRB found that the financial management of South Australian councils was severely deficient. For instance, Finding 10.3(1) stated that ‘few councils appear to have developed or implemented a rigorous policy framework for funding their services and infrastructure, stating (for example) the role to be played by “user pays” and how any grants shortfalls are to be covered for services provided through grants funding’. In an analogous vein, in Finding 13.2(3) it noted that:

> poor financial governance ... invariably leads to inadequate control on growth in operating expenses, a neglect of essential capital spending, revenue-raising that is inflexible and inequitable, and a low level of understanding within the community of the real costs of current infrastructure and service commitments.

The FSRB therefore proposed a ‘financial governance and policy framework’ including possible amendments to the *Local Government Act*:

- to highlight the need for long-term financial sustainability and to oblige councils to target both an annual operating surplus and a net infrastructure renewal/replacement balance, to be achieved over their planning cycle and within a set time frame, say five years;
- to require councils to publish statements on the number and nature of services to be delivered and the methods for delivery, and how they will fund both operating expenses and capital expenditures, along the lines of the statements required in New Zealand.

The framework would also involve:

- councils considering further resource-sharing initiatives, especially involving the smaller councils, ranging from working together more effectively to more formalised regional groups, area integration and whole-of-sector initiatives
- incorporating into the LGA’s governance principles adherence to best-practice financial governance policies and procedures contained in the CPA Australia/LGMA’s *Excellence in Governance* manual
- the local government sector accepting that elected members require specific training in support of their financial governance responsibilities.

The FSRB also identified a need for significant improvements to intergovernmental relations to tackle problems such as inadequate federal and state funding support, unwarranted state restrictions on revenue raising from fees and charges (notably developer contributions), and excessive compliance costs (ibid: 4-5).

The FSRB made a number of comments relating to structural reform. It noted that ‘the size and density of councils ... seem to play little role in explaining the observed differences in the sustainability of the long-term financial performance and position of councils’ (FSRB 2005b: 49). The

FSRB also commented on claims made that the program of amalgamations which reduced the number of councils in South Australia from 118 to 68 in the mid 1990s would bring about recurrent savings of $19.4 m per annum and one-off savings of $3.9 m. It concluded (ibid: 85) that:

> Whether the on-going savings have in fact continued is a moot point. Fewer, larger councils are not the instant or easy fix that many would like to believe, especially in non-metropolitan areas dominated by the 'tyranny of distance' and other impediments.

The FSRB (ibid: 85) went on to advocate significant expansion in various forms of cooperative service delivery, including shared service models, strategic alliances and virtual local governments. It concluded that:

> It is important that councils become more heavily involved in real resource sharing. Collaboration between councils can and should be a major contributor to councils being financially sustainable in the future.

In total, the FSRB put forward 62 recommendations, a substantial number of which have since been implemented through cooperation between the LGA and the state government.

2.4 Independent Inquiry into NSW Local Government 2006

In October 2005 the NSW Local Government and Shires Associations (LGSA) announced an Independent Inquiry into the Financial Sustainability of NSW Local Government. Its final report (often known as the 'Allan' report after the Inquiry panel's chair) was released in May 2006. In contrast to the South Australian FSRB (2005), the Inquiry considered a broad range of questions relating to the role and governance of local government, and adopted a much less accounting-oriented approach. However, it did commission an Access Economics (2006a) report *Local Government Finances in NSW: An Assessment,* and stressed in its final report that financial sustainability lay 'at the heart of this Inquiry' (Independent Inquiry 2006: 267).

The Inquiry made 49 recommendations, many of which echoed those of the 'Hawker' report and South Australian Financial Sustainability Review Board. The LGSA subsequently established a 'Strengthening Local Government' task force to follow-up the recommendations, and adopted a number of new or amended policies as a result. There was no official response from the NSW government at the time, and none of the Inquiry's recommendations were formally adopted, but some of the ideas put forward in relation to strategic planning and financial management were reflected in the Integrated Planning and Reporting Framework implemented by amendments to the *Local Government Act* in 2009.

The aims of the NSW Inquiry were fourfold (ibid: 35):

- To assess the current financial position and performance of NSW local government
- To gauge the adequacy of NSW local government physical infrastructure and service delivery
- To assess the financial capacity of local government to meet its obligations and future challenges
- To identify possible financial, administrative, governance and intergovernmental reforms.

In line with the earlier Commonwealth Grants Commission and 'Hawker' reports, the Inquiry established that significant changes had occurred in the composition of NSW local government expenditure. It noted that changes in local government expenditure since 1995–96 had three outstanding features (ibid: 152):

- the fastest growing activities were housing and community amenities, public order and safety, and economic affairs
- transport and communications (largely road maintenance and depreciation, though not necessarily renewal) showed a marked increase in 1996–97, but then stabilised
- health and mining, manufacturing and construction fell relative to the CPI.

The Inquiry noted that the meaning that should be given to 'financial sustainability' is a controversial issue (ibid: 283). It adopted essentially the same definition as that used in South Australia:

> A council's finances should be considered sustainable in the long term only if its financial capacity is sufficient – for the foreseeable future – to allow the council to meet its expected financial requirements over time without having to introduce substantial or disruptive revenue (and expenditure) adjustments (ibid: 283).

It went on to suggest that, to ensure its long-term financial sustainability, a council should be able to provide answers to the following questions (ibid: 283-4):

- Does the council have the long-term ability to finance its statutory and accountability obligations to the community and to fund its future activities?
- Can the community be convinced to accept a lower level of service if the council's future financing requirements look set to outstrip its future financial capacity?
- Does the council currently have the financial capacity to sustain its infrastructure?

The Inquiry found that cost-shifting from state to local government was a significant issue, but that the LGSA needed to develop a better understanding of the magnitude of and trends in cost shifting if it is to seek any redress under the Intergovernmental Agreement (IGA) negotiated following the 'Hawker' report (ibid: 71). It recommended that the LGSA undertake an annual survey to build on the Inquiry's own work (ibid: 300). In response the LGSA has undertaken an annual cost shifting survey through a representative sample of the 152 general purpose councils in NSW.[1]

Seven recommendations had special significance in the context of financial reform and financial sustainability:

- Recommendation 5 proposed that councils restrain other activities until assets are restored to a satisfactory condition (an 'optimalist' role)
- Recommendation 6 argued that all councils should implement Total Asset Management
- Recommendation 7 suggested an additional $900m per annum be allocated to asset maintenance and renewal through a combination of increased federal and state grants ($200m), council expenditure savings ($200m),and higher rates, fees and charges ($500m)

[1] Information on the survey can be accessed at: http://www.lgsa-plus.net.au/www/html/2071-cost-shifting-survey.asp

- Recommendation 8 proposed progressive introduction of annual cash funding of depreciation
- Recommendation 9 called for the state government to fund regional roads in small (in population terms) rural shires
- Recommendation 21 advised that the NSW system of rate-capping (under which councils have to make a special application to increase rates above a set level) be abolished, as well as limitations on some fees and charges, in return for councils adopting longer term strategic and financial planning with outcome targets.
- Recommendation 27 proposed that the Commonwealth set its financial assistance grants (FAGs) to local government at a fixed proportion of GDP, preferably 0.22%.

The Inquiry put forward a number of recommendations to improve financial management. After consideration of the 'practical realities' of financial reporting by NSW councils, the Inquiry (ibid: 271–2) concluded that each council's financial reports should be accompanied by disclosure of relevant key financial performance indicators, and must provide information on the following financial dimensions of a council's operations:

- A council's financial position, which involves the state of its balance sheet, and so the relative level and composition of its assets and liabilities.
- A council's annual financial performance, which involves the state of its annual operating statement, and especially the size of relevant annual surpluses or deficits.

Financial KPIs should bear 'a strong predictive relationship with the degree to which a council's finances are likely to be sustainable in the long term, being based upon generally-accepted key analytical balances' (ibid: 272). The Inquiry (ibid: 273) prescribed benchmark values based on the average NSW council, with upper and lower 'safe' limits, with the caveat that these values should be adjusted on account of each council's individual circumstances, for example whether it is developed or developing, growing or declining.

The Inquiry sought longer term reform through an Intergovernmental Agreement between the NSW government and the LGSA to determine the respective roles, responsibilities and financial commitments of each level of government, and the limits of state intervention in local government (Recommendation 2). It also called for a 'summit' to consider its recommendations (Recommendation 48) and possibly the establishment of an 'Independent Commission' made up equally of representation from the LGSA and the state to assess the gravity of the problems facing NSW local government (Recommendation 49).

The Inquiry also considered the administration and management of local councils in detail. It benchmarked the administrative performance of nine volunteer councils (three metropolitan, three regional and three rural) against other councils, public institutions and private enterprises world-wide. This demonstrated that whereas these councils were not in the 'elite best practice' league, they were nonetheless very close to it except in 'client focus' (ibid: 21). The Inquiry argued that the results showed that local government was capable of performing as well as or better than other public and private organisations.

In addition, the Inquiry found that back-office overheads in 58 NSW councils on average represented only 10% of total operating expenses, where 'best practice' was around 10-16% for entities of the same size, suggesting that councils had 'a lean corporate support structure' (ibid: 21). However, the Inquiry established that use of asset management plans and risk management plans was inadequate. Moreover, while mandatory management (corporate) plans were taken seriously, the three-year planning and one-year budgeting horizons used were 'too short for meaningful medium to long-term decision-making' (ibid: 21). As well, the Inquiry found that all NSW councils had experienced a shortage of professional skills, especially in planning, engineering and accounting (ibid: 22).

While the Inquiry thus found that management was basically sound, it nevertheless considered methods of improving the administration and management of local councils. Recommendation 32 sought to enhance governance structures and urged the NSW government to amend the local government act to provide for a choice of governance structures, including a 'Corporate Board' structure and a 'Parliamentary/Executive' structure. Recommendation 34 dealt with long-term planning and proposed that all councils develop and adopt a long-term strategic and financial plan in close consultation with their communities that would be subject to annual external compliance audits. This recommendation has been reflected in the new Integrated Planning and Reporting Framework, but without an audit requirement.

The Inquiry also considered the question of council size and efficiency, including the potential benefits of council mergers. It found (ibid: 21-22) that the evidence was inconclusive, except perhaps for the smallest councils, and even in these cases other factors better explained higher costs per resident, especially low population density in remote areas. An alternative approach would be cooperative service provision for those services with scale economies through service sharing, joint processing and external outsourcing, notably financial transaction processing, IT and procurement.

2.5 Western Australian Systemic Sustainability Study 2006

In late 2005 the Western Australian Local Government Association (WALGA) appointed a Systemic Sustainability Study (SSS) panel chaired by Professor Greg Craven, then of Curtin University, to research and investigate the sustainability of local government. In turn, the panel commissioned a report by Access Economics into *Local Government Finances in Western Australia*, completed in June 2006. Based on this analysis and extensive consultation with local government representatives from throughout WA, the panel framed 41 recommendations for further action. Its report *In Your Hands* was released in December 2006 (Craven et al 2006). WALGA subsequently established a taskforce and five working parties to carry forward the SSS panel recommendations, leading ultimately to a final paper *The Journey: Sustainability into the Future* published by WALGA in 2008.

While the SSS panel report considered the entire gamut of local government activity and governance in Western Australia, most attention focused on financial reform and financial sustainability. Its assessment of financial sustainability derived largely from the Access Economics (2006b) study. Access Economics (ibid: 55) again applied its familiar definition that: a 'council's finances are sustainable in the long term only if its financial capacity is sufficient – for the foreseeable future – to allow a council to meet its expected financial requirements over time without having to introduce substantial or disruptive revenue (and expenditure) adjustments'. This was interpreted to mean that a council is sustainable if its operating deficit is less than 10% of own-source revenue.

On that basis, Access Economics (ibid: 60-61) found that 83 (out of 142) Western Australian councils (or 58%), serving around 21% of the population, were financially unsustainable in the longer term. It compared this with its earlier calculations for South Australia and NSW: 'In NSW, 25% of that state's councils were assessed as financially unsustainable, with such councils serving 17% of the state's population' whereas in South Australia '50% of that state's councils were assessed as financially unsustainable, with such councils serving 50% of the state's population'. Access Economics went on to note (ibid: 61):

> In WA, to an extent not evident in either NSW or SA, financial unsustainability is a problem particularly prevalent among smaller and/or declining population regional councils. It is hard to deny that this is evidence of a structural problem within local government in WA.
>
> However, interestingly, 31% of the largest councils and 45% of the above-average growth councils are also assessed as financially unsustainable. This suggests to us that more factors are at work in explaining the sustainability of a council's long-term finances than just whether it is small in size or has stagnant growth characteristics.

Access Economics (ibid: 62) also pointed out that:

> Being classified as unsustainable does not mean a council is in imminent danger of defaulting on its debt service obligations. The financial viability of such councils is not necessarily being called into question. Rather, what is being flagged is that substantial and disruptive revenue (or expenditure) adjustments appear inevitable if the long term finances of such a council are to be put onto a sustainable basis going forward.

As in the case of the Independent Inquiry in NSW, the recommendations of the SSS report covered a very broad range of local government issues, albeit with a focus on financial sustainability. Some of the key needs identified were:

- A change in the annual escalation methodology for federal financial assistance grants (Recommendation 4)
- Best practice guides for rating (Recommendations 9 and 20) and debt financing of infrastructure (Recommendation 11)
- Greater use of developer charges (Recommendation 14)
- An improved funding model for roads (Recommendation 16)
- Consistent treatment for revenue forgone from state concessional policies (Recommendation 19)
- Improved financial reporting (Recommendation 22)
- A wide range of measures to improve asset management (Recommendations 23-29 and 31-33), including preparation of comprehensive 10 year asset management plans integrated within business and financial plans (Recommendation 26)
- A local government sector skills strategy (Recommendation 34).

Interestingly, the SSS panel foreshadowed the subsequent Productivity Commission (2008) finding that some councils could do more to increase revenues from rates. It noted that (Craven et al 2006:35):

> The methodology applied by Access Economics to estimate extra rating revenue found that WA Councils could more than halve their operating deficit ratios if those among them with below-par rating and cost-recovery efforts lifted their effort to match that of peer group Councils. This would result in around an 11% increase in these Councils' own-source operating revenue. During dialogues a number of representatives commented on the political nature of the rating decision and that "hard" decisions are occasionally deferred to avoid the Council electoral cycle. The paradox is that some Councils cite a "zero rate increase" as a highly positive achievement, notwithstanding the presence within their authority of an unfunded infrastructure backlog.

The SSS panel supported greatly expanded resource sharing and regional collaboration as the best means to improve the efficiency and effectiveness of local government. It argued that a 'state/territory' model involving strong regional councils, or an 'industry-owned service provider', which delivered selected services on a regional basis for member councils, were the most promising options (ibid: 67-68). The panel did not favour forced amalgamations of councils, noting that 'there was little prospect that forced amalgamations would achieve any lasting community benefit' and that 'there is a growing literature and operating experience to this effect elsewhere in Australia' (ibid: 70).

The subsequent WALGA paper *The Journey: Sustainability into the Future,* published in 2008 after further extensive consultation, largely adopted the concepts set out by the panel. It highlighted the need for local government to initiate a voluntary reform program focused on regional cooperation, enhanced efficiency and effectiveness, and improved asset and financial management. WALGA also emphasized the case for increased external – especially federal – funding.

Programs to strengthen strategic planning and asset and financial management have since been put into effect. However, the state government has also identified a need for widespread voluntary mergers of councils and/or enhanced regional collaboration. In 2009 it launched a reform process across the state encompassing those two elements.[2] More recently, it announced:

> … the appointment of a high level independent panel to examine the social, economic and environmental challenges facing Perth. The panel will be responsible for recommending appropriate boundaries and governance models for local governments in the Perth metropolitan area.[3]

2.6 National Financial Sustainability Study 2006

In 2006 the Australian Local Government Association (ALGA) contracted PriceWaterhouseCoopers (PWC) to prepare an analysis of Australian local government that assessed the viability of the sector, identified key financial issues and developed recommendations for improved financial sustainability. The PWC report was completed in November 2006. It built on earlier inquiries and developed its own sample of councils for analysis.

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[2] See http://www.dlg.wa.gov.au/Content/LG/LGReform/About.aspx

[3] See http://www.mediastatements.wa.gov.au/Pages/WACabinetMinistersSearch.aspx?ItemId=141710&minister=Castrilli&admin=Barnett

The PWC report (ibid: 6–7) took a national perspective on financial reform. It stressed the difficulties involved in assessing the 'financial viability' of local councils across Australia, with three main problems preventing a common sustainability index:

- Mixed approaches to measuring and recording financial data and inconsistencies between states.
- Infrequent asset valuations and differences in assumed asset lives.
- Incomplete financial and asset management records, especially in smaller councils.

These difficulties forced PWC to adopt two techniques to assess financial sustainability:

- Financial ratio analysis was applied to a sample of 100 local councils weighted by state and stratified in proportion to the categories set out in the Australian Classification of Local Governments.
- Extrapolations from the Access Economics studies undertaken in South Australia, New South Wales and Western Australia, and the Municipal Association of Victoria's (2005) 'viability index' (based on cumulative capital renewal expenditure and long-term debt).

Echoing Access Economics, PWC (ibid: 96) concluded that the 'financial sustainability of a council is determined by its ability to manage expected financial requirements and financial risks and shocks over the long term without the use of disruptive revenue or expenditure measures'. This involves two elements:

- Councils should maintain 'healthy finances', given current expenditure and revenue policies and foreseeable future developments.
- Councils must ensure infrastructure expenditure 'matches' asset planning.

Common characteristics of councils facing financial sustainability constraints included (ibid: 13):

- minimal (or negative) revenue growth
- cost growth which has typically exceeded revenue growth. Expenditures have been rising by an average of CPI +2-3% per annum … The divergence between cost and revenue growth can lead to operating deficits which in turn are often partly funded by deferring some infrastructure renewals expenditure
- increasing involvement in non-core service provision due to escalating community demands, coupled with a related tendency by some councils to 'step-in' to provide a non-traditional service
- a tendency by some councils to run operating deficits creating a need to defer or underspend on renewal of infrastructure, particularly community infrastructure which is often repeated annually creating a backlog
- limited access for some councils to strong financial and asset management skills which are critical to identifying sustainability problems, optimising renewals expenditure and improving revenue streams, and
- a small proportion of councils also have limited access to rate revenue due to relatively small annual rate increases and a low initial rating base.

PWC drew four key findings from its various analyses (ibid: 12-13):

- 10-30% of councils have 'sustainability issues'.
- Large metropolitan councils were generally viable, or 'have the ability to self-effect an improvement in financial sustainability', but some are over-stretched owing to service expansion.
- Urban fringe councils demonstrate mixed sustainability, but only some require additional external funding.
- Rural-remote and rural-agricultural councils exhibited pronounced sustainability problems; they had scope for 'internal reforms' but often 'battle against lack of scale' and most require extra external funding for the renewal of existing community infrastructure.

The report went on to conclude that (ibid: 13):

> While significant progress has been made by local government to increase their [sic] financial management effectiveness and understand the need for robust asset management plans (AMP), this analysis suggests internal reforms alone will not resolve sustainability issues for a large part of the local government sector. Hence, such councils may need to either reduce existing services/assets, or to seek additional revenue. As council own-revenue options are limited, this lends significant merit to consider reforms to intergovernmental transfers.

From its extrapolation of the KPIs used in the Access Economics and MAV studies, PWC (ibid: 113) found that:

- 25-40% of all Australian councils could be unsustainable
- NSW appears to have relatively larger sustainability issues in dollar terms
- The average annual per council underspend on existing infrastructure renewals lies between $1.3m and $1.7m (ie a national total of around $1 bn)
- In order to remedy the annual infrastructure shortfall plus the accumulated infrastructure backlog, the average council would need to spend an additional $2.6–3.3 million per year on asset management.

PWC re-examined functional shifts in local government service delivery, as well as the issue of cost-shifting, using similar terminology to that adopted by the Commonwealth Grants Commission (2001) and the 'Hawker' report (House of Representatives Standing Committee 2003). It concluded that (ibid: 72):

> The intergovernmental agreement on cost shifting should make significant progress in avoiding devolution and cost shifting of services to local government without adequate support. However, local government also needs to ensure that it only agrees to take on service delivery where clear funding streams are identified, and where the services fit with the priorities of the community. Overall, other spheres of government must recognise their responsibility to fund local government when they are required to take on roles that belong to the Commonwealth or states, and local government must exercise strong caution prior to stepping in to deliver such a role.

With respect to structural reform, PWC noted that (ibid: 75-76):

> Structural reforms have been adopted by councils in order to provide more cost-effective local services … many of the most unsustainable local governments have already been merged, although further voluntary amalgamations may achieve further efficiency improvements. Self motivated review processes such as the SSS Review being undertaken in Queensland, can provide the appropriate forum for voluntary structural reforms to emerge pending appropriate investigation and analysis …
>
> However, simply merging a number of adjoining unviable councils is unlikely to increase financial sustainability and it may decrease effectiveness and result in greater disputes between councillors based on parochial interests ...Hence, any amalgamation must be accompanied by other reforms to increase efficiency and effectiveness.

The report went on to argue (ibid: 149) that whilst there is a need for councils to obtain adequate scale in their operations to reduce unit costs:

> This does not suggest a need for forced amalgamations. Better scale can be obtained through a variety of approaches (see Section 2.5) such as shared corporate services, regionally provided operational services, councils outsourcing etc.

In summary, PWC recommended (ibid: 152-154) a ‘twin track’ approach for improving financial sustainability including internal reforms by some councils to improve their efficiency and effectiveness, plus changes to inter-government funding primarily to assist particular types of councils with sustainability challenges. Specific recommendations encompassed:

- Further realising gains from greater economies of scale and reducing unit costs via approaches such as regional or shared service provision, outsourcing, use of state-wide purchasing agreements etc
- Working with state governments to remove or relax legislative impediments and improve the capacity of local government to raise revenue from its own sources
- Establishing robust long-term service plans which define what councils will provide and how services will be undertaken, including securing long-term funding (not just capital grants) prior to developing new services and infrastructure
- Working with other spheres of government to facilitate improved asset management and financial skills in order to lift the skills in all councils to a reasonable base level, including use of total asset management plans and systems
- Developing nationally consistent local government financial and asset management data
- Establishing a new federally financed Local Community Infrastructure Renewals Fund (LCIRF) to support councils in the more timely funding of renewals work across a range of community infrastructure assets – set at around $200-250 million per annum
- Revising the escalation methodology for FAGs from a mix of population growth and CPI to a new formula tailored more to local government cost movements
- Making funding for the Roads to Recovery Program permanent
- State governments to provide funding support to encourage efficiency and asset management reforms.

While ALGA endorsed the report's findings, there was no official response at the time to those recommendations from either the Commonwealth or any state government. However, a number of the recommendations were later reflected in the objectives of the federal government's Local Government Reform Fund, announced in 2009. Those objectives focused especially on the need for improved asset and financial management, as well as more consistent national data. In addition, the Roads to Recovery program has been extended and the federal government provided very substantial funding for community infrastructure projects as part of its stimulus expenditure response to the 2008 Global Financial Crisis.

2.7 Local Government Association of Tasmania 2007

Like its counterparts in South Australia, NSW and Western Australia, the Local Government Association of Tasmania (LGAT) commissioned Access Economics to examine the financial sustainability of Tasmanian local government, including an assessment of its present financial condition, the outlook over the next 10-years, options to increase own-source revenues, policy adjustments required, and potential improvements in financial governance. The final report was completed in March 2007. Access Economics followed a similar methodology to that previously used in other states.

In its Tasmanian report, Access Economics contrasted 'financial sustainability' with 'financial viability'. It defined financial sustainability as 'the extent to which a council's financial capacity is sufficient – for the foreseeable future – to allow the council to fund the spending that is necessary to meet both its existing statutory obligations and any associated spending pressures and financial shocks without having to introduce substantial or disruptive revenue (and expenditure) adjustments' (Access Economics 2007: vii). Again, this echoed definitions used in previous inquiries. 'Financial viability' was not formally defined in the report, but referred to a council's ability to continue trading – to pay its bills and repay debt (ibid: 24).

The report set out six financial KPIs and associated benchmark values and applied these to Tasmanian councils. The results demonstrated that six councils (about 20%), serving 8% of the population, could be classified as 'unsustainable'. This implied that these councils faced substantial or disruptive revenue (or expenditure) adjustments to correct imbalances in long-term finance, including the need to provide adequate funding for asset management. The Tasmanian figure of 20% of councils being unsustainable can be compared with previous estimates of around 50% in South Australia, 25% in NSW and 58% in Western Australia.

In Tasmania, an additional five councils (some 17%), serving 14% of the population, were classified as 'vulnerable'.

The report found that, on average, the current financial governance policies and processes of Tasmanian councils just meet minimum acceptable standards, but that shortcomings were evident from the operating deficits and infrastructure renewals gaps documented in the report (ibid: 57). It indicated that particular areas for improvement included establishing internal structures, such as an audit committee, that provide for independent review of processes and decision-making to assist councillors meet their accountability to ratepayers and the community; longer term financial planning; and improved financial reporting (ibid: 57-58).

To address financial concerns, Access Economics canvassed three options (ibid: iv-v):

- expenditure restraint (amounting to a real terms reduction in operating expenses of about 1% pa for 10 years) through a combination of more modest and targeted infrastructure expansion, operational efficiencies and re-ordering of service priorities
- own-source revenue growth with increases in real terms of 1.1% pa for rates, 1.7% pa for fees and charges, and 6.2% pa for developer levies (all to be maintained for 10 years and in each case far above currently projected increases – indeed developer levies had been projected to decline)
- increased borrowings funded by increased revenues.

Mention was made of the possibility that the need for increased own-source revenue might be reduced by additional state or federal assistance, but the report specifically eschewed increased external support as the sole solution on the revenue side, and noted that increasingly state and federal governments expect to see sound financial management practices on the part of program partners (ibid: 57&65).

The report advanced a substantial number of recommendations to improve financial and asset management and address revenue shortfalls. Central to these was a recommendation that councils prepare 'a rolling 10-year financial plan' aimed at meeting local infrastructure needs, generating additional revenue, better planning of services and ensuring that the outcome complies with sustainable financial targets. Access Economics endorsed LGAT's move to establish a Tasmanian Asset Management Improvement program (ibid: 64).

The report again advocated increased cooperation and resource sharing amongst councils as part of the solution to financial difficulties, but did not place strong emphasis on this (ibid: 65-66). It observed as a starting point that forced amalgamations offered limited prospects of achieving lasting community benefit and that the main benefits of amalgamation can usually be achieved by other means (ibid: 65). It also noted the two models set out in Craven et al (2006): two-tier local and regional government, or achieving regional efficiencies through a robust, sector-owned service provider.

2.8 Queensland Local Government Reform Commission 2007

The Queensland Local Government Reform Commission's (LGRF) report of July 2007 was the centrepiece of a process that began with the *Size, Shape and Sustainability* (SSS) program launched by the Local Government Association of Queensland in early 2005, and concluded with the final report of the Queensland Treasury Corporation (QTC) on *Financial Sustainability in Queensland Local Government* published in October 2008 (but based on research conducted in 2006-07).

In 2004, the Local Government Association of Queensland (LGAQ) had considered the long-run viability of councils. A discussion paper *Size, Shape and Sustainability of Queensland Local Government* was released in March 2005 and a *Guidelines Kit* for council reviews in 2006 (LGAQ 2006). The discussion paper had identified a number of key challenges facing Queensland local government and foreshadowed the need for significant structural reforms – but <u>not</u> forced amalgamations. It suggested that councils should explore alternative models for change including (LGAQ 2005:5):

- **Resource sharing through service agreements**, where Councils as a group agree to allocate functions between themselves with an individual Council undertaking a function on behalf of the group.
- **Resource sharing through joint enterprise**, where Councils form a joint business unit to achieve economies of scale across a functional area of core business.
- **Merger/amalgamation**, where Councils join together voluntarily.
- **Significant Boundary Change** which may also include joint arrangements.

The subsequent Guidelines Kit (LGAQ 2006) proposed that councils assess their current and future sustainability against a number of key indicators, covering the financial and resource base, community of interest, planning, and standards of governance.

The Queensland government initially supported the *SSS* program and joined with LGAQ in requesting the QTC to assess the financial sustainability of the participating councils. The QTC conducted assessments of councils between March 2006 and July 2007. This involved defining financial sustainability, selecting suitable financial indicators, and developing an assessment methodology and a rating scale. Its definition of financial sustainability drew heavily on the FRSB (2005): a council is sustainable if it is able to manage likely developments and unexpected financial shocks in future periods without having at some time to introduce economically significant or socially destabilising revenue or expenditure adjustments (QTC 2008: 16).

In its assessment, the QTC considered past financial performance and long-term (10-year) financial forecasts, several quantitative and qualitative indicators, discussions with senior council officers, as well as macroeconomic considerations. Using this methodology, the QTC ranked councils on six level scale: ‘Very strong’, ‘strong’, ‘moderate’, ‘weak’, ‘very weak’ and ‘distressed’, depending on the capacity of councils to meet financial commitments in the short, medium and long-term, and manage unforeseen financial shocks without the need for significant revenue or expenditure adjustments. Of 105 councils 38.5% were rated ‘weak’, ‘very weak’ or ‘distressed’.

The QTC made 17 formal recommendations. Perhaps the most important was that councils should target a balanced or surplus operating result, and if this is not feasible, then operating deficits should be no greater than 4.0% of annual operating revenue. Secondly, increases to net rates, utilities and charges should be a function of service provision costs rather than the Consumer Price Index. Thirdly, asset management plans should be prepared and linked to a long-term financial forecasting model.

However, before the LGAQ and QTC completed their processes the Queensland government decided to abandon the SSS program in favour of forced amalgamation. The Local Government Reform Commission (LGRC) was appointed in early 2007 to review all councils except the City of Brisbane and to make recommendations on (inter alia):

- how many local government areas there should be
- what the external boundaries of each of the local government areas should be, including the local government areas for which no external boundary change is recommended (LGRC 2007: 33).

In doing so, the Commission's charter was to ensure strong, effective and financially-viable councils capable of:

- facilitating optimum service delivery to Queensland communities
- effectively contributing to and participating in Queensland's regional economies
- better managing economic, environmental and social planning consistent with regional communities of interest
- effectively partnering with other levels of government to ensure sustainable and viable communities (ibid: 32).

The rationale for this decision was explained in the publication, *Local Government Reform* (Department of Local Government, Planning, Sport and Recreation 2007) and rested on a claim that under the SSS program local councils had not proceeded with sufficient haste. The Department put forward four main objectives (ibid: 11):

(a) the need to address medium to long-term sustainability in local government
(b) the need for greater collaboration in infrastructure and regional planning
(c) the need for local councils to avoid an internally focused parochial mindset and instead consider the bigger picture
(d) the need to reduce the inconsistency of performance and service delivery across the local government sector.

The Department also pointed to administrative and technical staff shortages and the impact of this on local government capacity, particularly that of small councils. It contended that 'large councils with greater financial resources would be significantly better placed to establish robust regionally-based employment frameworks' (ibid: 39).

The Reform Commission reported in July 2007. It recommended that the number of local councils be reduced from 157 to 73 (including the City of Brisbane), but left unchanged the boundaries of most indigenous local governments as well as the sparsely populated rural-remote councils in the western part of Queensland. The state government accepted the Commission's recommendations, which were implemented at the scheduled local government elections in March 2008.

Interestingly, and to some extent in contrast with reviews in other states, the Commission argued that local government reform was about much more than financial viability (LGRC 2007: 12). It focused on the increasing and diverse challenges facing councils across the state including:

- Sustaining the social fabric and viability of remote communities
- Rural economies in transition
- The explosion of economic activity generated from resource based projects
- Managing the associated growth in regional cities
- Managing growth in coastal regions stimulated by tourism and the sea-change and tree-change phenomena
- Managing growth in South East Queensland which is forecast to remain one of the fastest growing regions in Australia over the next 20 to 30 years.
- Coping with the unpredictable and potentially costly impacts of climate change

- Responding to community expectations for sustainable and environmentally responsible development, whilst dealing with the costs of meeting ever increasing demands for essential infrastructure and services (ibid: 4-5).

The Commission then asserted that:

> The challenges confronting Queensland in the coming decades require governments of all levels to be high capacity organisations with the requisite knowledge, creativity and innovation to enable them to manage complex change … Local governments which are small in size and under-resourced will struggle to develop and retain the skills and experience needed to discharge the financial management, reporting, risk profiling and other accountabilities associated with the governance of contemporary public sector institutions. Similarly, councils struggling to maintain their financial sustainability are less likely to be able to attract and retain in-demand professional and technical expertise (engineers, planners and environmental scientists) that enable local governments to manage their affairs with self-assurance and confidence (ibid: 5).

The Commission rejected the notion of a 'one size fits all' response to its terms of reference. It undertook a region-by-region analysis and acknowledged that:

> In circumstances where amalgamation of councils is not feasible due to the vast areas already covered by some local governments, or the particular requirements relating to the government of indigenous communities, there will remain a need to provide these councils with adequate support in the interests of equity for all Queenslanders (ibid: 5-6).

On this basis, the Commission did not propose any amalgamations of the large (geographically) councils in western Queensland due to the inability of structural reform to lead to any significant service delivery or capacity benefits. In terms of financial sustainability the Commission recommended that regular public reviews be undertaken by Queensland Treasury Corporation having regard to the assessed rating of the local government, namely:

- financially distressed, very weak, and weak local governments should be reviewed annually
- moderate local governments every two years
- strong and very strong local governments every three years (ibid: 30).

The Commission considered the option of legislative provisions for the establishment within large local government areas of 'community boards' similar to those in New Zealand, but recommended instead that this be left to the discretion of individual councils. However, it also recommended that all councils should consider the desirability of internal electoral divisions (wards) – but that mayors should be elected at large.

2.9 Productivity Commission 2008

In April 2007, the Commonwealth requested the Productivity Commission (PC) 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
- the impact of any State regulatory limits on the revenue raising capacity of councils.

This reference to the Commission was in fact a long-delayed promised response to the 2003 'Hawker' inquiry (PC 2008: 1). The Commission reported in April 2008. It summarized its key findings as follows (ibid: xviii):

- The ratio of local government own-source revenue to GDP is about 2 per cent; the ratio of rates revenue (the only tax instrument of councils) to GDP decreased from 1.0 per cent to 0.9 per cent between 1990-91 and 2005-06.
- Local governments in urban areas are predominantly funded from their own sources of revenue, particularly rates, fees and charges. For most rural and remote councils, grants are also a substantial source of their revenue.
- The revenue-raising capacity of local governments depends partly on their fiscal capacity, which differs by class of local government; the fiscal capacity of a council is best measured as the aggregate after-tax income of its community.[4]
- Urban developed councils tend to draw lightly on their fiscal capacities, while remote and rural councils tend to draw more heavily on their fiscal capacities.
- Analysis of the relative potential of local governments to increase their own-source revenue indicates that councils are raising about 88 per cent of their hypothetical benchmarks, on average across Australia, but this should not be taken to imply that local governments should increase the revenue they raise and whether councils can realise this hypothetical benchmark will depend on their individual circumstances and the willingness of their communities to pay.
- Most councils could do more to help themselves, but a small number will remain highly dependent on grants, despite high levels of revenue-raising effort.
- State governments impose legislative and regulatory constraints on the raising of revenue by local governments that affect the ways in which councils raise revenue, but the overall impact on revenue-raising capacity is unclear, except in New South Wales where rate pegging and only partial reimbursement of concessions appear to dampen revenue raised by councils in that State.
- The application of a set of principles to guide the revenue-raising and expenditure decisions of councils can assist them in improving the well-being of their communities.

The Commission noted both the diversity of local government and its changing roles. It observed that (ibid: 18):

> There has been a particularly notable transition of local government roles, from being essentially providers of property-related services to increasing involvement in the provision of social services, including health and welfare services, community housing and recreation and sporting facilities. Provision of a broader range of services and increased service

[4] Fiscal capacity is defined later in the PC report (p xxv) as aggregate after-tax community income per resident

> standards has occurred in many council areas. Local governments have also been actively promoting economic development in their areas.

Variations in the characteristics and patterns of revenue raising of local government were documented in some detail. The Commission found that (ibid: xxi-xxiii):

- The bottom 25% of councils raise less than $7.3 million each, but the top 25% raise more than $41 million each
- In terms of <u>total</u> revenue per person (which includes grants from other spheres of government), the spread is less pronounced, but at the low end, 25% of councils have total revenue less than $1102 per person, whilst at the top end, 25% raise more than $2847 per person – the median is $1645.
- The lowest 25% councils raise <u>own-source</u> revenue of less than $831 per person and the highest 25% raise more than $1683.
- For 25% of councils, own-source revenue accounts for more than 85% of their total revenue, and for 50% of councils, own-source revenue accounts for at least 72% of their total revenue.
- Although grants represent about 17% of local government revenue nationally, the level of grants differs significantly across councils – 25% receive 44% or more of their revenue from grants, and 10% are highly dependent on grants, which account for more than 58% of their revenue (but these councils represent only about 0.4% of the total population residing in local government areas).

The Commission observed that fiscal capacity differed by category of local government. Capital (central) city councils had the highest fiscal capacity, due to high business income, parking and traffic fine revenues and comparatively small resident populations. By contrast, those remote councils without resource-based industries had low fiscal capacity, particularly indigenous councils with little or no rateable land. On average, ‘urban developed’, ‘urban regional’ and ‘rural’ councils had intermediate capacity, while ‘urban fringe’ councils generally had low capacity (ibid: xxv).

Based on its estimates of fiscal capacity, the Commission found that on average councils were raising 88% of their hypothetical revenue benchmarks. However, their revenue raising efforts varied widely, from a low of 56% to a high of 95%. The Commission also made estimates of the additional revenue that could be raised if fiscal capacity were used to the full. It found that many councils could become financially self-sufficient at <u>current levels</u> of expenditure (which may of course be too low to address asset management and other community needs).

> As a generalisation, all councils have some potential to raise additional revenue. For many, but not all, urban councils, the increase in revenue-raising effort would lead to them being financially independent, based on current levels of expenditure.
>
> For rural and remote councils, the situation is different. Notwithstanding the increase in revenue-raising effort, a significant number would remain substantially dependent on grants, at current levels of expenditure (ibid: xxx).

The Commission was careful to point out that a council's ability to raise revenue is also constrained by the community's willingness to pay (ibid: xxiii). However, as a result of its analysis, the Commission concluded that (Finding 5.6):

> Given the differences in the scope to raise additional revenue across different classes of councils, there is a case to review the provision of Australian Government general purpose grants to local governments.

This echoed the 'Hawker' report's finding that the current system and distribution of financial assistance grants should be revisited.

The Commission also explored the extent to which state regulations impinged on the revenue-raising capacity of councils, for example through limitations on land valuation methods, the scope for differential rating, exemptions for certain classes of property owner, concessions to ratepayers, rate pegging in NSW, and constraints on fees and charges (ibid: xxxii-xxxiii). It noted that: 'The evidence suggests that the NSW Government has chosen to have a more significant constraining influence on the revenue raised by local governments than have other State governments' (ibid: xxxiv), and found that (Finding 6.8):

> There is a case for periodic reviews of the restrictions and regulations imposed on local government by other spheres of government to assess both their rationales and their benefits and costs.

Finally, the Commission put forward a set of principles that could 'play a useful role in guiding the revenue-raising (and expenditure) decisions of local government' (ibid: xxxv). The principles related to:

- sustainable financial management
- evaluation and priority setting
- core functions
- identifying costs of service delivery
- prudent borrowings
- rate setting and pricing of services
- responsibility and accountability
- openness and transparency
- providing services on behalf of other spheres of government.

The Commission went on to note that:

> The application of the principles is likely to raise practical challenges for a number of local governments. One particular issue is whether smaller regional councils can actually implement the principles. In these councils, the elected councillors and non-elected administrators may not have the necessary skills and there may be insufficient resources available for the task. There would appear to be a need for State governments and/or local government associations to provide further assistance and guidance to some local governments.

> Councils apply many of the principles already, although to varying degrees. State government legislation governing the operation of local governments and associated administrative policies, procedures and processes often includes, or implicitly have, some of these principles embedded within them.
>
> However, the wider and more rigorous application of the principles offers councils a way to determine more effectively, those services that local communities really want and value and how much they are prepared to pay for them. In this way, local governments can enhance the well-being of their communities.

No specific action flowed from the Productivity Commission's study. It may prove influential, however, in the forthcoming review of federal financial assistance grants, announced in the 2011 budget (see section 4).

2.10 Municipal Association of Victoria

Since the turn of the century there has been no major inquiry into the future of local government in Victoria. This is perhaps explained in part by the sweeping nature of reforms implemented in the 1990s. However, the Municipal Association of Victoria has produced a valuable series of reports on Trends in Local Government Finance. The most recent was published in March 2010 and analysed data for the period until 2007-08.

The purpose of these reports is to identify those councils facing financial risks. Over the years the MAV has found that such councils typically have a common set of characteristics, namely: small populations; large geographic area; large infrastructure portfolios relative to their revenue. However, it emphasizes that no council is about to 'go broke': the risks relate to longer term sustainability issues, especially adequate provision and maintenance of infrastructure, not short term liquidity or cash management (MAV 2010: 3-4).

Based on its analysis, the MAV has identified around 20 Victorian councils at high, very high or extremely high risk of not meeting their debt and infrastructure requirements into the future. Most are seen to require increased external financial support for infrastructure, as their capacity to need own-source revenues is very limited (ibid: 6-7). This applies particularly to smaller rural councils, which account for 9 of the 20. The others include 5 large rural shires, 2 regional cities, 2 outer metropolitan and 2 inner metropolitan councils (ibid: 9).

Importantly, in seeking additional federal and state financial support for councils at high risk, the MAV notes that (ibid: 10):

> An important element of any financial assistance package from another level of government is the requirement that councils implement adequate asset management, financial management and community planning reforms. As such, the MAV is supportive of the Commonwealth's Local Government Reform Fund, which is seeking to implement nationally consistent frameworks for asset management and financial data.

> Councils' long-term strategies should identify the appropriate community service and infrastructure needs and align them to their revenue raising capacity and infrastructure renewal and maintenance needs. This would ensure future ability to manage financial and asset management challenges without the need for ongoing external funding assistance once infrastructure backlogs have been overcome.

Clearly, the MAV's methodology, findings and policy prescriptions resonate with those of the major inquiries.

3. Unfinished Business?

3.1 Comparative Analysis

A useful way of comparing the content of the inquiries summarised in section 2 is to apply the typology of reform used by Dollery, Garcea and LeSage (2008) in their comparative study of local government systems in Australia, Britain, Canada, Ireland, New Zealand and the United States. They distinguished between:

- *Financial reforms* which consist of changes to the financial circumstances of local government, including any changes to revenue sources (i.e. 'own-source' revenue and intergovernmental transfers), expenditure (i.e. financial responsibilities and financial restrictions), and financial management.
- *Functional reforms* which involve changes in the number or types of functions performed by local government, including the realignment of functions between local government and other tiers of governments.
- *Jurisdictional reforms* which consist of changes to the authority and autonomy of local government, including general competency powers, specific by-law making powers, and the like.
- *Organisational and managerial reforms* which involve changes to the administrative, executive, and management processes of local councils.
- *Structural reforms* which consist of changes to the boundaries, numbers and types of local authorities.

The following table compares the coverage and key findings/recommendations of the inquiries in those terms. It also identifies the driver for each inquiry and the extent to which their recommendations have been implemented. The four national inquiries are listed first. Dominant areas of concern are shaded.

Inquiry	Driver	Agendas for Reform					Implementation or Impacts
		Financial	Functional	Jurisdictional	Organisational/ Managerial	Structural	
CGC 2001	Legislative Requirement to review operation of Financial Assistance Act	Proposed relatively minor adjustments to system of FAGs Highlighted problems of small, grant dependent councils	Identified broadening role and shift towards services for people rather than property, and fiscal implications				Contributed to pressure for cost-shifting inquiry; minor adjustment to distribution of road funding
Hawker 2003	Local government's concerns about cost-shifting from States and federal government	Overall, LG finances are sound, but smaller councils face problems Proposed major reforms to FAGs system	Wider role is out of balance with growth in revenue	Unwarranted state cost-shifting and limitations on LG revenues Proposed inter-government summit and agreements	Some councils have poor financial management Need for national capacity building organisation	Proposed further investigation of scope for both regional cooperation and amalgamations	Inter-Government Agreement on cost-shifting; Productivity Commission inquiry; resolution of Parliament acknowledging local government's role
PWC 2006	ALGA initiative to bring together findings of State-based inquiries and re-state case for increased federal financial assistance	25-40% of all councils may be 'unsustainable', mainly rural and remote Severe under-spending on infrastructure Revise FAGs escalation factor	Expansion of services is causing financial stress	Remove state restrictions on revenue-raising 2006 IGA on cost-shifting should ameliorate problem	Widespread need for 'internal reform': asset management, long term planning, skills development State governments should support these reforms	*Voluntary* mergers may be appropriate, but not for unviable councils Explore shared services, regional cooperation, outsourcing	Helped lay foundations for federal funding of community infrastructure and Local Government Reform Fund
PC 2008	Part of federal government's response to Hawker cost-shifting report	Wide variations amongst councils LG share of GDP has declined Scope for all councils to increase own source revenues: most urban councils could self-fund *current levels* of expenditure Case to review current arrangements for FAGs	Broadening of LG roles	Restrictions imposed by NSW government have dampened LG revenues Case for periodic reviews of restrictions and regulations imposed on LG by other spheres	Need to apply a set of principles to guide revenue-raising and expenditure Lack of skills to apply principles in some councils		No response to date; may influence upcoming FAGs review

<table>
<tr><th rowspan="2">Inquiry</th><th rowspan="2">Driver</th><th colspan="5">Agendas for Reform</th><th rowspan="2">Implementation or Impacts</th></tr>
<tr><th>Financial</th><th>Functional</th><th>Jurisdictional</th><th>Organisational/ Managerial</th><th>Structural</th></tr>
<tr><td>SA 2005</td><td>Concerns about apparent financial problems faced by a substantial number of councils</td><td>About one-third of councils ‘unsustainable’

State and federal grants inadequate</td><td></td><td>Unwarranted state restrictions on fees and charges, some cost-shifting, excessive compliance costs

Need for state-local agreements</td><td>Poor financial governance and management: need for improved asset/ financial planning, councillor training etc</td><td>Expand regional cooperation and shared services

Questionable savings/benefits from amalgamations</td><td>Range of initiatives by local government association and State government to strengthen councils’ financial management</td></tr>
<tr><td>NSW 2006</td><td>As for South Australia, plus impact of rate-pegging and need to strengthen local government’s position generally</td><td>About one quarter of councils ‘unsustainable’

Range of measures needed to address severe asset management backlog</td><td>Broadening of role is causing financial stress: need to focus on asset management</td><td>Cost shifting is significant

Need state-local agreement on roles and relationships

Abolish rate-pegging</td><td>Administration basically sound and efficient, but poor long term planning and need to improve financial management

Review political/ governance structures</td><td>Evidence on amalgamations inconclusive

Explore cooperation and shared services</td><td>Helped lay foundations for review of rate-pegging and Integrated Planning and Reporting system; manual cost-shifting survey by local government associations</td></tr>
<tr><td>WA 2006</td><td>As for South Australia</td><td>Nearly 60% of councils ‘unsustainable’

Increase rating effort and developer charges

Increase state and federal support</td><td></td><td></td><td>Improve financial and asset management

Develop skills strategy</td><td>Structural problem of many small, declining councils

Need for strong regional entities – perhaps two-tier system</td><td>Some follow-up by local government association</td></tr>
<tr><td>Tasmania 2007</td><td>As for South Australia</td><td>About 20% of councils ‘unsustainable’

Excessive operating deficits and infrastructure backlogs

Options: restrain non-asset expenditure, increase own-source revenue, increase debt</td><td></td><td></td><td>Financial governance barely adequate and improvements required

Introduce long term financial/asset plans</td><td>Increase resource sharing and regional cooperation – noted WA proposal for strong regional entities</td><td>Some follow-up by local government association</td></tr>
</table>

Inquiry	Driver	Agendas for Reform					Implementation or Impacts
		Financial	Functional	Jurisdictional	Organisational/ Managerial	Structural	
Queensland 2007	State government decision that major structural reform should be pursued as a matter of urgency	About 40% of councils 'weak, very weak or distressed' Need for regular reviews of financial sustainability But 'reform about much more than financial viability'	Need for LG to face challenges – optimum service delivery, support economic development, manage growth and change, ensure sustainable communities		Need for high capacity organisations with knowledge, creativity and innovation	Widespread amalgamations to create more robust organisations to address challenges But no benefit in merging vast, thinly populated western councils	Amalgamations implemented as proposed

Clearly, the first decade of the 21st century saw an overwhelming pre-occupation with local government's financial health, especially the precarious position of small rural and remote councils, but also broader weaknesses in asset and financial management.

A conceptual issue to emerge is that of defining financial 'sustainability'. Over the decade there was widespread acceptance of the approach taken by Access Economics in its various state-based studies: namely that 'sustainability' involves a medium-long term objective that councils should be able to maintain adequate levels of service and address needs for asset maintenance, renewal and augmentation without having to resort to exceptional increases in rates, fees and charges on the one hand, or disruptive cuts to expenditure on the other. However, applying a precise measure of sustainability both within and across jurisdictions clearly poses considerable methodological problems, not least the lack of consistent and reliable data.

Some of the inquiries also made a useful distinction between 'sustainability' as defined above, and 'viability'. The latter is a much less demanding proposition, referring simply to the ability of a council to continue trading, meeting its recurrent obligations (which it might perhaps minimise by keeping service levels low and deferring infrastructure investments) and paying off any debt. It seems evident, however, that viability thus defined does not connote robust local government.

The inquiries also reveal a broad consensus around the major issues facing Australian local government and, to a lesser extent, actions needed to address those challenges. This consensus centred on the following policy prescriptions:

- Local government's role and functions have expanded considerably over recent decades, and there is now a mismatch between expenditure demands and current levels of revenue, especially own-source revenues
- This mismatch manifests itself particularly in inadequate infrastructure maintenance and renewal
- More could be done by councils themselves to increase own source revenues and to improve financial governance and asset and financial management
- Local government's performance in long term strategic, asset, financial and workforce planning needs to improve considerably
- Many smaller councils struggle with lack of scale in their operations
- Greatly expanded regional cooperation and resource sharing may offer an alternative to amalgamations as a means of enabling councils to improve their efficiency and effectiveness
- Neither amalgamation nor resource sharing will ensure the sustainability of thinly populated and often geographically very large rural and remote councils: increased external support appears essential
- State governments should avoid cost-shifting on to local government, reduce compliance costs, and remove unwarranted restrictions on local government revenue-raising
- The federal government should review various aspects of the system of financial assistance grants, including the annual escalation factor
- State, and to a lesser extent federal, government relations with local government need to be enhanced through a variety of inter-government agreements.

The report of the Queensland Local Government Reform Commission was in some ways the 'odd man out'. In part this was because it began with terms of reference that sought a reduction in the number of councils. However, the Commission's analysis focused on the need for local government *to do more* in order to meet the varied challenges of state development; population growth; economic, social and environmental change; and community sustainability. It thus sought more robust local governments with a capacity for innovation and creativity and to deal with sometimes unexpected change or shocks. Its recommendations for sweeping amalgamations flowed from that analysis. At the same time, it recognised – as had others – that amalgamation is not the answer when the potential candidates for merger are already unsustainable. In that sense the Queensland Commission's approach is echoed to some extent in the option of a two-tier system of regional and local governments suggested by the Western Australian *Systemic Sustainability Study* panel.

3.2 Implementation

This final section addresses two questions. Firstly, to what extent have the principal findings and recommendations of the various national and state inquiries been implemented? Secondly, how much unfinished business remains to be transacted in order to place Australian local government on a sounder footing?

First, it should be noted that whilst action has often been slow to occur and many specific recommendations have not been implemented, in general terms the inquiries can be linked to a considerable number of subsequent policy initiatives. These encompass:

- Increased federal funding for local roads in South Australia (since 2005)
- Concerted action in South Australia since 2005 to improve financial management and other aspects of local government practice, including promotion of shared services, led in many cases by the Local Government Association (which recently launched a new 'Local Excellence' program)
- Various initiatives by other local government associations to help improve council performance
- The 'Inter-Governmental Agreement establishing Principles Guiding Inter-Governmental Relations on Local Government Matters' (cost-shifting) signed in 2006, and subsequent subsidiary agreements in most states
- Federal funding for community infrastructure provided as part of the stimulus response to the Global Financial Crisis of 2008
- Amalgamations in Queensland (2008)
- A review of rate-pegging in NSW by the state's Independent Pricing and Regulatory Tribunal in 2009 (leading to modification of the process but not abolition of the system)
- Introduction in 2009 of the Integrated Planning and Reporting Framework in NSW to improve strategic, asset, financial and workforce planning; and similar planning frameworks in several other states
- Federal funding of programs to improve asset and financial management, and collection of consistent national data, through the Local Government Reform Fund (launched in 2009).

That said, it is equally the case that other far-reaching reforms have been undertaken quite separately from the inquiry processes and/or contrary to their recommendations. Prominent among these are:

- The state government-sponsored reform program in Western Australia that strongly promotes voluntary amalgamations (or concerted regional collaboration in remote areas), culminating in the recent announcement of an independent review of local government in the Perth metropolitan region

- Restructuring of local government water supply and sewerage operations in Tasmania into three large regional utilities and a state-wide service organisation (but still owned by local government).

With the exception of the amalgamations in Queensland, the policy changes and other initiatives that can be related to the various inquiries have generally been welcomed by local government. As noted above, in the case of South Australia they are largely the work of the Local Government Association, which has access to substantial funds from tax equivalent payments made by its Finance Authority. However, the state-initiated reforms in Western Australia and Tasmania have been to varying degrees resisted by councils.

The patchy nature of responses to the inquiries, and evident differences of opinion between state and local governments on priorities for further reform, point to two underlying issues that slow the process of change:

- State governments tend not to respond to inquiry recommendations unless they initiate and control the agenda themselves – this would seem to indicate significant differences in perspective from, and failure in the 'conversation' with, local government organisations.

- Despite commissioning several of the inquiries, local government itself has mostly failed to assemble and prosecute packages of reforms that are acceptable to councils generally, and that also appeal to other key stakeholders – especially state governments. The diverse nature of local governments makes it very difficult to establish a durable consensus.

In relation to the second point, several of the key recurring recommendations from the inquiries could have been pursued independently by local government – for example increased regional collaboration and resource sharing; an enhanced rating effort (except in NSW where rate-pegging persists); better financial management and governance; improved asset management; more long term planning, and so on. Certainly, there are several instances of local government collectively taking the initiative, notably in South Australia and Victoria, and many individual councils pursue elements of best practice – for example, the Integrated Planning and Reporting Framework in NSW drew heavily on the established practices of several leading councils.

Overall, however, many councils appear reluctant to embrace necessary change unless and until it is sanctioned or enforced by states – suggesting a culture of compliance rather than innovation. There also seems to be a continuing widespread view within local government that its financial problems should be addressed through additional external – especially federal – funding, rather than a focus on opportunities to increase own-source revenues. Whilst the legal dominance of the states and the power of other external forces should not be underestimated, local government could do more to control its own destiny, and take the lead more often.

3.3 A Continuing Agenda

Against that background, the principal items of 'unfinished business' from the inquiries of the past decade may be identified as follows:

- **Ongoing concerted efforts to expand local government's own-source revenues** from rates, fees and charges. This would also be consistent with the findings of the 'Henry' tax review (Henry et al 2009). It would involve, among other things, review and removal of unwarranted state government controls and restrictions identified in most of the inquiries – notably rate-pegging in NSW. *(A national Tax Forum is to be held in October, based in part on the 'Henry' review. ACELG plans to follow-up its recently published analysis of the implications of the review for local government, including research into the scope to generate increased revenue from property rates.)*

- **A review of the system of federal financial assistance grants** (FAGs), including the annual escalation factor, which gives more weight to the differing fiscal capacities and revenue-raising efforts of councils, and which recognises that the quantum of assistance is unlikely to reach a level sufficient to achieve full equalisation. *(As noted earlier, a review was announced in the 2011 federal budget, but terms of reference have yet to be finalised.)*

- **Detailed examination of the special needs and problems faced by small (in population) rural-remote councils**, including their likely sustainability into the longer term and the appropriateness of current legislative concepts and frameworks. *(ACELG has commenced some work in this field. It is of particular relevance to 'Closing the Gap', programs for Northern Australia and broader regional development initiatives.)*

- **Full implementation of recent moves towards improved long-term strategic, asset, financial and workforce planning**, including increased efforts to improve the quality and reliability of data, and expanded programs to improve the understanding and skills of both managers and elected members. *(This is currently being supported by the federal government through the Local Government Reform Fund, and ACELG is undertaking related projects. It seems clear, however, that ongoing and increased efforts will be required, and resources need to be identified for that purpose.)*

- **Related measures to improve the quality and consistency of financial governance**, applying principles such as those outlined by the Productivity Commission (2008) and some form of performance auditing against agreed key indicators.

- **Expanded and strengthened regional collaboration and resource sharing** (shared services), based on the establishment of robust and well resourced regional entities, amounting in some instances to fully-fledged 'regional councils'. *(This is also relevant to regional development programs. ACELG will be following up its recent report 'Consolidation in Local Government: A Fresh Look' with further work on more robust and far-reaching approaches to regional collaboration and shared services.)*

- **Further examination of the potential for council amalgamations in specific regions and circumstances** in order to enhance local government's capacity to address emerging challenges and to become more resilient in the face of profound and/or unexpected changes in its operating environment.

- **A new or revised inter-government agreement** to establish a clearer consensus on the evolving responsibilities of local government and the role it may reasonably be expected to play in the broader system of government. ***(****A review of the 'Inter-Governmental Agreement establishing Principles Guiding Inter-Governmental Relations on Local Government Matters' is now due.)*

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Suggestions for future working papers are welcome and may be directed to ACELG's Senior Research Officer: stefanie.pillora@acelg.org.au

ABOUT ACELG

ACELG is a unique consortium of universities and professional bodies that have a strong commitment to the advancement of local government. The consortium is led by the University of Technology Sydney's Centre for Local Government, and includes the University of Canberra, the Australia and New Zealand School of Government, Local Government Managers Australia and the Institute of Public Works Engineering Australia. In addition, the Centre works with program partners to provide support in specialist areas and extend the Centre's national reach. These include Charles Darwin University and Edith Cowan University.

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