

Local government sustainability

The online *Macquarie Dictionary* runs a 'Word of the Year' contest, where subscribers vote for nominations from 17 categories including business, the environment and technology (the winner for 2007 was 'pod slurping'). There is not, unsurprisingly, a local government category, but if there were, the winner for several years running would surely have been 'sustainability'. Originally most often applied to matters environmental, the term is now applied to a range of aspects of council operations. Leading the field is 'financial sustainability', but *Brian Dollery* believes an over-emphasis on the money may be hindering a more holistic discussion of how – and why – local governments should survive.

What determines survival?

Local government in Australia is affected by a range of internal and external factors that must all be considered if policy solutions to dwindling sustainability are to be found.

Financial sustainability has become the most important policy problem in contemporary Australian local government. This is attested by the fact it has attracted a plethora of official inquiries. At the national level, we have seen the 2001 Commonwealth Grants Commission (CGC) report into the underlying causes of financial distress, the 2003 Hawker Report into 'cost-shifting', and the 2006 PricewaterhouseCoopers report. At the state level, we have seen the 2005 South Australian Financial Sustainability Review Board's *Rising to the Challenge* report, the 2006 Independent Inquiry into the Financial Sustainability of NSW Local Government, the 2006 Queensland Local Government Association *Size, Shape and Sustainability* program, the 2006 WA Local Government Association Inquiry and the 2007 Tasmania study.

While much has been learned from these inquiries about the causes of the current financial crisis in Australian local government, a comprehensive framework for developing remedial policy is still incomplete. An important reason for this deficiency is the excessive emphasis these reports have accorded financial sustainability to the exclusion of other forms of sustainability.

Put differently, which is more important: the financial sustainability of a council or its role as a local voice in Australian democracy?

One way of approaching the design of a conceptual framework for analysing the question of local government sustainability is to develop a typology of the main causes of financial sustainability. What is therefore required is a typology of local government sustainability that simultaneously embraces both 'internal' factors and 'external' forces that impinge on the long-run sustainability of municipal authorities. A taxonomy of this kind is useful in not only diagnosing the problems of contemporary Australian local government, but also in developing a prognosis and possible policy remediation.



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Taxonomy of local government sustainability

The exploratory taxonomy developed in this article hinges on five main sources of local government sustainability: demographic factors; council revenue; expenditure; financial management; and governance. It is evident that this constellation of influences combines both 'external' and 'internal' factors, thereby removing a central objection to the earlier approaches in the inquiries. Each of these elements of the tentative new typology is now considered in turn, using the contemporary milieu of NSW local government to provide illustrative examples.

(i) Demographic factors

Population trends have profound implications for the composition of local government services, revenue, infrastructure utilisation and future infrastructure needs, expenditure patterns and almost all other aspects of local governance. While local councils can exert some influence over population flows and population density directly and indirectly through efforts to attract or deter new residents, planning regulations, local economic growth strategies and so forth, in the main, demographic characteristics should be considered 'non-discretionary' variables since they lie beyond the control of individual municipalities.

A few examples can serve to illustrate the contention that important linkages exist between local government sustainability and demographic trends:

- Population relative to the local housing stock can have a powerful impact on housing prices. For instance, a shrinking population and a stagnant housing stock can lead to declining property prices and falling rate revenue as well as vice versa.
- Infrastructure utilisation is related to population since physical infrastructure, by its very nature, is a fixed asset. For example, roads are rarely ripped up in response to a population decline while a population trend increase is typically required to justify connecting new homes to water and sewerage systems.

- Population density and the rate of growth of population are not only intrinsically intertwined but also represent key determinants of local government sustainability; a point emphasised in the 2005 South Australian report. This report established that, regardless of whether a given council was located in a metropolitan zone or a regional area in South Australia, the rate of growth in population seemed to determine the extent of its operating deficit.

Constraints imposed by higher tiers of government in the Australian federation ... account for a good deal of non-sustainability amongst local councils.

While these examples illustrate the pervasive impact of demographic change on local government, its effects are further complicated by the fact that recent Australian population trends are both complex and spatially uneven. For instance, in the context of NSW local government, whereas general population growth has centred on the coastal fringe and areas immediately adjacent to Sydney, Sydney itself has seen consistent net out-migration.

These complicating factors are further exacerbated by associated changes in population densities. For example, low-income household movement has clearly been an important component in migration to coastal regions in NSW. This has important ramifications for local government largely due to the range of partially council-funded concessions in place for low-income recipients.

Population change is thus multifaceted and may have far-reaching effects on local government sustainability. Given long-standing out-migration trends from the NSW sheep and wheat belts, some rural shires will never be financially sustainable because of low population densities and negligible or even negative population growth rates.

This raises a central policy conundrum requiring explicit value judgment. What weight should be accorded rural local councils in their role as the only local democratic institution? Put differently, which is more important: the financial sustainability of a council or its role as a local voice in Australian democracy?

The long-run sustainability of local government should ... rest on the management of renewed local infrastructure and not the funding of current asset renewal.

(ii) Council revenue

Australian local government has three main sources of revenue: property taxes, fees and charges and intergovernmental grants. By international standards, this is a comparatively narrow range of potential sources of finance. Moreover, there are two broad revenue pressures confronting Australian local councils; legislative restrictions on its ability to raise revenue and limited access to a sufficiently broad range of revenue, including the 'holy grail' of a growth tax. It must therefore be acknowledged that not only do Australian councils survive on a relatively narrow revenue base, but that even within this narrow range, most revenue-raising has important 'non-discretionary' elements.

These general propositions can be readily illustrated in the financial milieu of NSW local government. For example, local government income in NSW has not kept pace with either the growth in state or federal income or growth in the economy of the state and national GDP; the same cannot be said for either state or federal government income.

Even more important than aggregate local government income is the growth of local government rates since this is often said quintessentially to represent a completely 'discretionary' source of revenue for councils empowered to strike their own rates. While it can be argued that NSW is peculiar in the context of Australian local government because its state government has adopted a longstanding policy of rate-capping, evidence on rate revenue growth presented in the state-based inquiries shows a similar picture across all Australian local government jurisdictions relative to consumer price inflation.

Grants represent the second major source of revenue for local councils. For years local government has been exhorted by higher levels of government to end its reliance on grants. But to reduce the pejoratively phrased 'grant dependency', local government must either raise its rates or increase income from other sources, such as charges and fees for services provided. However, in both instances NSW local government is restricted. Quite apart from rate-capping, charges are often subject to ministerial control and/or frequently fall under the purview of other regulatory bodies.

In any event, in a federal system of government afflicted by vertical fiscal imbalance (VFI), where the majority of tax receipts are collected by the Commonwealth and a disproportionate degree of expenditure occurs at subordinate levels of government, grants will always be an important means of equalising revenue with expenditure. While this structural feature of Australian fiscal federalism appears to have evaded the debate on local government grants, in practice federal government grants direct to local government have emerged as an increasingly important source of revenue for local government, especially the *Roads To Recovery (R2R)* program.

The trend towards more specific grants, taken together with the inevitability of a system of local government grant disbursement in a federal system characterised by VFI, places local council autonomy under threat and once again raises the question of the value accorded local democracy. Indeed, it might not be alarmist to argue that tied grants essentially reduce local government to expenditure agencies devoid of decision-making power.

Finally, all local government systems are troubled by horizontal fiscal imbalance (HFI) and Australian local government is no exception. In essence, HFI implies that different councils have different revenue raising abilities and the costs of service provision vary between councils. Unless HFI is addressed, marked differences in local services between different councils will emerge. In Australia this almost inevitably implies that people in poor remote, rural and regional areas will enjoy a far lower level of service provision than their metropolitan counterparts. This problem has traditionally been tackled in Australian states and territories through 'equalisation grants' by state-based local government grants commissions. However, the decline in the real value of these grants across Australia has threatened this system and thus bred a growing differentiation in local service provision.

(iii) Council expenditure

The third element in our proposed taxonomy of local government sustainability focuses on the expenditure dimension of local government activity. A critical feature of the cost structure of contemporary Australian local government resides in the impact of cost-shifting; a factor recognised by the 2001 CGC, the 2003 Hawker Report and the 2006 NSW Local Government Inquiry. While the monetary magnitudes involved in cost-shifting are difficult, if not impossible, to compute with any degree of precision, in the context of local government the phenomenon is undoubtedly significant.

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The chief problem with cost-shifting is not the shifting of expenditure functions per se but rather the lack of adequate accompanying funding. It often makes perfect sense for local government to carry out various functions, such as engaging rural doctors, since local councils typically possess superior information on local needs. The problem is that adequate matching funding is usually not transferred along with the functional responsibilities. Accordingly, unfunded cost-shifting by higher levels of government all but guarantees that many councils will be unsustainable in the long run.

(iv) Financial management

All inquiries identified a severe local infrastructure problem in local government. Two aspects of this problem are important. Firstly, the inquiries found that inadequate financial management, and particularly asset management, had played a significant role. The problems involved should not be underestimated. In particular, it is very difficult to place a value on an asset that cannot be sold. Secondly, the infrastructure problem is so large that many local authorities will never be able to bear the financial burden of rectifying it, leading to calls for alternative methods of financing reconstruction, including a Commonwealth infrastructure fund.

In order to understand how the local infrastructure crisis has arisen, it must be acknowledged that most local infrastructure was simply given to local government in the immediate post-World War II era. Local government thus did not finance its development and the local government revenue model was never designed to pay for its renewal. It should also be acknowledged that a significant proportion of the stock of local infrastructure is reaching the end of its economic life largely around the same time.

Since local councils are already struggling to remain solvent in their day-to-day operations, it is widely recognised that local government cannot fund all of the infrastructure renewal programs that will be required over the next decade. Indeed, for each year that the problem is left unattended, the financial burden grows by around \$400 to \$600m in NSW alone. While arguments rage over how to determine the extent of the infrastructure renewal task, attention may drift from the much more important task of implementing systems that will put aside reserves so that such a crisis will not recur in the future. The long-run sustainability of local government should thus rest on the management of renewed local infrastructure and not the funding of current asset renewal.

(v) Governance

In order to develop our exploratory typological framework for evaluating sustainability in contemporary Australian local government, we have considered local government demographics, revenue, expenditure and cost-shifting and financial management. The first three elements focus exclusively on the 'external' environment facing local councils, while financial management combines features of both the 'internal' and 'external' context. By contrast, governance deals solely with the internal dynamics of municipal operations.

The need for an internal perspective is warranted by the fact that the overwhelming majority of council 'failures', as epitomised by the dissolution of local authorities by their respective Departments of Local Government, are caused by internal factors, especially conflicted elected bodies. An excellent starting point for a diagnostic analysis of governance is to recognise three critical elements of local government sustainability: local democracy, local social capital and local capacity.

Local democracy refers to the sense in which local government can be differentiated from other levels of government; the very existence of local government suggests that it will make decisions differently from higher tiers of government by giving a voice to local preferences. This is sometimes encapsulated by the term 'vibrancy'. If a council fails to embrace local preferences, then there is little reason for it to exist and its ongoing sustainability as an 'independent' entity comes into question.

In the municipal context, social capital engenders a local civic awareness that manifests itself in community projects, ranging from local social associations to local business initiatives. Local social capital breeds a 'sense of community' and a 'sense of place' that derive from living in a small and distinctive local government area, with community size and community social capital therefore intrinsically linked. It follows that, if a council does not play a positive role in facilitating the formation of social capital, its long-term sustainability must be called into question.

Finally, local government capacity influences local council sustainability. It has been argued that local government cannot command the respect of its constituents if it is unable to formulate agreed policy and implement decisions effectively.

Local government capacity thus has three features: functioning elected leadership, adequate administrative and technical expertise and the ability to make autonomous decisions. These three attributes of local government capacity are thus crucial to council sustainability.

Concluding remarks

A common thread running through the discussion of demographic factors, council revenue, expenditure, as well as part of financial management was the 'non-discretionary' nature of the external environment in which Australian local government is placed. Constraints imposed by higher tiers of government in the Australian federation thus account for a good deal of non-sustainability amongst local councils.

Accordingly, all inquiries found that large numbers of Australian municipalities are unsustainable if present trends continue. This serves to illustrate a dismal truth about Australian local government; unless dramatic change occurs, unsustainability will become the rule rather than the exception.

A beneficial aspect of our taxonomy is that it obliges policy makers to recognise that, due to the predominantly 'non-discretionary' nature of demographic factors, council revenue, expenditure, as well as part of financial management, there are limits on the extent to which individual local councils can be held responsible for their own long-term sustainability. Moreover, given the high degree of VFI in Australian fiscal federalism and the fact that additional expenditure responsibilities can be loaded on local government, it is inevitable that higher tiers of government will always have to assist local councils financially.

In the short-run, this means that immediate local infrastructure crisis will have to be resolved by subsidies from the Commonwealth and state governments. In other words, in the absence of additional taxation powers, local government sustainability is inextricably dependent on fiscal transfers from higher levels of government. For the majority of Australian local authorities, self-secured long-term financial sustainability is simply not feasible.

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