

## **The Proposal to Cap Council Rate Demands.**

### **Submission from Ratepayers Victoria Inc.**

#### **Introduction.**

Ratepayers Victoria has been researching the morality and legality of Municipal Council conduct in the collection and spending of the funds it obtains by compulsion. This work is essentially complete and is ready to be handed to lawyers for possible action. In the process, our view on the matter has been put to a previous Minister for Local Government; the matter has also been put to the exemplar council, the City of Bayside; the basis of a claim of false accounting is also being brought to the attention of the Victorian Auditor-General. The general response is one of avoidance.

The +3 years of research into the matter forms the basis of this submission.

#### **General Proposition.**

Rate Capping to CPI will have little effect on the improper conduct of Councils. One has only to look at page 19 of the VAGO report, ***Local Government: Results of the 2013-14 Audits***, to see that the cost of the real tasks has grown by only 2%pa in the past five years – an acceptable trend. For the annual average increase in costs to be 5%pa, the wasteful part, the administrative costs, must be growing by 8 or 9%pa. In our exemplar council, staff numbers have doubled in the past fifteen years (5%pa) yet the council has not had any expanded production tasks since it was formed. Indeed, the computerisation of its affairs during this period ought to have brought significant administrative savings. The cause of this growing imbalance between production costs and administrative costs is that Councillors have no control on the level of employment – the control is exclusive to the CEO, who has an obvious self-interest.

**Should the rates be capped to CPI or lower, we anticipate that the productive work would be curtailed and the administrative work expanded to cater for the staff self-interest. (Note that the MAV has already stated that services will be reduced). Capping of the rates will not cap the expansion of employment! Neither the Council nor the Minister has any control mechanism. While a rate cap is supported, the improper conduct of Councils (promoted by the MAV) must be corrected, to enable a capping system to work.**

#### **The Cause of Excessive Rate Charges.**

Councils assert that they are a third tier of Government; they openly claim that the municipal rates and charges are simply the taxes applied by their tier of government. A reference document, *Local Government, Funding and Constitutional Recognition. A Twomey. CRU Report No3.* pp 64-68; p84, shows that Victorian councils have only the authorities given to them by the Parliament. They have no constitutional independence to raise taxes.

Council staff blatantly ignore the controls implemented by Parliament, as applied by the Local Government Act 1989 and the Constitution Act 1975. There is widespread practice of the tort of conversion; this is concealed by false and misleading accounting, supported by inept (possibly corrupt) auditing.

Examples of misapplication of funds in our exemplar Council, are:

- Depreciation and amortisation is deducted as an expense in the income and expenditure account. It is based on the value of assets not the cost; as capital is not obtained from the

balance sheet, there is no place to transfer this deduction. The deducted amount is hypothetical in magnitude and mystical in purpose. (It represents about 20% of the General Rate).

- The surplus collected each year is retained and “disappears” into the accumulated assets. It is collected as a pre-payment yet the balance sheet has no such account. (This represents upwards of 8% of the General Rate). Bayside which has a General Rate revenue of around \$65million has about \$40million of unallocated funds accumulated in this manner.
- The Municipal Charge is intended, in the LGA, to provide for the costs of governance. It is limited to (effectively) 25% of the costs of the productive work, materials and contracts. In Bayside, the administrative cost is estimated to be 58% of the cost of production. (It is estimated that 30% of the General Rate is composed of charges that ought to be provided as a Municipal Charge but would thus bring it seriously over its limit).
- Our exemplar Council provides funds from the rates to provide benefits to parties (such as sporting clubs) who pay for their exclusive occupancy of the assets as a “licence fee”. (This is the same mechanism as fees from parking meters). If the rates are raised as a “fee for service” and used to subsidise a necessary licence fee, this is the tort of conversion. (Because of accounting difficulties, it is not clear what influence this has on the rates)

### **Capital Provision.**

In our exemplar Council, capital is provided, in the year of purchase, from the rates. There is a minor contribution from the State and from some of the users of the capital. In the 2014 year, 93% of the capital budget was provided from rate payments. This raises the issue of intergenerational transfers. Because there is no functional depreciation provision, there is no spreading of the cost of the asset over its useful life. In terms of Council raising money as a fee for service, the present generation is paying for a service that is being provided to future generations.

Examples of failure to properly account are:

- The income and expenditure account fails to show expenditure on loan repayments and interest.
- The income and expenditure account fails to show capital expenditure. (There is a strange element where the capital income is shown but the capital expenditure is not listed).

### **The Ratepayers View.**

**Ratepayers Victoria believe that simply capping rate increases will have little effect on the extravagance and unlawful conduct of Local Government. Much more comprehensive action is necessary. There is an urgent need to limit the authority of the CEO and make him or her subject to the total direction of the Council. In turn, Councillors should be subject to the same rules and limitations as company directors. Maybe Councils should return to the status they had in 1996 when operating for a few years being managed by Commissioners.**

**Should this not be an option, a basic requirement is to ensure that all accounts are correctly prepared - particularly the income and expenditure account. Accounts should be prepared separately for different activity groups that are serviced differently and financed from different sources. The cost of administration should be accounted for separately and then the limitations set out in s159 of the LGA, applied. A target to keep the increase in expenditure on goods and service within its historical range of lower than CPI, is suggested. Ensuring that all the administration expenditure forms the municipal charge, it will then reduce to the CPI limits.**

**It would also be a good idea to abolish the MAV – the MAV Act of 1907 is seriously outdated. The MAV is complicit in encouraging Council to act improperly. It has no function that cannot be better conducted by a commercial organisation. Also, Councils and the MAV ought to be banned from spending ratepayer funds for political purposes – such as supporting the VLGA. Note the levy of funds raised by the MAV to be spent by the ALGA to promote the YES case in the proposed referendum of 2014.**

**Addressing some of the Matters Raised in the Briefing Paper.**

### **1. Autonomy of Councils.**

This matter has been addressed by Professor Twomey in her report “Local Government Funding and Constitutional Recognition”. Essentially part IIA of the Constitution Act of 1975 purports to give Local Government the status of a separate tier of Government. However, this freedom is immediately removed by the clause “having the function and powers that the Parliament considers necessary..”. When the powers given by the Parliament are examined, Local Government is found to be a tier of the administration function of Government. The “function and powers” are contained in various Acts of the Parliament, particularly the Constitution Act 1975 and the Local Government Act 1989. It is also given delegated authority in many other Acts, e.g. the Road Safety Act and the Road Management Act. A determination by the High Court of Australia in the 1904 Sydney Municipal Council case found, “Municipal Government is the State”. This status has not changed!

These enabling Acts restrict the autonomy of Local Government; it, like the rest of us, must follow the requirements of the law.

### **2. CPI is not an Appropriate Index to use in Rate Capping.**

This may be true when dealing with Council costs. However, it is an appropriate index to use when dealing with the capacity of a community to pay. Pensions, both State and private, when indexed, follow the CPI. The minimum wage and Average Weekly Earnings follow the CPI closely.

Many of us, in managing the budget process of large corporations, know that unaffordable calls are regularly made for funds; the budget has then to select those that the company can afford. It is desirable that a similar constraint be applied in Local Government. Community affordability ought to be the criteria for selection of the capping index.

### **3. Level of Service Will Deteriorate if Rates are Capped.**

Experience shows that Councils over-service and play favourites. Councils give grants to “needy” causes because the favourite (vote gathering) cause cannot pay its way. This requires a subsidy from one group to another – particularly in intergenerational transfers. Capping of the rates will minimise this practice. Greater use of Council guaranteed loans will spread capital costs to an affordable level across a number of generations. A schedule of interest and capital repayments needs to be committed when loans are drawn down. Capping of total loan obligations is a necessity

### **4. Rate Capping may Create Perverse Incentives.**

This may be true but rates may be monitored to ensure that sectoral interests do not overpower the public good. Isn't this what organisations like the ESC are for?

The LGA contains provisions for Special Rates and Special Charges. Sectoral interests have this mechanism available to them. Most importantly it contains methods of estimating sectoral benefit

and allowing a ratepayer vote on implementation. (Not used much as it limits the opportunity for Councils to display omnipotence).

## **6. An Additional Layer to the Budgetary Cycle.**

If special provision is needed to deal with unusual aspects of plans, plenty of time exists in the present system. Councils run to a 10 year planning cycle. If as in 4 above special issues were dealt with by special rates, the matter would be well resolved. Emergency issues like bushfires are an issue involving the supply of Public Goods and must be dealt with in conjunction with the State. Note the function and importance of the Fire Services Levy.

## **7. Ratepayers Concerned with High Rates.**

This is the substance of substantial work by Ratepayers Victoria Inc. (RVI) over the past three years. The document, Council Rates – a Tax or a Fee for Service, sets out our conclusions on the issue.

We also have a set of three PowerPoint diagrams (CASHFLOW -COMPANY) which trace the cash flow from rates and charges and try to relate it to the delegation which Councils have to collect revenue. Slide 2 shows the value the current generation of ratepayers get from their rate payments and links it to the payments made. In our exemplar Council, about \$43M of the (\$65M) general rate charged in 2014 is delivered as current value. The \$27M difference is either stolen or the benefit is transferred to later generations. In addition, significant amounts are charged for administration costs which are above and beyond the allowance set by the LGA.

It is not surprising that ratepayers have an intuitive understanding that they are not receiving proper value for their contribution. Slide 3 in the document shows a more equitable arrangement using secured borrowing to provide most of the capital needs.

## **8. VAGO's Critical Assessment.**

In RVI, we have a serious problems with the work of VAGO. In our exemplar Council, we claim that the accounts are false and misleading. VAGO, of course, has certified these accounts as “true and fair”. The false accounting begins with the incorrect treatment of depreciation. As far as we are able to ascertain from a casual look at the accounts of other Councils, this improper treatment is common to many of the other 78 Councils in Victoria. As we have stated earlier, depreciation in Council accounts has a hypothetical magnitude and a mystical purpose. We suggest that the accounting problem is the most important issue facing Local Government. It needs to be fixed ahead of any action to cap rates.

## **General Conclusion**

**Simply making Councils follow the provisions of the LGA and the Constitution Act will solve many of the problems current in Local Government. It may not be necessary for the ESC to promote changes to any Act to ensure that Councils conduct their affairs fairly. The LGA and the Constitution Act provide adequate controls on the conduct of Local Government to ensure a fair and legitimate outcome. However, tightening up of the wording of some provisions may be needed. Councils need to be given a much clearer view of its true function – governance of a tier of state administration. Making the Finance and Reporting Regulations 2014 operate as intended will bring great benefit to ratepayers.**

**Necessary tasks are:**

**Proper cost allocation.** Recast Income and expenditure accounts by different classes of economic goods or economic benefit produced.

Supply capital goods by borrowing – hopefully at State rates – with a fixed repayment schedule.

Treat any surplus collected as a pre-payment to be used in the following year.

Limit administrative costs to 25% of the cost of Capital and Operating Cost as per s159 of the LGA.

Limit the total borrowed capital by some criteria such as rateable value or number of ratepayers.

Ensure those with a Licence to Occupy pay for the full cost of occupation.

**Deal with Special Needs.** Encourage wider use of Special Rates and Special Charges

**Deal with Municipal Enterprises.**

Encourage the use of Municipal Enterprises but ensure they are self-financing.

Use Risk Analysis to justify capital raised but allow it to be outside the ordinary capital limits.

While these tasks may be judged as difficult and time consuming, this is not so. The various Acts and the Financial and Reporting Regulations 2014 have been set up to permit the implementation of systems such as those suggested. It is simply a matter for the Minister to publish appropriate guidelines and limits which require Council compliance. The only change to the LGA which is required, is to remove Clause 94A(2).

End of Document. Escratecap140415. Author G. Reynolds. Rev 2. 070515.

Reference documents. Local Government Funding and Constitutional Recognition. A Twomey. CRU Report No.3.

Council Rates – a Tax or a Fee for Service? G Reynolds. Yet to be published.

PowerPoint Presentation CASHFLOW – COMPANY. Attached.



# **Local Government Funding and Constitutional Recognition**

## **Constitutional Reform Unit**

### **Report No 3, January 2013**

**By Anne Twomey\***

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\* Professor of Constitutional Law, University of Sydney. Part of this report was first published as: Anne Twomey, 'Always the Bridesmaid – Constitutional Recognition of Local Government' (2012) 38(2) *Monash University Law Review* 142.

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## I INTRODUCTION

In December 2011, the Expert Panel on the Constitutional Recognition of Local Government recommended that a referendum be held to amend s 96 of the Commonwealth Constitution to allow the Commonwealth Parliament to make grants of financial assistance to ‘any local government body formed by State or Territory Legislation on such terms and conditions as the Parliament sees fit’.<sup>1</sup> This recommendation was made subject to conditions, one of which was that the ‘Commonwealth negotiate with the States to achieve their support for the financial recognition option’.<sup>2</sup>

This paper provides the information and analysis that will be needed to underpin those negotiations and ensure that they are conducted upon an informed basis. Chapter II explains the current status of local government under the Commonwealth Constitution. It is necessary to understand this before an assessment can be made of how the Constitution ought to be changed.

As the debate about the ‘financial recognition’ of local government in the Commonwealth Constitution largely concerns the method of funding of local government, the next two chapters provide vital factual information to support the debate. Chapter III provides a detailed history of Commonwealth funding of local government, from specific funding for roads, to general purpose grants, tax-sharing and financial assistance grants. It highlights the various problems with different methods of funding and why they were changed. It also notes the many reviews of local government funding and proposals that have been made for change. Chapter III concludes with an analysis of the High Court’s decision in the *Pape* and *Williams* cases and their potential effect upon the direct funding of local government, as well as a discussion of the current funding of local government and an assessment of the level of financial autonomy of local government.

Chapter IV provides contrasting material which looks at how local government is funded in other federations. It includes an assessment of the benefits and problems arising from different forms of funding, including own-source revenue, transfers and tax-sharing. It concludes with an assessment of how Australian local government differs from local government in most other federations, but continues to consider what ideas might still usefully be borrowed from other countries.

Chapter V provides an analysis of the 1974 and 1988 failed referenda on the constitutional recognition of local government. In doing so, it shows the types of arguments that are likely to be re-run in any future referendum. It also provides a detailed analysis of how local government is recognised in State Constitutions.

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<sup>1</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 8.

<sup>2</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 2.

Chapter VI addresses the current campaign for the constitutional recognition of local government. In particular, it provides a critique of the Final Report of the Expert Panel on the Constitutional Recognition of Local Government. It assesses submissions made to the Panel as well as the Panel's findings. It concludes by providing a more in depth analysis of the potential effects of the proposed amendment upon the federal system as well as the financial implications of such a referendum.

## II LOCAL GOVERNMENT AND THE COMMONWEALTH CONSTITUTION

The Commonwealth Constitution establishes Australia's federal system. It is a classic dualist federal system,<sup>3</sup> in which powers and functions are allocated to two levels of government, with local governments being 'mere creatures of states, existing at their will and having no independent relations with the federal government'.<sup>4</sup>

At the time of federation, it would have been most unusual if local government had been recognised as a separate level of government. The United States Constitution makes no reference to local government. The Canadian *British North America Act 1867* only mentions 'municipal institutions of the Province' through its inclusion in a list of powers exclusively held by the Provinces.<sup>5</sup> Local government, since its inception by colonial legislation,<sup>6</sup> has remained subordinate to the colonies, and later the States, and is not a separate level of government. The States, in the exercise of their plenary legislative powers, have the power to establish local government in whatever form they wish and give it such powers, functions and responsibilities as they choose.

Jenks, writing in 1891 on *The Government of Victoria*, noted that in England some 'local organs date back to a time far older than the central government itself'. He observed that the position in Victoria was quite different:

In the true sense of the term, there never has been any local government in Victoria. That is, there has never been any local unit evolved spontaneously and independently of the central power. Every local authority is a creation either of the Imperial or the colonial legislature, and is a subordinate body deriving its existence from a higher source.<sup>7</sup>

After federation, the same view was taken by the High Court. In one of the first cases concerning local government, the Chief Justice of the High Court, Sir Samuel Griffith, noted that under the Commonwealth Constitution 'the Commonwealth and the State are regarded as distinct and separate sovereign bodies, with sovereign powers limited only by the ambit of their authority under the Constitution'.<sup>8</sup> Included within that sovereign

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<sup>3</sup> Cheryl Saunders, 'Constitutional recognition of local government in Australia', in N Steytler (ed), *The place and role of Local Government in Federal Systems* (Konrad-Adenauer-Stiftung, 2005), 47, 60; Alan Fenna, 'Federalism and Local Government in Australia', *Public Administration Today*, January-March 2008, 47-8.

<sup>4</sup> Nico Steytler, 'Comparative Conclusions' in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, Montreal, 2009) p 393.

<sup>5</sup> *British North America Act 1867*, s 92(8).

<sup>6</sup> See further: F A Larcombe, *The Origin of Local Government in New South Wales 1831-58* (Sydney University Press, 1973).

<sup>7</sup> Edward Jenks, *The Government of Victoria, Australia*, (Macmillan, London, 1891) p 325.

<sup>8</sup> *Municipal Council of Sydney v Commonwealth* (1904) 1 CLR 208, 231 (Griffith CJ).

power was the right of taxation, which is a right of a State that can only be exercised by a municipality if delegated to it by the State.<sup>9</sup> Justice O'Connor also observed:

The State, being the repository of the whole executive and legislative powers of the community, may create subordinate bodies, such as municipalities, hand over to them the care of local interest, and give them such powers of raising money by rates or taxes as may be necessary for the proper care of these interests. But in all such cases these powers are exercised by the subordinate body as agent of the power that created it.<sup>10</sup>

Local government therefore has no status or powers of its own. It does not exist as a spontaneous or independent creation of the people. Its existence and powers are derived from State legislation. Local government is a subordinate body of the State, exercising its powers by delegation from the State and under the State's supervision and authority.

Under the Commonwealth Constitution, local government is not explicitly recognised. It does however, fall within the meaning of the term 'State'. It is therefore subject to the same obligations as the States under the Commonwealth Constitution<sup>11</sup> and receives the same implied protection as the States.<sup>12</sup> This is relevant to any effort to make local government a third level of government, independent from the others.

If it was proposed to establish local government as a third level of government in the Commonwealth Constitution, then consideration would have to be given to how this would affect existing provisions, such as s 114 of the Constitution, and existing constitutional implications. It would also require the implication or express inclusion of provisions dealing with the allocation of powers and responsibilities between the newly established three levels of government and rules concerning clashes between them. Such an exercise would involve a major review of the operation of the federal system and significant and detailed formal amendments throughout the Commonwealth Constitution.

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<sup>9</sup> *Municipal Council of Sydney v Commonwealth* (1904) 1 CLR 208, 230 (Griffith CJ).

<sup>10</sup> *Municipal Council of Sydney v Commonwealth* (1904) 1 CLR 208, 240 (O'Connor J).

<sup>11</sup> For example, local government cannot impose rates upon Commonwealth property because of the application of s 114 of the Commonwealth Constitution which prohibits a 'State' from taxing Commonwealth property: *Municipal Council of Sydney v Commonwealth* (1904) 1 CLR 208.

<sup>12</sup> Note that the implied constitutional protection of the States from Commonwealth legislation that discriminates against them or impedes their capacity to exercise their constitutional powers was first established in a case concerning the capacity of a local government body to enter into banking transactions: *Melbourne Corporation v Commonwealth* (1947) 74 CLR 31.

### III THE FUNDING OF LOCAL GOVERNMENT IN AUSTRALIA

#### The early Commonwealth funding of local government – Roads 1922-1945

Local government, from its inception in Australia, has been largely funded by property taxes, imposed in the form of rates. Local government, primarily through its responsibility for roads, plays a larger role in the construction of infrastructure in Australia than it does in relation to the provision of services. This capital expenditure has long needed extra assistance. In 1922 the Commonwealth made its first grant to the States, under the *Loan Act (No 7) 1922* (Cth). It was to be used for the maintenance of existing highways and rural and regional roads outside of cities. The intention was to relieve unemployment in the lead up to the Great Depression. The money was distributed to the States on a *per capita* basis and the States had to match the grants from their own revenue.

The following year the *Main Roads Development Act 1923* (Cth) went further, authorising for the first time grants under s 96 of the Commonwealth Constitution. Section 96 provides that ‘the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit.’ It does not permit the making of direct grants to local government, but a condition may be placed upon the grant to the States that all or part of the money in the grant is passed on to local government bodies.

This time the expressed purpose was not only the relief of unemployment but the construction of new roads to open up areas of the country for settlement and development. Again, the States were required to match the amount of funding from their own revenue (although if the funding was passed by the State on to local government, in many cases the State also expected local government to provide the matching expenditure).<sup>13</sup>

The money was not paid upfront. The State’s Auditor-General was required to assess the expenditure of funds before the Commonwealth would reimburse the States. As one of the aims was to open up country areas, the grants were made in accordance with a formula which balanced the geographical size of States with their population. Two-fifths of the grant was allocated by reference to the area of a State and three-fifths by reference to a State’s population. This applied in relation to ninety-five per cent of the total granted. The final five percent was reserved for Tasmania. The effect was to reduce roads funding to States such as New South Wales and Victoria and increase it in States

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<sup>13</sup> ‘Road Grants Legislation in Australia: Commonwealth Government Involvement 1900-1981’, Bureau of Transport Economics Occasional Paper, (AGPS, Canberra, 1981), p 5, <http://www.bitre.gov.au/publications/00/Files/OP048.pdf>.

such as Western Australia.<sup>14</sup> This method of funding allocation for roads continued until 1959.<sup>15</sup>

The States sought to cover their obligations to provide matching funds by taxing the use of State roads, calculating usage by reference to the sale of petrol in the State. The intention was that the users of the roads should pay for their construction and maintenance. The South Australian Parliament not only enacted such a tax in 1925 but also enacted a law that would suspend the tax if an adequate arrangement was made with the Commonwealth for the payment to the State of any excise on petrol collected by the Commonwealth. The Commonwealth challenged the validity of the State Act, arguing both that it breached s 90 of the Constitution (which prohibits the States from imposing an excise) and s 92 of the Constitution (which requires that inter-state trade and commerce be absolutely free). On 25 November 1925, the High Court held in *Commonwealth v South Australia* that the South Australian tax was invalid because it was really an excise on petrol. It was also held to violate s 92 of the Constitution.<sup>16</sup>

While this litigation was proceeding before the courts, the Commonwealth Parliament enacted the *Federal Aid Roads Act* in 1926. It authorised the making of agreements between the Commonwealth and the States in the form set out in the Schedule. The Schedule provided for the grant of £2 million per year for ten years for the construction and reconstruction of main roads which open up and develop new country, trunk roads between important towns and arterial roads to carry the concentrated traffic from developmental, main, trunk and other roads. The formula of three-fifths population and two-fifths area was retained, as was the requirement for matching State grants, although they were reduced to 15 shillings for every Commonwealth pound. The money was again payable to the State, although s 7(2) protected local government by providing that where a local governing authority constructs or reconstructs a road, the State shall not require it 'to contribute more than one-half of the amount to be provided by the State as its proportion of the cost of constructing or reconstructing such road'. Hence, the States could not pass on more than half of their 'matching' responsibilities to local government.

Although the funding to the States for roads was increased by this Act, the States were concerned that it undermined their autonomy by being too prescriptive. The Victorian Government challenged its validity in the High Court. It was argued that the law was not supported by a head of Commonwealth legislative power, because it was a law with respect to road-making, not financial assistance to the States. Even if it were an Act for the grant of financial aid to the States, it was argued that the conditions attached to it could only be financial terms and conditions and could not amount to the exercise of a legislative power beyond those conferred upon the Commonwealth in s 51 of the Commonwealth Constitution.<sup>17</sup> The Commonwealth, in reply, attempted to attach such

<sup>14</sup> R H Burke, 'History of Commonwealth Government Legislation Relating to Roads and Road Transport 1900-1972', Bureau of Transport Economics, Occasional Paper No. 8, 1977: p 3.

<sup>15</sup> R H Burke, 'History of Commonwealth Government Legislation Relating to Roads and Road Transport 1900-1972', Bureau of Transport Economics, Occasional Paper No. 8, 1977: p 3.

<sup>16</sup> *Commonwealth v South Australia* (1926) 38 CLR 408.

<sup>17</sup> See the arguments of Robert Menzies, who was the Attorney-General of Victoria at the time: *Victoria v Commonwealth* (1926) 38 CLR 399, 405.

spending to its powers with respect to immigration and defence, arguing that road construction was necessary to support its immigration program and the resettlement of soldiers on Crown land in rural areas.<sup>18</sup> In a judgment handed down five days after its judgment striking down South Australia's attempt to tax road usage through petrol use, the High Court upheld the validity of the *Federal Aid Roads Act* 1926. It did not appear to require any further head of power beyond s 96 of the Constitution, effectively allowing the Commonwealth to fund any matters through grants to the States upon any conditions that it wished to apply.

The consequence of these two cases was that the Commonwealth continued to fund State roads through s 96 grants, imposing any conditions upon the grants that it chose. It also increased its excise upon petrol to fund its own grants to the States, permitting a form of 'user-pays' funding that the States were unable to achieve.<sup>19</sup>

By 1931 the Commonwealth and the States were all struggling to maintain their road funding commitments as the depression began to bite. The *Federal Roads Act* 1931 (Cth) removed the fixed grants of £2 million and replaced them with an amount calculated by reference to a proportion of the customs duty on imported petrol and the excise duty on locally refined petrol.<sup>20</sup> The States were also released from the obligation to match the grants and the purposes for which the money could be used were expanded to allow the maintenance as well as the construction of roads in both rural and metropolitan areas.

The fact that grants were now tied to revenue from the Commonwealth's fuel customs and excise duties meant that the amounts of the grants fluctuated greatly according to the circumstances. By the outbreak of World War II the grants had risen to approximately \$9 million per annum<sup>21</sup> because of the increasing use of petrol and greater car ownership. However, during the war, petrol was rationed and the grants dropped to approximately \$3 million in 1943 as a consequence.

### **Post-War Commonwealth Roads Funding**

In 1947 the mechanism for making grants for road funding was changed. The Commonwealth ceased making agreements with the States and returned to simply making grants calculated by reference to a proportion of the amount raised from petrol taxes and according to conditions set out in the relevant Act. The grants were confined to a three year period, instead of ten years as in the previous agreements, due to the existing fiscal uncertainty. Specific amounts were quarantined for rural roads (which permitted

<sup>18</sup> *Victoria v Commonwealth* (1926) 38 CLR 399, 402-4.

<sup>19</sup> 'Road Grants Legislation in Australia: Commonwealth Government Involvement 1900-1981', Bureau of Transport Economics Occasional Paper, (AGPS, Canberra, 1981), pp 13-15, <http://www.bitre.gov.au/publications/00/Files/OP048.pdf>.

<sup>20</sup> R H Burke, 'History of Commonwealth Government Legislation Relating to Roads and Road Transport 1900-1972', Bureau of Transport Economics, Occasional Paper No. 8, 1977: p 5.

<sup>21</sup> This figure and those following use dollar estimations rather than pounds and are taken from: R H Burke, 'History of Commonwealth Government Legislation Relating to Roads and Road Transport 1900-1972', Bureau of Transport Economics, Occasional Paper No. 8, 1977.

States to buy road-making equipment for rural local government bodies), strategic roads and for road safety.<sup>22</sup> In Parliament, concern was expressed that the full amount reaped from the petrol taxes was not being used for roads funding. The Opposition argued that specific purpose taxes of that kind should not be used for general revenue and that either the taxes should be reduced to benefit motorists, or the full amount should be used for roads.<sup>23</sup> The Commonwealth did not agree and the grants remained link to only a proportion of the yield from these taxes.

By 1949, the size of the grants had rebounded from their low point during the war of \$3 million to \$17.7 million, as a result of rising fuel consumption and an increased proportion of fuel excise and customs duties being used for the grants. This increased rapidly throughout the 1950s, up to \$33.2 million in 1953-54 and \$77.8 million in 1958-9. This was in part a response to the perceived need to address road infrastructure needs in the wake of the war period where little had been spent on roads and many roads had been damaged by heavy military vehicles and needed repair.

The method for funding road grants and their distribution amongst the States was changed in 1959. The relationship with the fuel taxes was cut. Fixed amounts were granted from general Commonwealth revenue. Part of the grant was subject to the States matching it dollar for dollar, but most of it was not. In terms of State distribution, five percent was maintained for Tasmania. The rest of the grant was distributed between the other States on the basis of one-third area, one-third population and one-third the numbers of registered motor vehicles. The reason was that those States (primarily New South Wales and Victoria) with significant industry and commercial transport, found that this caused damage and congestion to their roads and claimed extra assistance.<sup>24</sup> The focus for road funding had moved from its early aim of opening up rural areas for settlement and farming, to supporting industry and economic development.

As the Commonwealth's financial commitment to roads funding continued to increase significantly, the Commonwealth became more concerned with road planning, transport and the efficiency of the road system. In 1964 it established the Commonwealth Bureau of Roads to advise on these matters, including the making of grants to the States for roads. The focus turned to increasing national productivity through a roads programme that met economic and community needs.<sup>25</sup> By 1969 the Commonwealth had become more prescriptive in its roads funding, allocating grants between four categories – urban arterial roads, rural arterial roads, rural local roads and planning and research. The

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<sup>22</sup> R H Burke, 'History of Commonwealth Government Legislation Relating to Roads and Road Transport 1900-1972', Bureau of Transport Economics, Occasional Paper No. 8, 1977: p 7.

<sup>23</sup> 'Road Grants Legislation in Australia: Commonwealth Government Involvement 1900-1981', Bureau of Transport Economics Occasional Paper, (AGPS, Canberra, 1981), pp 24-5.

<sup>24</sup> R H Burke, 'History of Commonwealth Government Legislation Relating to Roads and Road Transport 1900-1972', Bureau of Transport Economics, Occasional Paper No. 8, 1977: p 9.

<sup>25</sup> R H Burke, 'History of Commonwealth Government Legislation Relating to Roads and Road Transport 1900-1972', Bureau of Transport Economics, Occasional Paper No. 8, 1977: p 12.

funding of the construction of urban arterial roads became a new focus, receiving nearly 50% of the grant.<sup>26</sup>

### **Specific purpose grants other than general roads funding 1922-1972**

During the period from 1922 to 1972, the Commonwealth also made specific grants in relation to particular roads or particular types of roads. For example, grants were made in relation to the Eyre Highway and the Barkly Highway. Money was also granted for the improvement of 'beef roads' to permit cattle transport and expand the beef export industry to the United Kingdom.<sup>27</sup>

Beyond roads, in rare circumstances local government did receive some funding from the Commonwealth, particularly where local government bodies were providing the same services as religious, charitable or non-profit welfare organisations, as they were all eligible for the same grants. Hence local government bodies in Victoria (but not other States) applied for and received grants for the provision of welfare services to the elderly under the *States Grants (Home Care) Act 1969* (Cth). Local government bodies also received capital grants for the construction of senior citizens' centres. The first direct payments by the Commonwealth to local government authorities came through the meals on wheels program. Again, most recipients of the grants were non-government bodies, but in Victoria local government bodies became involved in providing these services and therefore received direct grants.<sup>28</sup>

### **The Whitlam Government funding revolution**

The Whitlam Government came to office with a strong antipathy towards the States. Its plan to increase Commonwealth power and dominate the States included raising the status, funding and responsibilities of local government and encouraging local government bodies to join together in regional organisations.<sup>29</sup> Its intention was to bypass the States<sup>30</sup> by funding local government and eventually supplant the States with regional bodies that would be under Commonwealth control. It did not succeed. However, as part of this plan, local government was accorded greater significance and representation on bodies such as the Australian Constitutional Convention.

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<sup>26</sup> 'Road Grants Legislation in Australia: Commonwealth Government Involvement 1900-1981', Bureau of Transport Economics Occasional Paper, (AGPS, Canberra, 1981), p 35.

<sup>27</sup> R H Burke, 'History of Commonwealth Government Legislation Relating to Roads and Road Transport 1900-1972', Bureau of Transport Economics, Occasional Paper No. 8, 1977: pp 14-15.

<sup>28</sup> Margaret Bowman, 'Local Government and Specific Purpose Grants' in *National Inquiry into Local Government Finance*, Vol 2 – Research and Consultancy Reports, (AGPS, 1985), p 21.

<sup>29</sup> Gough Whitlam, 'The future of Australian federalism' in E G Whitlam *On Australia's Constitution* (Widescope International Publishers, 1977) pp 152-3.

<sup>30</sup> Cheryl Saunders, 'Constitutional recognition of local government in Australia', in N Steytler (ed), *The place and role of Local Government in Federal Systems* (Konrad-Adenauer-Stiftung, 2005), 47, 50-1.

Local government was also granted both general purpose untied funding and specific purpose grants above and beyond those previously made for the construction and maintenance of roads. Local government bodies were encouraged to band together in regional groups. Approved regional organisations could then make applications for grants of financial assistance. The Commonwealth Grants Commission would assess those applications and make recommendations to the Commonwealth Government to provide general purpose grants through the states to local government bodies within the region. The principle that the Commonwealth Grants Commission had to apply was that grants should enable ‘all the local governing bodies in a region to function, by reasonable effort, at a standard not appreciably below the standards of the local governing bodies in other regions’.<sup>31</sup>

Further, funding was sent directly to local government through programs such as the Regional Employment Development Scheme.<sup>32</sup> The amounts involved were significant. At the height of this program, direct payments exceeded general purpose grants, amounting to \$93.9 million.<sup>33</sup> However, the scheme was inefficient and ineffective because the grass-roots work had not been done to develop programs that would turn local government into an effective source of job creation.<sup>34</sup> Another direct grant scheme was to local authorities to assist in provision of training and employment for Aboriginal people.<sup>35</sup>

Other programs, such as the Australian Assistance Plan,<sup>36</sup> were focused on regions and did not utilise the existing structure of local government authorities. A High Court challenge to the direct funding of regional organisations through the Australian Assistance Plan failed, although the judgment did not result in a clear majority either way on the Commonwealth’s capacity to spend, as the Court was split and one judge decided the case upon the issue of standing only.<sup>37</sup>

Prime Minister Whitlam argued that the ‘role we assign to local government is the real answer to charges of centralism’.<sup>38</sup> Indeed, it was. Direct funding to local government and the expansion of its functions was intended to increase Commonwealth control over functions and bodies previously controlled by the States. Whitlam stated that his government had deliberately ‘made and shall make local government a vehicle for our legislation on aged persons’ homes and hostels, sheltered employment, handicapped

<sup>31</sup> *Grants Commission Act 1973* (Cth), s 6.

<sup>32</sup> Lyndon Megarrity, ‘Local government and the Commonwealth: An evolving relationship’ Parliamentary Library Research Paper No 10, 3020-11, 31 January 2011, p 8.

<sup>33</sup> Margaret Bowman, ‘Local Government and Specific Purpose Grants’ in *National Inquiry into Local Government Finance*, Vol 2 – Research and Consultancy Reports, (AGPS, 1985), p 22.

<sup>34</sup> Margaret Bowman, ‘Local Government and Specific Purpose Grants’ in *National Inquiry into Local Government Finance*, Vol 2 – Research and Consultancy Reports, (AGPS, 1985), p 22.

<sup>35</sup> *State Grants (Aboriginal Advancement) Act 1972* (Cth). See also: Margaret Bowman, ‘Local Government and Specific Purpose Grants’ in *National Inquiry into Local Government Finance*, Vol 2 – Research and Consultancy Reports, (AGPS, 1985), p 27.

<sup>36</sup> See further, Geoffrey Sawer, *Federation Under Strain*, (MUP, 1977) pp 22-4.

<sup>37</sup> *Victoria v Commonwealth and Hayden* (1975) 134 CLR 338.

<sup>38</sup> Gough Whitlam, ‘1974 Party Policy Speech’ in E G Whitlam *On Australia’s Constitution* (Widescope International Publishers, 1977) p 332.

children, meals on wheels, home care and nursing, nursing homes and homeless men and women.’<sup>39</sup> Yet the main focus was on funding non-profit organisations to fulfil these roles and while local government could also ‘buy into programs’ if it wished, it was not an integral part of service delivery for these programs and it competed with the non-government sector for grants.<sup>40</sup>

Whitlam’s support for regionalism was seen as overshadowing his government’s commitment to local government<sup>41</sup> or even as hostile to it.<sup>42</sup> Funds allocated upon a regional basis were usually for ‘programs administered by development corporations with little local government involvement in policy formulation and implementation.’<sup>43</sup> New funding which was initially greeted with ‘euphoria’ eventually gave rise to ‘difficulties and mistrust’.<sup>44</sup>

In addition to making general purpose grants to local government, through the States, the Whitlam Government also continued funding roads. But the price for the funding was far greater Commonwealth involvement in the planning of roads and oversight of the spending of the grant. The Commonwealth assumed full funding responsibility (and complete control) of what it nominated as ‘national highways’ With respect to other roads, it proposed that the States be required to submit their proposals for road-works to the Commonwealth for approval. Some argued that this was inappropriate, because the Commonwealth has no expertise in road building and could hardly pass judgments on the projects.<sup>45</sup> The Commonwealth argued, however, that it had a responsibility to ensure that its grants were being administered efficiently and that national policy outcomes were being achieved. The Senate amended the *National Roads Bill* and the *Roads Grants Bill* to reduce Commonwealth interference with State activities. However, the requirement that the Commonwealth give approval for all expenditure on urban arterial roads, regardless of whether it was funded by State or Commonwealth money, was retained.<sup>46</sup>

### **The Fraser era – tax sharing**

The Fraser Government’s ‘new federalism’ involved a return to funding local government through 96 grants to the States. The Government also abandoned the ‘regionalism’ aspects of the Whitlam funding approach, announcing that ‘artificial regions will not be forced on local authorities’ and that ‘regions will not be used by the

<sup>39</sup> Gough Whitlam, ‘1974 Party Policy Speech’ in E G Whitlam *On Australia’s Constitution* (Widescope International Publishers, 1977) pp 332-3.

<sup>40</sup> Margaret Bowman, ‘Local Government and Specific Purpose Grants’ in *National Inquiry into Local Government Finance*, Vol 2 – Research and Consultancy Reports, (AGPS, 1985), p 22.

<sup>41</sup> Lyndon Megarrity, ‘Local government and the Commonwealth: An evolving relationship’ Parliamentary Library Research Paper No 10, 3020-11, 31 January 2011, pp 9-10.

<sup>42</sup> Margaret Bowman, ‘Local Government and Specific Purpose Grants’ in *National Inquiry into Local Government Finance*, Vol 2 – Research and Consultancy Reports, (AGPS, 1985), p 22.

<sup>43</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), p 45.

<sup>44</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), p 45.

<sup>45</sup> Commonwealth, *Parliamentary Debates*, House of Representatives, 1 August 1974, p 989 (Mr Nixon).

<sup>46</sup> ‘Road Grants Legislation in Australia: Commonwealth Government Involvement 1900-1981’, Bureau of Transport Economics Occasional Paper, (AGPS, Canberra, 1981), pp 38-40.

Commonwealth as centralist instruments to by-pass the States, to amalgamate areas or impose Commonwealth policies'.<sup>47</sup> Prime Minister Fraser, however, had his own radical 'new federalism' plan. He proposed giving the States and local government access to income tax. Local government initially received 1.52% of personal income tax revenue (excluding special levies and surcharges), which eventually rose to 1.75% in 1979 and 2% in 1980. The intention was that the States and local government would gain the benefits of economic growth, with the expansion of income tax revenue, but also bear its cost in times of recession.<sup>48</sup> The Commonwealth gave a guarantee, however, that the total entitlement of local government would not be less in absolute terms in one year than the previous year.<sup>49</sup>

The *Local Government (Personal Income Tax Sharing) Act 1976* (Cth) provided for the distribution of local government's share of income tax revenue to each State according to a fixed percentage. For example, New South Wales initially received 36.6345%, Queensland received 17.3016% and Tasmania received 2.8601%.<sup>50</sup> This allocation was determined by reference to the Commonwealth Grants Commission's recommendation which was built on the previous approach put in place by the Whitlam Government.<sup>51</sup> Despite a number of reviews and many complaints, this allocation, as adjusted in 1977,<sup>52</sup> remained in force until 1985.<sup>53</sup>

Once distributed to the States, the money was then distributed amongst local government within the State with 30% allocated to local government bodies on a population basis. The rest was distributed on a 'general equalization basis' with the 'object of ensuring, so far as is practicable, that each of those local governing bodies is able to function, by reasonable effort, at a standard not appreciably below the standards of the other local governing bodies in the State, being a basis that takes account of differences in the capacities of those local governing bodies to raise revenue and differences in the amounts required to be expended by those local governing bodies in the performance of their functions.'<sup>54</sup> In making this distribution, the State Government was required to take into account the recommendations of a Local Government Grants Commission, which it had to establish as a condition of receiving the grants.<sup>55</sup>

It was also a condition of the grant to the State that it would make the payments to local government 'without undue delay' and that those payments be 'unconditional' in the way

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<sup>47</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), pp 45-6.

<sup>48</sup> Judy McNeill, 'Local government in the Australian federal system' in B Dollery and N Marshall (eds), *Australian Local Government: Reform and Renewal* (Macmillan, 1997) p 27.

<sup>49</sup> Commonwealth, *Parliamentary Debates*, House of Representatives, 14 October 1976, p 1898.

<sup>50</sup> *Local Government (Personal Income Tax Sharing) Act 1976* (Cth), s 5(2).

<sup>51</sup> For a discussion of the way in which the Commonwealth Grants Commission made its assessments, see: Commonwealth Grants Commission, 'Special Report 1979 on Financial Assistance for Local Government' (AGPS, 1979) pp 4-8.

<sup>52</sup> See the 1976 and 1977 comparisons in: *National Inquiry into Local Government Finance* (AGPS, 1985), p 58.

<sup>53</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), pp 4 and 58.

<sup>54</sup> *Local Government (Personal Income Tax Sharing) Act 1976* (Cth), s 6(2)(b).

<sup>55</sup> *Local Government (Personal Income Tax Sharing) Act 1976* (Cth), ss 6-7.

they could be used. The State also had to provide a certificate by the Auditor-General certifying the payments made.<sup>56</sup>

In its roads funding the Fraser Government reinserted some flexibility into the process, making it easier to transfer funding between different categories of roads and reducing Commonwealth control over the program for the construction and repair of local roads. States were given the choice either to submit the details of their roads program to the Commonwealth or a list of how the money was to be allocated between local government bodies. In relation to urban roads, the need for the Commonwealth's approval was limited to projects using Commonwealth money.<sup>57</sup>

### **The Hawke/Keating era – a return to grants**

When the Hawke Government came to office it commissioned a Committee of Inquiry into Local Government. It reported in October 1985<sup>58</sup> and the Government accepted most of the recommendations of the report. These were largely implemented in the *Local Government (Financial Assistance) Act* 1986 (Cth). This Act dropped the tie between local government funding and personal income tax revenue. The reason primarily given for this change was that the link to personal income tax revenue was too volatile. Local government could not plan ahead because it could not predict what the size of its grants would be. It was argued in the second reading speech that a direct grant system would be more stable and allow better forward planning.<sup>59</sup>

The true underlying reason, however, was that the Hawke Government wished to impose limits on public sector spending in order to reduce the budget deficit and found that it was easier to do this if it took direct control over the grant of financial assistance to the States and through the States to local government.<sup>60</sup> It sought to 'un-lock' existing expenditure commitments so that it could make its allocations of funding within the 'annual budgetary context'.<sup>61</sup> The Finance Minister noted that under the Fraser Government's scheme, local government would have received a 20% increase of funding in 1985-6, but that the Hawke Government would, for economic reasons, limit this to a two per cent increase in real terms.<sup>62</sup>

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<sup>56</sup> *Local Government (Personal Income Tax Sharing) Act* 1976 (Cth), s 8.

<sup>57</sup> 'Road Grants Legislation in Australia: Commonwealth Government Involvement 1900-1981', Bureau of Transport Economics Occasional Paper, (AGPS, Canberra, 1981), pp 40-1.

<sup>58</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), sometimes known as the 'Self Report' after its Chairman, Peter Self.

<sup>59</sup> Commonwealth, *Parliamentary Debates*, House of Representatives, 2 May 1986, p 2999.

<sup>60</sup> Judy McNeill, 'Local government in the Australian federal system' in B Dollery and N Marshall (eds), *Australian Local Government: Reform and Renewal* (Macmillan, 1997) p 27.

<sup>61</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), p 63, quoting from the Treasurer in the 1984-5 budget papers.

<sup>62</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), p 63, quoting the Minister for Finance, Senator Walsh, 25 March 1985.

The Hawke Government introduced Financial Assistance Grants ('FAGs'). They were distributed between the States by reference to the population of a State as a proportion of the total population of all States in the preceding year, rather than the fixed proportions based on recommendations of the Commonwealth Grants Commission, as had previously been the case.<sup>63</sup> The Fraser Government's distribution model was, by 1985, well out of date and no submissions made to the Commonwealth inquiry on the subject (the 'Self inquiry') supported its continuation.<sup>64</sup> Distribution on the basis of population had previously been recommended by the Commonwealth Grants Commission in 1979 because of its 'simplicity and predictability'.<sup>65</sup> The Commission considered that the adoption of any other system 'would entail analyses and decisions of a highly complex character' and require it to make direct contact with local government bodies to obtain the necessary information.<sup>66</sup> Its recommendation was rejected at that time because a majority of the States disagreed.<sup>67</sup>

By 1985, however, the Self inquiry noted that changes in population meant that the switch from the existing system to allocation on a per capita basis would be relatively minor in effect upon the States and that the money that would otherwise be spent on another inquiry on methods of equalisation 'would be better spent on improving local government services directly'.<sup>68</sup> It pointed to the inefficiency of a Commonwealth agency being involved in collecting or checking data on individual local government areas in order to assess interstate relativities. It regarded such activity as costly and wasteful, as it would duplicate the work of the existing local government grants commissions.<sup>69</sup> The Self inquiry also noted other problems with the Commonwealth making such an assessment, such as the fact that the 'boundary line of responsibility between local and State governments is differently drawn in different States, and indeed may vary within States.'<sup>70</sup> Any central body which was trying to assess the distribution of grants between States on an equalisation basis would have to be able to accommodate the fact that water services, welfare services and transport services are variously provided by State and local government bodies depending upon the relevant jurisdiction, and are often different within States. The inquiry concluded that while population was not the best method of assessment, it was preferable to the existing method, and could be 'adopted in the short run pending a comprehensive review' in the future.<sup>71</sup> The Hawke Government adopted this 'short run' population approach for distributing funds between the States and it continues to operate today.

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<sup>63</sup> *Local Government (Financial Assistance) Act 1986* (Cth), s 7(4). Note that this was phased in over a number of years.

<sup>64</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), p 293.

<sup>65</sup> Commonwealth Grants Commission, 'Special Report 1979 on Financial Assistance for Local Government' (AGPS, 1979) p 18.

<sup>66</sup> Commonwealth Grants Commission, 'Special Report 1979 on Financial Assistance for Local Government' (AGPS, 1979) p 18.

<sup>67</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), p 293.

<sup>68</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), p 294.

<sup>69</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), p 294.

<sup>70</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), p 295.

<sup>71</sup> *National Inquiry into Local Government Finance* (AGPS, 1985), p 300.

The amount of the funding provided each year under the Hawke Government's local government FAGs program was linked to the amount granted to the States in FAGs and certain other grants each year. However, for the first two years a 'real terms guarantee' applied, so that local government received, at a minimum, the amount granted in the previous year adjusted for inflation. This guarantee was relied upon, as in the following years the amount of funding to the States was cut in real terms. However, after the guarantee period finished, local government also 'suffered cuts in real terms in 1988-89, 1989-90 and 1990-91 when real State general purpose funding fell.'<sup>72</sup>

The Hawke Government retained the role of the Local Government Grants Commissions, but also required each State to formulate principles for allocating the money amongst local governing bodies and to provide those principles to the Commonwealth Minister. In formulating those principles, States were required to consult with bodies that represent local government. They were also required to have regard to the objective of making the allocation 'on a full horizontal equalisation basis' subject to the distribution of 30% of the grant on the basis of population.<sup>73</sup> Local Government Grants Commissions were required to hold public hearings and accept submissions before making their recommendations on the allocation of grants. A State's entitlement to these grants was dependent upon the Commonwealth Minister being satisfied that the State had regard to, or adopted, the recommendations of the Local Government Grants Commission and that the allocation was made in accordance with the principles.<sup>74</sup> As under the Fraser Government's scheme, the States had to make the payments to local government bodies 'without undue delay' and the payments had to be unconditional. The payments also had to be certified by the Auditor-General.<sup>75</sup>

Roads funding was provided to local government, through the States, under the *Australian Land Transport Development Act 1988* (Cth). As some local roads came under the authority of the States rather than local government bodies (for example, roads in unincorporated areas where there was no local government body) some portions of these grants were retained by the State and were not passed on to local government.<sup>76</sup> This is perhaps the source for the common misconception that financial assistance grants to local government are not passed on in their entirety and that the States 'skim' money off the top of them.

Some specific purpose payments were still made directly to local government, but these were largely either capital grants for buildings (eg senior citizens' centres or child care centres) or for welfare services, where local government could apply for grants in the same manner as any other group, such as a charity or other non-government body. As Margaret Bowman noted in 1985:

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<sup>72</sup> Richard Webb, 'Commonwealth general purpose financial assistance to local government' Parliamentary Library Research Paper No 9, 2007-08, 14 September 2007, p 5.

<sup>73</sup> *Local Government (Financial Assistance) Act 1986* (Cth), s 9(2).

<sup>74</sup> *Local Government (Financial Assistance) Act 1986* (Cth), s 10.

<sup>75</sup> *Local Government (Financial Assistance) Act 1986* (Cth), s 11.

<sup>76</sup> Commonwealth Grants Commission, 'Report on the Review of the Interstate Distribution of Local Roads Grants' (2006) p 7.

Specific purpose grants paid direct to local authorities are the most numerous, but are less important for local government in general than those passing through the States for the following reasons:

- except for the Aerodromes Local Ownership and Local Government Development and Improvement programs, all payments made direct to local government are for health/welfare services for which local authorities form a minority of providing agencies. They are primarily directed towards non-government bodies;
- they involve for local government relatively small aggregate sums; and
- they are variable in their impact either because only designated authorities or those successful in making a submission will receive grants.

Specific purpose grants passed on to local government authorities by the States involve much larger sums in aggregate and include the only program which is universal in its distribution: roads funds.<sup>77</sup>

The distribution of FAGs between the States upon a per capita basis remained controversial and the issue was sent to the Commonwealth Grants Commission for further consideration. The Commission supported in principle distribution on a fiscal equalisation basis but noted that there were data and methodology deficiencies which prevented moving to such a system at that time. The Commonwealth decided in 1992 to retain the existing per capita distribution for FAGs.<sup>78</sup>

A Special Premier's Conference, in October 1990, agreed that the specific purpose grants given to local government for the funding of local roads under the *Australian Land Transport Development Act* 1988 should be continued but 'untied' so that they could be used for any purpose. These untied grants became known as 'identified local road grants' and from then on were distributed under the *Local Government (Financial Assistance) Act* 1986 (Cth) along with general purpose financial assistance grants. However, if these grants were distributed upon the same per capita basis, this would have disadvantaged Western Australia, Tasmania, Queensland and the Territories. It was therefore agreed that the identified local road grants would continue to be distributed on the previous basis, leaving it frozen in time even though population and needs changed over time.<sup>79</sup>

The local government funding system was reviewed again in 1994. The resulting report noted that the Local Government Grants Commissions operated their systems of fiscal equalisation differently, with some favouring local government areas with growing populations and others favouring those with shrinking populations. It also recommended against distributing identified local road grants upon a per capita basis as this would be

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<sup>77</sup> Margaret Bowman, 'Local Government and Specific Purpose Grants' in *National Inquiry into Local Government Finance*, Vol 2 – Research and Consultancy Reports, (AGPS, 1985), p 32.

<sup>78</sup> Commonwealth Grants Commission, 'Report on the Review of the Interstate Distribution of Local Roads Grants' (2006) p 6.

<sup>79</sup> Richard Webb, 'Commonwealth general purpose financial assistance to local government' Parliamentary Library Research Paper No 9, 2007-08, 14 September 2007, p 6.

disruptive.<sup>80</sup> In response to the review, the Commonwealth Parliament enacted the *Local Government (Financial Assistance) Act 1995* (Cth). Section 3 of the Act stated that in providing financial assistance, it was the goal of the Parliament to ‘increase the transparency and accountability of the States with respect to the allocation of funds under this Act to local governing bodies’ and to ‘promote consistency in the methods by which grants are allocated to achieve equitable levels of services by local governing bodies’. To achieve these goals, it provided for the Commonwealth Minister to set out national principles<sup>81</sup> for the allocation of funding amongst local government bodies. These principles were to ensure ‘as far as practicable’ that such allocations were made on a ‘full horizontal equalisation basis’ subject to the continuation of the 30% per capita distribution.<sup>82</sup> The reference to ‘full horizontal equalisation’ was explained further as meaning an allocation of funds that ‘ensures that each local governing body in a State is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in the State’ and ‘takes account of differences in the expenditure required to be incurred by local governing bodies in the performance of their functions and in their capacity to raise revenue.’<sup>83</sup> The Local Government Grants Commission’s recommendations must be made in accordance with the national principles.

### **The Howard Government and local government funding**

The Howard Government radically changed the funding of State Governments by introducing a goods and services tax (‘GST’) and transferring the proceeds (after the costs of collection were deducted) to the States on an equalisation basis. The original agreement involved the States taking over the funding of local government, drawing on the proceeds of the GST. However, the scope of the GST was diminished in a deal between the Government and the Australian Democrats, reducing the proceeds that would flow to the States. The Commonwealth therefore retained its financial role in providing assistance to local government. It could no longer do so, however, by reference to State FAGs, as these had terminated and been replaced with the GST payments. So the Commonwealth enacted the *Local Government (Financial Assistance) Amendment Act 2000* (Cth), which included a formula (being an ‘escalation factor’ based upon population growth and the consumer price index) to calculate the general purpose FAGs to be provided to local government each year.<sup>84</sup>

In December 2000 the Howard Government introduced the ‘Roads to Recovery’ program, directly funding local government rather than funnelling funding through s 96

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<sup>80</sup> Richard Webb, ‘Commonwealth general purpose financial assistance to local government’ Parliamentary Library Research Paper No 9, 2007-08, 14 September 2007, p 7.

<sup>81</sup> A copy of the national principles may be found at:

[http://www.regional.gov.au/local/assistance/doc/National\\_Principles260809.doc](http://www.regional.gov.au/local/assistance/doc/National_Principles260809.doc).

<sup>82</sup> *Local Government (Financial Assistance) Act 1995* (Cth), s 6(2). See also: Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 111.

<sup>83</sup> *Local Government (Financial Assistance) Act 1995* (Cth), s 6(3).

<sup>84</sup> Richard Webb, ‘Commonwealth general purpose financial assistance to local government’ Parliamentary Library Research Paper No 9, 2007-08, 14 September 2007, p 10.

grants to the States. The rhetoric behind the program has been described as ‘Whitlamesque’ in nature.<sup>85</sup> The money is allocated in a two stage process. First, it is distributed to the States on the basis of a formula that takes into account both population and road length. It is then allocated within the States to individual local government bodies by using the State Local Grants Commissions’ formulae with respect to the local roads component of financial assistance grants.<sup>86</sup> At the time the *Roads to Recovery Bill* was debated, a list was tabled setting out the allocation of funding to each local government body over the life of the program. This was later formalised in a list published in the *Government Gazette*. The focus was therefore placed upon actual amounts to be distributed to particular local government bodies over the life of the program, rather than the methodology for that distribution. This might explain why those who seek the abolition of State local government grants commissions and prefer direct funding under the Roads to Recovery methodology do not seem to appreciate that this program is reliant upon work done by State local government grants commissions.

Section 7 of the *Roads to Recovery Act 2000* (Cth) required that conditions be placed on the grants including that they be used for roads expenditure, that existing levels of roads expenditure other than under this program be maintained and that signs acknowledging Commonwealth expenditure under this program be erected.

This program was only intended to run for four years, but has since been extended on a number of occasions due to its popularity.<sup>87</sup> The current program runs from 2009-10 to 2013-14 and involves \$1.75 billion in funding for roads which is paid directly to local government bodies (or in the case of unincorporated areas, to States).<sup>88</sup> This program is in addition to the ‘identified local road grants’ which continued to be untied and paid according to the old formula. For example, in 2011–12, the Commonwealth paid out \$836.9 million in ‘identified local road grants’ under s 96 of the Constitution and \$349.8 million in the Roads to Recovery program.<sup>89</sup>

The Commonwealth Grants Commission in a 2001 review recommended that local government funding be clarified by being placed into three pools. The per capita pool would cover the existing 30% minimum grant for each local government area. The relative need pool was to cover the rest of the general purpose grants to local government, on a ‘relative need’ assessment based upon equalisation principles. The local roads pool would cover the identified local road grants, but distribute them on the basis of ‘relative road needs’, which would take into account the cost of maintaining existing road

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<sup>85</sup> Lyndon Megarrity, ‘Local government and the Commonwealth: An evolving relationship’ Parliamentary Library Research Paper No 10, 3020-11, 31 January 2011, p 12.

<sup>86</sup> Cth Department of Transport and Regional Services and ALGA, ‘Report on the Roads to Recovery Programme’, February 2003, pp 7-8 and 34; and Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 114.

<sup>87</sup> From 2005 the payments were made under *Auslink (National Land Transport) Act 2005* (Cth): Richard Webb, ‘Commonwealth general purpose financial assistance to local government’ Parliamentary Library Research Paper No 9, 2007-08, 14 September 2007, p 19.

<sup>88</sup> The grants are now paid under the *Nation Building Program (National Land Transport) Act 2009* (Cth).

<sup>89</sup> Commonwealth, *Budget: Australia’s Federal Relations: Budget Paper No 3* (2012–13) 98, 114.

networks, including factors such as the age, type and length of roads, the number of road users and the climate and terrain.<sup>90</sup>

Instead of adopting its recommendations, the Commonwealth referred the matter to the House of Representatives Economics, Finance and Public Administration Committee, as part of an inquiry into cost-shifting. It took a different approach, arguing that the general purpose FAGs and the identified local roads grants should be collapsed into the one pool and that grants should be paid directly by the Commonwealth to local government bodies. It concluded that they should be distributed on equalisation principles and that a new model should be developed for this distribution through the Commonwealth Grants Commission.<sup>91</sup> These recommendations were rejected and the existing funding methods continued to operate.

In 2005 the Howard Government asked the Commonwealth Grants Commission to review the formula for the allocation of the identified roads component of its financial assistance grants to the States. This allocation has not been adjusted since 1991 and had come to be regarded as ‘increasingly anachronistic’.<sup>92</sup> The Commission was asked to recommend a distribution between the States based upon the relative needs of local government. It concluded, however, that it could not make such a recommendation due to the lack of reliable and comparable data on road characteristics. Instead, it recommended as an interim measure the distribution of funds ‘on the basis of average expenditure per person on urban, rural and remote areas and the population of each State resident in those areas’.<sup>93</sup> This would have resulted in reductions in road grants to Western Australia, Tasmania, the Australian Capital Territory and the Northern Territory and increases in funding in the other States. Its recommendations were not adopted by the Commonwealth.

In 2006 the Commonwealth, the States and Territories and the Australian Local Government Association entered into the ‘Inter-Governmental Agreement Establishing Principles Guiding Inter-Governmental Relations on Local Government Matters’. One of the aims of this agreement was to recognise the problem of cost-shifting and to prevent it from occurring in the future. However, the actual terms of this commitment in the Agreement are very weak. It provides:

The Parties agree in principle that where local government is asked or required by the Commonwealth Government or a State or Territory Government to provide a

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<sup>90</sup> Commonwealth Grants Commission, ‘Review of the Operation of the Local Government (Financial Assistance) Act 1995’ (2001) p 38.

<sup>91</sup> House of Representatives Standing Committee on Economics, Finance and Public Administration, *Rates and Taxes: A Fair Share for Responsible Local Government* (October 2003), pp 125-138.

<sup>92</sup> Richard Webb, ‘Commonwealth general purpose financial assistance to local government’ Parliamentary Library Research Paper No 9, 2007-08, 14 September 2007, p 16.

<sup>93</sup> Commonwealth Grants Commission, ‘Report on the Review of the Interstate Distribution of Local Roads Grants’ (2006) p ix.

service or function to the people of Australia, any consequential financial impact is to be considered within the context of the capacity of local government.<sup>94</sup>

Accordingly, the commitment only goes so far as ‘considering’ the potential effects of cost-shifting, rather than doing anything about them.

Both Houses of the Commonwealth Parliament also adopted a resolution in 2006 that provided parliamentary recognition of local government. It stated that the House ‘recognises that local government is part of the governance of Australia’, acknowledged its role and the importance of cooperating and consulting with local government and acknowledged ‘the significant Australian Government funding that is provided to local government to spend on locally determined priorities, such as roads and other local government services’.<sup>95</sup> A proposed amendment moved by the Opposition which would have provided that the House ‘supports a referendum to extend constitutional recognition to local government’ failed.<sup>96</sup>

While Sansom has described this resolution as a ‘token gesture’ he also noted that it underlined the fact that the Commonwealth has increasingly become involved with local government issues regardless of the absence of constitutional recognition.<sup>97</sup>

### **The Rudd/Gillard governments and local government**

Under the Rudd and Gillard Labor governments, the funding of local government has been continued as under the Howard Government. The Roads to Recovery program was extended and the method for the distribution of financial assistance grants was maintained. Local government also benefited from increased infrastructure expenditure during the global financial crisis. In 2011–12, the Commonwealth gave \$2,722,866,000 in financial assistance grants to local government, which passed through the States as 96 grants.<sup>98</sup> It also made direct grants to local government in the sum of \$623,786,000 (which is less than a fifth of total Commonwealth funding to local government).

In 2008 the Rudd Government established the Australian Council of Local Government. Its first meeting was held in November 2008. Its initial aims were to develop a ‘partnership’ between local government and the Commonwealth with regard to a ‘nation building program’ for infrastructure development, to deal with problems in major cities such as congestion and planning and to consult upon plans for a referendum on the

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<sup>94</sup> Inter-Governmental Agreement Establishing Principles guiding Inter-Governmental Relations on Local Government Matters, 2005, cl 3:  
[http://www.lga.sa.gov.au/webdata/resources/files/IGA\\_on\\_cost\\_shifting\\_-\\_signed.pdf](http://www.lga.sa.gov.au/webdata/resources/files/IGA_on_cost_shifting_-_signed.pdf). See also cl 10 which requires consultation with the relevant peak local government representative body and that the financial implications are ‘taken into account’.

<sup>95</sup> Cth, *Parliamentary Debates*, House of Representatives, 17 October 2006, pp 54-8.

<sup>96</sup> Cth, *Parliamentary Debates*, House of Representatives, 17 October 2006, pp 55-6.

<sup>97</sup> Graham Sansom, ‘Commonwealth of Australia’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, Montreal, 2009) 8, 13.

<sup>98</sup> Commonwealth, *Budget: Australia’s Federal Relations: Budget Paper No 3* (2012–13) 114, 158.

constitutional recognition of local government.<sup>99</sup> The Rudd Government also established the Local Government Reform Fund, to aid reforms in the areas of asset and financial management and to develop better and more consistent data collection. The Australian Centre of Excellence for Local Government was also established in 2009 to support research into best practice and innovation in the area of local government.

The Gillard Government, in its negotiations with the Australian Greens and Independents upon the formation of government after the 2010 general election, promised that it would hold a referendum at or before the next general election upon the ‘recognition of local government in the Constitution’.<sup>100</sup> It established an expert panel, chaired by the Hon James Spigelman, ‘to report on and make recommendations regarding:

- a. the level of support for constitutional recognition among stakeholders and in the general community; and
- b. options for that recognition’.<sup>101</sup>

As discussed in more detail in Chapter VI below, the Panel reported in December 2011. A Joint Select Committee on Constitutional Reform of Local Government has since been established to consider the Expert Panel’s recommendations.

### **The *Pape* Case**

As part of its response to the global financial crisis, the Rudd Government sought to stimulate the economy by providing a payment of \$900 to a large number of tax-payers. The constitutional validity of this payment was challenged by a potential recipient, Mr Bryan Pape. While the High Court upheld the validity of these payments in *Pape v Commissioner of Taxation*,<sup>102</sup> its reasoning led to doubts about the constitutional validity of Commonwealth payments made directly to local government, including payments made under the Roads to Recovery program.

The constitutional background to this case is as follows. Section 81 of the Commonwealth Constitution provides for Commonwealth revenues to form a Consolidated Revenue Fund ‘to be appropriated for the purposes of the Commonwealth in the manner... imposed by this Constitution.’ Section 83 sets out that manner by providing that money cannot be drawn from the Treasury ‘except under appropriation made by law’. Relying on sections 81 and 83, the Commonwealth has argued that it can appropriate money for any purpose it chooses, as any purpose nominated by the

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<sup>99</sup> Press Conference with the Prime Minister, the Hon Kevin Rudd, the Minister for Infrastructure and Local Government, the Hon Anthony Albanese and the President of ALGA, Mr Paul Bell, 18 September 2008: <http://pmrudd.archive.dpmc.gov.au/node/5585>.

<sup>100</sup> Agreement between the Australian Greens and the ALP, 1 September 2010, para. 3(f); Agreement between the ALP and Mr Tony Windsor and Mr Rob Oakeshott, 7 September 2010, Annex B, 4.3; and Agreement between the Hon Julia Gillard and Mr Wilkie, 2 September 2010, para. 3.2(f).

<sup>101</sup> Department of Regional Australia, Local Government, Arts and Sport, ‘Expert Panel Terms of Reference’: <http://www.regional.gov.au/local/crlg/terms.aspx>.

<sup>102</sup> (2009) 238 CLR 1.

Commonwealth Parliament will be a ‘purpose of the Commonwealth’. This view has been supported by some judges,<sup>103</sup> while others have taken the view that the ‘purposes of the Commonwealth’ is a matter for the courts to determine by reference to the distribution of powers within the Constitution.<sup>104</sup> Authority on this proposition remained inconclusive, but this did not deter the Commonwealth from appropriating money and spending it on subjects outside its express heads of legislative power. Indeed, such action was also tactical, as it allowed the Commonwealth to argue in future cases that to confine the ‘purposes of the Commonwealth’ to those matters within its legislative heads of power would result in a great swathe of laws being rendered unconstitutional and payments being rendered invalid.

Until 2009, the Commonwealth had argued that it had the power under s 81 of the Constitution to appropriate and spend money on such purposes as the Commonwealth Parliament chose. In *Pape v Commissioner of Taxation*,<sup>105</sup> the High Court overturned this argument, holding that s 81 itself did not support the expenditure of money appropriated by the Parliament.<sup>106</sup> A different head of power was needed. This pushed the debate from one concerning ‘purposes of the Commonwealth’ to one concerning whether other constitutional powers support the expenditure of appropriated funds.<sup>107</sup> In particular, where there is no express head of power to support particular expenditure, is the combination of the executive power in s 61 of the Constitution and the incidental legislative power in s 51(xxxix) sufficient to support such expenditure for ‘national purposes’?<sup>108</sup>

In *Pape*, a majority held that the combination of ss 61 and 51(xxxix), sometimes known as the ‘nationhood power’, was sufficient to support a law that employed short-term fiscal measures to respond to a global financial crisis by stimulating the economy.<sup>109</sup> Justices Gummow, Crennan and Bell stated that the *Pape* case could be ‘resolved without going beyond the notions of national emergency and the fiscal means of promptly responding to that situation’.<sup>110</sup> Chief Justice French was not even prepared to go quite that far, arguing that this power should not be equated with a ‘general power to manage the national economy’<sup>111</sup> or a power to make laws with respect to matters of ‘national concern’ or

<sup>103</sup> *Attorney-General (Vic); Ex rel Dale v Commonwealth* (1945) 71 CLR 237, 254 (Latham CJ), 273 (McTiernan J) (‘*Pharmaceutical Benefits Case*’); *Victoria v Commonwealth and Hayden* (1975) 134 CLR 338, 369 (McTiernan J), 396 (Mason J), 417 (Murphy J) (‘*AAP Case*’).

<sup>104</sup> *Pharmaceutical Benefits Case* (1945) 71 CLR 237, 266 (Starke J), 271 (Dixon J), 282 (Williams J); *AAP Case* (1975) 134 CLR 338, 360-3 (Barwick CJ), 373 (Gibbs J).

<sup>105</sup> (2009) 238 CLR 1.

<sup>106</sup> (2009) 238 CLR 1, [111] (French CJ), [178], [183] (Gummow, Crennan and Bell JJ), [320] (Hayne and Kiefel JJ), [601]-[602] (Heydon J).

<sup>107</sup> ‘[I]t is now settled that [ss 81 and 83 of the Constitution]... do not confer a substantive spending power and that the power to expend appropriated moneys must be found elsewhere in the Constitution or the laws of the Commonwealth’: *ICM Agriculture Pty Ltd v Commonwealth* [2009] HCA 51, [41] (French CJ, Gummow and Crennan JJ).

<sup>108</sup> For further discussion of this case, see: Anne Twomey, ‘Pushing the Boundaries of Executive Power – *Pape*, the Prerogative and Nationhood Powers’ (2010) 34 MULR 313.

<sup>109</sup> (2009) 238 CLR 1, [8]-[9] and [133]-[134] (French CJ), [241]-[243] (Gummow, Crennan, Bell JJ).

<sup>110</sup> (2009) 238 CLR 1, [241].

<sup>111</sup> (2009) 238 CLR 1, [133].

‘national emergencies’.<sup>112</sup> He appeared to be sensitive to the need to confine the scope of his finding.

It is difficult to see how direct Commonwealth funding to local government for the construction and maintenance of roads can be considered equivalent to a national response to a global economic crisis or a national emergency. This is particularly so when it is clear that the same money can be provided to local government through s 96 grants to the States. This negates any argument that without the power to fund local government directly, local government could not be adequately funded. There is no need to imply a power for the Commonwealth to be able to grant money to local government, as the Commonwealth Constitution already provides a means of doing so in s 96, albeit through the States.

This issue was addressed in a confused manner by the Senate Select Committee on the Reform of the Australian Federation. The Committee noted the views of academics and ALGA that direct Commonwealth funding of local government with respect to roads might be unconstitutional.<sup>113</sup> It then observed that these views ‘were not necessarily shared by all’. It referred to submissions of the Council for the Australian Federation (‘CAF’) and the Western Australian Government which both argued that the *Pape* case did not have detrimental consequences for the funding of local government because such funding can be given to local government through s 96 grants to the States.<sup>114</sup> However, these views are not inconsistent with the views of ALGA and academics that *direct* Commonwealth funding of local government might be invalid. Indeed, all seemed to agree that the funding of local government through s 96 grants to the States was valid and the direct funding of local government by the Commonwealth was of doubtful validity. The only difference was whether this was regarded as a reason to change the Constitution to permit direct funding or whether one should simply revert to the tried and true method of making grants to local government through the States.

The Committee then suggested that the views of CAF and Western Australia were consistent with the Commonwealth Government’s view that it was entitled to continue its current methods of making payments to local government, including direct payments. Clearly this was not consistent with the views of CAF and Western Australia which instead supported the making of Commonwealth payments through the States. However, from its misunderstanding of the various positions put to it, the Committee concluded that ‘it is not entirely clear that the constitutionality of direct payments from the Commonwealth to local government is in doubt.’<sup>115</sup> On the contrary, it was very clear that there was doubt, although it was unclear as to how the High Court might resolve this

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<sup>112</sup> (2009) 238 CLR 1, [10].

<sup>113</sup> Senate Select Committee on the Reform of the Australian Federation, ‘Australia’s Federation: An Agenda for Reform’, June 2011, pp 89-90.

<sup>114</sup> Senate Select Committee on the Reform of the Australian Federation, ‘Australia’s Federation: An Agenda for Reform’, June 2011, pp 90-1.

<sup>115</sup> Senate Select Committee on the Reform of the Australian Federation, ‘Australia’s Federation: An Agenda for Reform’, June 2011, p 91.

doubt. The Commonwealth took the optimistic view that the High Court would favour direct funding, while ALGA took the pessimistic view that it might not.<sup>116</sup>

### **The *Williams* Case**

The Commonwealth also provides direct funding to local government under a range of executive programs that are not supported by legislation. Examples include the Local Government Energy Efficiency program and the Safer Suburbs program. Such programs came under additional threat in 2012 as a consequence of the High Court's judgment in *Williams v Commonwealth*.<sup>117</sup> In that case, the High Court held that it was beyond the executive power of the Commonwealth to enter into an agreement to fund a chaplaincy program in a school and to make payments under that agreement without statutory authority to do so.

A majority of the Court in *Williams* rejected the Commonwealth's 'broad' proposition that it had the capacities of a legal person to enter into contracts and expend money on any subject matter, regardless of whether or not it came under a Commonwealth head of legislative power,<sup>118</sup> and its 'narrow' proposition that its executive power extends to actions that *could* be authorised by Commonwealth legislation, even though no such statute has been enacted.<sup>119</sup> While the majority recognised that there were some categories of executive power involving expenditure that could be exercised without statutory authority, such as prerogative powers,<sup>120</sup> the ordinary administration of government departments<sup>121</sup> and the nationhood power,<sup>122</sup> this particular funding program did not fall within any of those categories and therefore required the enactment of valid legislation to support it.

These two cases have left much of the direct Commonwealth funding to local government vulnerable to constitutional challenge. Those direct funding programs, such as the Roads to Recovery program, that rely on Commonwealth legislation could be struck down as constitutionally invalid because there is no constitutional head of power to support the Commonwealth's legislation. Those programs that are based solely on

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<sup>116</sup> Australian Local Government Association, Submission to the Senate Select Committee Inquiry into Reform of the Australian Federation', 20 August 2010, p 10; Senate Select Committee on the Reform of the Australian Federation, 'Australia's Federation: An Agenda for Reform', June 2011, p 90.

<sup>117</sup> (2012) 86 ALJR 713.

<sup>118</sup> (2012) 86 ALJR 713, 720 [4] (French CJ); 754 [159] (Gummow and Bell JJ); 757 [182], 773 [253] (Hayne J); 820 [534] (Crennan J); and 830 [595] (Kiefel J). Heydon J found it unnecessary to decide: at 801 [407].

<sup>119</sup> (2012) 86 ALJR 713, 720 [4] (French CJ); 751 [138] (Gummow and Bell JJ); 822 [544] (Crennan J). Hayne J, 778 [286] and Kiefel J, 826 [569], found it unnecessary to decide the point because the expenditure could not have been supported by valid legislation in any case. Heydon J, 786 [340]–[341], 779–800 [404], was the only Justice who supported the Commonwealth's narrow proposition.

<sup>120</sup> (2012) 86 ALJR 713, 720 [4] (French CJ); 812 [484] (Crennan J); 828 [582] (Kiefel J).

<sup>121</sup> (2012) 86 ALJR 713, 720 [4], 727 [34] (French CJ); 751 [139] (Gummow and Bell JJ); 812 [484], 814 [493] (Crennan J); 828 [582] (Kiefel J).

<sup>122</sup> (2012) 86 ALJR 713, 720 [4], 727 [34] (French CJ); 760 [194] (Hayne J); 812 [485] (Crennan J). See also: 799 [402] (Heydon J).

Commonwealth executive power would need authorisation by a valid Commonwealth statute. In both cases the difficulty will be finding a head of legislative power to support the statute.

### **The Commonwealth's response to the *Pape* and *Williams* cases**

After *Pape*, the Commonwealth largely ignored the Court's decision. One can only assume that it drew from the fact that the Court upheld the validity of the \$900 tax bonus, a conclusion that the High Court would always, ultimately, uphold Commonwealth expenditure, no matter how much the Court opined upon the need for accountability and compliance with the distribution of powers under the Commonwealth Constitution. In other words, it appeared to conclude that the High Court was a constitutional watchdog that might growl but would never bite when it came to Commonwealth expenditure.

The Commonwealth therefore took what the former NSW Chief Justice, the Hon James Spigelman, has described as an 'aspirational' view<sup>123</sup> that its legislation concerning direct funding to local government remained valid. Officers of the Department of the Prime Minister and Cabinet told the Senate Select Committee on the Reform of the Australian Federation that it had received advice from the Attorney-General's Department 'that we should continue with current arrangements unless a demonstrated need arises to change them'.<sup>124</sup> The Department advised that having taken into account the High Court's judgment in *Pape*, 'the Commonwealth remains able to make grants under its general powers in the Constitution'.<sup>125</sup> It did not specify what these 'general' powers were. It appears, however, from its arguments in *Williams*, that the Commonwealth assumed that it had a broad general power to spend that fell within its executive power. The High Court, in *Williams*, begged to differ.

This time the Commonwealth could not completely ignore the High Court's judgment as there was considerable pressure from those persons and bodies funded by the Commonwealth under its purported executive power for the matter to be rectified. The Commonwealth rushed through Parliament, with only cursory debate, the *Financial Framework Legislation Amendment Act (No 3) 2012* (Cth). It came into force on 28 June 2012, despite only having been introduced into Parliament on 26 June.

The Act inserts s 32B in the *Financial Management and Accountability Act 1997* (Cth), which purports to give statutory authority to Commonwealth expenditure under arrangements or grants where the expenditure could not otherwise be supported by

<sup>123</sup> James Spigelman, 'A Tale of Two Panels' (Speech to the Gilbert + Tobin Centre of Public Law's Constitutional Law Conference and Dinner, 17 February 2012) 3.

<sup>124</sup> Senate Select Committee on the Reform of the Australian Federation, Parliament of Australia, *Australia's Federation: An Agenda for Reform*, 2011, 91.

<sup>125</sup> Senate Select Committee on the Reform of the Australian Federation, Parliament of Australia, *Australia's Federation: An Agenda for Reform*, 2011, 91. See also Mr English's reference to 'our general capacity to make grants off the Commonwealth's own authority': Evidence to Senate Select Committee on the Reform of the Australian Federation, Parliament of Australia, Canberra, 5 May 2011, 42 (Dominic English).

executive power alone. The relevant arrangements and grants must also be specified in the *Financial Management and Accountability Regulations* 1997 or be for the purposes of a program specified in the Regulations.

The Regulations were also amended (directly by the Act — presumably to avoid scrutiny and the prospect of disallowance if the changes had been made by amending Regulations)<sup>126</sup> to insert a Schedule 1AA which contained a list of over 400 government programs. In many cases these programs are so broadly described that a vast swathe of potential future Commonwealth expenditure would fall under them.<sup>127</sup> This avoids the prospect of new Commonwealth programs facing possible scrutiny — which the amendment of the Regulations might entail — as long as the new programs can be shoehorned under the existing, broad, categories in the Regulations. It also, however, raises doubt as to the effectiveness and constitutional validity of these provisions. As Spigelman has observed, some programs have been ‘identified in such a general language that they could not withstand constitutional scrutiny’.<sup>128</sup>

The major difficulty with the Act is that there is no obvious head of Commonwealth legislative power to support it. The *Financial Management and Accountability Act* 1997 (Cth) is most likely supported by s 97 of the Constitution, regarding audit laws, in combination with s 51(xxxvi). It could also be supported by s 64 of the Constitution, regarding the administration of Commonwealth departments in conjunction with s 51(xxxix) of the Constitution. It is doubtful, however, that either source would extend to supporting the new Division 3B of Part 4 of that Act which purports to authorise Commonwealth expenditure generally and not just in relation to the ordinary administration of government. It is also doubtful that a ‘nationhood power’ could be regarded as supporting such a broad range of Commonwealth expenditure given that, in *Williams*, the nationhood power was not regarded as capable of supporting Commonwealth expenditure on chaplains.<sup>129</sup> Indeed, Hayne J noted that if the combination of s 61 and s 51(xxxix) of the Constitution were regarded as supporting a power to spend, as the Executive chooses, regardless of the purposes for which the expenditure is to be applied, then this would ‘work a very great expansion in what hitherto has been understood to be the ambit of Commonwealth legislative power’.<sup>130</sup>

The best argument that one could make for the validity of s 32B is that it is supported by a web of constitutional heads of power, to the extent that each program specified in the Regulations falls within the subject matter of a head of power. This argument would then lead to difficult questions about reading down and severance in relation to those

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<sup>126</sup> See further: Amanda Sapienza (2012) 23 *Public Law Review* 161, 163-4.

<sup>127</sup> In relation to local government, for example, program 421.002 is described as ‘to build capacity in local government and provide local and community infrastructure’. It could cover all sorts of future Commonwealth expenditure without the need for future amendments to the Regulations.

<sup>128</sup> James Spigelman, ‘Constitutional Recognition of Local Government’, Address to the Local Government Association of Queensland, 116<sup>th</sup> Annual Conference, Brisbane, 24 October 2012, p 10. Note also his observation that the programs of the Department of Regional Australia are currently ‘travelling naked’.

<sup>129</sup> (2012) 86 ALJR 713, 741 [83] (French CJ); 743 [96] (Hayne J); 799 [402] (Heydon J); 815 [498] (Crennan J); 830 [594] (Kiefel J).

<sup>130</sup> (2012) 86 ALJR 713, 770 [241]–[242].

programs that do not fall within a head of power and their purported statutory authorisation. This provision is therefore vulnerable to constitutional attack. Even if it survives intact, the most it will do is shore up the validity of direct grants from the Commonwealth to local government which were previously unsupported by statutory authority, where the subject matter of those grants falls within a Commonwealth head of legislative power. For example, the ‘Clean Energy Future — Low Carbon Communities’ program, which provides funding to local government, might be regarded as supported by the external affairs power in s 51(xxix) of the Constitution, to the extent that it implements treaty commitments.

The other difficulty with the Act is that the Government seems to have ignored the principles that lay behind the High Court’s decision in *Williams*. In that case the Court had stressed: (a) the role of federalism as a limitation on Commonwealth executive power; (b) that s 96 of the Constitution should not be by-passed without a sufficient reason; and (c) the importance of parliamentary accountability, particularly when it came to the expenditure of public money. The *Financial Framework Legislation Amendment Act (No 3) 2012* ignored these points and effectively abdicated parliamentary accountability for expenditure in relation to the listed programs or anything that can conceivably be brought under them in the future.<sup>131</sup> By taking this approach, the Commonwealth has defied and provoked the High Court, seemingly relying upon an expectation that its law will not be challenged because of the absence of an interest or standing to do so.

Spigelman, reaching the same conclusion, has observed:

The Commonwealth appears to be proceeding on the basis that as long as it has an arguable Constitutional case, it can still do whatever it likes. This may be because it is overwhelmingly probable that these programs will never be challenged in Court. If that is right, it disturbs me. I think the High Court may well be disturbed too.

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It is not permissible to approach the Constitution on the basis that whatever is in the institutional interests of the Commonwealth must be the law. It is not consistent with the rule of law that the Executive and the Parliament proceed on the basis that an arguable case is good enough, as distinct from a genuine, predominant opinion as to what the law of the Constitution actually is. Furthermore, it is not consistent with the rule of law for the Parliament or Executive of the Commonwealth to act on the basis that an arguable case is good

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<sup>131</sup> See further: Anne Twomey, ‘Parliament’s Abject Surrender to the Executive’, *Constitutional Critique Blog*, 27 June 2012: [http://blogs.usyd.edu.au/cru/2012/06/parliaments\\_abject\\_surrender\\_t\\_1.html](http://blogs.usyd.edu.au/cru/2012/06/parliaments_abject_surrender_t_1.html); and James Spigelman, ‘Constitutional Recognition of Local Government’, Address to the Local Government Association of Queensland, 116<sup>th</sup> Annual Conference, Brisbane, 24 October 2012, p 14 where he stated that the: ‘essential character of the Act is that, to a significant degree, it abdicates Parliamentary control of expenditure’.

enough if it is unlikely than anyone will challenge a particular program or a law.<sup>132</sup>

### **The constitutional validity of the Roads to Recovery program**

The *Financial Framework Legislation Amendment Act (No 3) 2012* (Cth) did not affect the Roads to Recovery program because it only dealt with executive funding programs which were not already supported by statute. The Roads to Recovery Program is currently authorised by Part 8 of the *National Building Program (National Land Transport) Act 2009* (Cth). What head of legislative power supports it? There are two possibilities: (a) the corporations power, and (b) the nationhood power.

#### ***Corporations Power***

There are three main problems with reliance on s 51(xx) to support the Roads to Recovery program. First, the Commonwealth's legislative power under s 51(xx) is confined to 'foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth'. The *National Building Program (National Land Transport) Act 2009* does not confine the making of payments under the Roads to Recovery program to foreign, trading or financial corporations ('constitutional corporations'). Section 87 of the Act simply refers to a 'person or body' who is to be the recipient of payments. It does not require that the person or body be a corporation, let alone a constitutional corporation.

The same problem arose in *Williams*, where the chaplaincy program did not specify that the recipient of funding had to be a corporation. Only two judges considered the application of the corporations power, but both held that it could not support a law that permitted agreements with bodies that were not constitutional corporations.<sup>133</sup>

Secondly, not all local government bodies are trading corporations. After the *Work Choices Case*,<sup>134</sup> the States of New South Wales and Queensland terminated the status of local government bodies as bodies corporate and brought them back under the Crown.<sup>135</sup> An attempt to reverse the status of local government bodies in NSW was defeated in the Legislative Council in March 2012.<sup>136</sup> Hence, local government bodies in Queensland and New South Wales are not corporations at all, but still receive funding under the Roads to Recovery program.

Further, even amongst those local government bodies that have a corporate status, not all would be regarded as 'trading' or financial corporations. In relation to each local

<sup>132</sup> James Spigelman, 'Constitutional Recognition of Local Government', Address to the Local Government Association of Queensland, 116<sup>th</sup> Annual Conference, Brisbane, 24 October 2012, pp 11 and 12.

<sup>133</sup> (2012) 86 ALJR 713, 775 [267], [271] (Hayne J); 827 [575] (Kiefel J).

<sup>134</sup> *New South Wales v Commonwealth* (2006) 229 CLR 1.

<sup>135</sup> See *Local Government Amendment (Legal Status) Act 2008* (NSW) sch 1 cl 1; *Local Government and Industrial Relations Amendment Act 2008* (Qld) Prt 3 cl 17.

<sup>136</sup> New South Wales, *Parliamentary Debates*, Legislative Council, 28 March 2012, 10018.

government body, it would depend upon whether the ‘trading activities form a sufficiently significant proportion of its overall activities as to merit its description as a trading corporation’.<sup>137</sup> This may well differ between council and council, and in relation to the same council over a period of time. For example, in *Australian Workers’ Union, Queensland v Etheridge Shire Council*,<sup>138</sup> Spender J of the Federal Court held that the Etheridge Shire Council was not a constitutional corporation because trading was not its predominant and characteristic activity and did not form a sufficiently significant proportion of its overall activities.

Thirdly, it could be argued that the law that establishes and implements the Roads to Recovery program is not a law with respect to the activities, functions, powers or relationships of trading corporations. In *Williams*, the two Justices who considered the corporations power appeared to imply that simply granting money to a corporation was not enough to attract the application of s 51(xx). Kiefel J said:

Any statute authorising the Funding Agreement could not be said to be concerned with the regulation of the activities, functions, relationships and business of a corporation, the rights and privileges belonging to a corporation, the imposition of obligations upon it, or the regulation of the conduct of those through whom it acts.<sup>139</sup>

Hayne J also distinguished a law concerning the funding of chaplains from a law supported by the corporations power, observing:

Unlike the law considered in *New South Wales v Commonwealth (Work Choices Case)* it would not be a law authorising or regulating the activities, functions, relationships or business of constitutional corporations generally or any particular constitutional corporation; it would not be a law regulating the conduct of those through whom a constitutional corporation acts nor those whose conduct is capable of affecting its activities, functions, relationships or business.<sup>140</sup>

While these comments were only made by two Justices (as the others did not address the issue), they raise the distinct possibility that merely giving a grant to a constitutional corporation is not enough in itself to attract the support of s 51(xx).

For these three reasons, it would seem extremely unlikely that the High Court would regard the legislation enacting the Roads to Recovery program as supported by s 51(xx) of the Constitution.

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<sup>137</sup> *R v Federal Court of Australia; Ex parte WA National Football League* (1979) 143 CLR 190, 233 (Mason J).

<sup>138</sup> (2008) 171 FCR 102.

<sup>139</sup> (2012) 86 ALJR 713, 827 [575] referring to the touchstones of the corporations power as identified in *Re Pacific Coal Pty Ltd; Ex parte Construction, Forestry, Mining and Energy Union* (2000) 203 CLR 346, 375 [83] (Gaudron J); *New South Wales v Commonwealth* (2006) 229 CLR 1, 114–5 [178] (Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ).

<sup>140</sup> (2012) 86 ALJR 713, 775 [272].

### *Nationhood Power*

Section 3 of the *Nation Building Program (National Land Transport) Act 2009* (Cth) provides that the object of the Act is ‘to assist national and regional economic and social development by the provision of Commonwealth funding aimed at improving the performance of land transport infrastructure’. This suggests that the Commonwealth might be relying on the ‘nationhood’ power on the ground that its legislation provides for the development of national infrastructure, which is a truly national activity that could not be otherwise carried on by the States for the benefit of the nation.

The ‘nationhood power’ finds its modern source in a statement made by Mason J in the *AAP Case* that:

there is to be deduced from the existence and character of the Commonwealth as a national government and from the presence of ss 51(xxxix) and 61 a capacity to engage in enterprises and activities peculiarly adapted to the government of a nation and which cannot otherwise be carried on for the benefit of the nation.<sup>141</sup>

Despite the fact that the *Williams* case did not directly concern the nationhood power, the Court did review the authorities on it and placed stress upon the following aspects of it:

- the enterprise or activity must be peculiarly adapted to the government of a nation and be a truly ‘national’ endeavour;<sup>142</sup>
- the enterprise or activity must be one that cannot otherwise be carried on for the benefit of the nation by the States or others;<sup>143</sup>
- the Commonwealth’s executive power cannot be expanded outside its heads of power simply because it is ‘convenient’ to do so;<sup>144</sup>
- s 96 of the Constitution must not be rendered otiose — so there must be large areas of activity which are outside the executive power of the Commonwealth which can only be entered by way of a s 96 grant;<sup>145</sup> and
- the Commonwealth’s exercise of executive or legislative power must involve no real competition with the States.<sup>146</sup>

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<sup>141</sup> *AAP Case* (1975) 134 CLR 338, 397.

<sup>142</sup> (2012) 86 ALJR 713, 727 [34] (French CJ); 760–1 [196] (Hayne J); 812 [485] (Crennan J); 828–9 [583] (Kiefel J).

<sup>143</sup> (2012) 86 ALJR 713, 760–1 [196] (Hayne J); 815 [498] (Crennan J); 828–9 [583] (Kiefel J).

<sup>144</sup> (2012) 86 ALJR 713, 790–1 [363] (Heydon J); 816 [504] (Crennan J); 829 [587] (Kiefel J).

<sup>145</sup> (2012) 86 ALJR 713, 770 [243], 812 [247] (Hayne J); 815 [501], 816 [503] (Crennan J); 830 [592] (Kiefel J). See also 751 [143] (Gummow and Bell JJ) regarding s 96 of the Constitution and federal considerations.

<sup>146</sup> (2012) 86 ALJR 713, 726 [31] (French CJ); 751–2 [144] (Gummow and Bell JJ); 773 [256] (Hayne J); 816 [505] (Crennan J); 829–30 [588] (Kiefel J).

All five of these propositions, when applied to the funding of the Roads to Recovery program, would suggest that it is not supported by the nationhood power.

**(a) National Endeavour**

While the funding of national infrastructure, such as a railway line across several States, might be regarded as a truly ‘national’ endeavour — and one peculiarly adapted to the government of a nation — it is hardly likely that the funding of the construction and maintenance of local roads would be regarded the same way. Kiefel J observed in *Williams* that ‘there is nothing about the provision of school chaplaincy services which is peculiarly appropriate to a national government’ as such services are ‘the province of the States, in their provision of support for school services’.<sup>147</sup> Much the same could be said of the provision of local roads.

In *Pape*, it was the magnitude and urgency of the subject that moved it into the sphere of the nationhood power.<sup>148</sup> Gummow, Crennan and Bell JJ observed that ‘only the Commonwealth has the resources available to respond promptly to the present financial crisis on the scale exemplified by the Bonus Act.’<sup>149</sup> Hayne J, in *Williams*, suggested that this extended the nationhood power to matters ‘peculiarly within the capacity and resources of the Commonwealth Government’.<sup>150</sup> While it could be argued that the amount needed to fund local government roads is large, and that a Commonwealth contribution is therefore needed,<sup>151</sup> the same could be said for almost all areas of expenditure (eg schools or hospitals). Moreover, the need for funding is ongoing and the funding is provided regularly. There is no emergency with which only the Commonwealth can deal promptly and adequately.

**(b) Cannot Otherwise Be Carried On**

The High Court in *Williams* laid significant emphasis on the fact that the Queensland Government already ran its own chaplaincy funding program.<sup>152</sup> A number of Justices noted that no party could have argued that a chaplaincy program was something that could not be carried on without Commonwealth involvement, as manifestly the State was not only capable of doing so but was actually doing so.<sup>153</sup>

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<sup>147</sup> (2012) 86 ALJR 713, 830 [594].

<sup>148</sup> (2009) 238 CLR 1, 63–4 [133] (French CJ); 91–2 [242] (Gummow, Crennan and Bell JJ).

<sup>149</sup> (2009) 238 CLR 1, 91 [241].

<sup>150</sup> *Williams* (2012) 86 ALJR 713, 760–1 [196], referring to *Pape* (2009) 238 CLR 1, 63–4 [133] (French CJ).

<sup>151</sup> Note, however, that Commonwealth financial assistance only makes up around 8.5 per cent of local government operating revenue: Productivity Commission, ‘Assessing Local Government Revenue Raising Capacity’, April 2008, xxii; Australian Local Government Association, Submission No 24 to the Senate Select Committee Inquiry into Reform of the Australian Federation, *Inquiry into the Reform of the Australian Federation*, 20 August 2010, 8.

<sup>152</sup> (2012) 86 ALJR 713, 722 [12] (French CJ); 752 [146] (Gummow and Bell JJ); 773 [257] (Hayne J); 810 [469] (Crennan J); 830 [591] (Kiefel J). Cf Heydon J at 781 [308].

<sup>153</sup> (2012) 86 ALJR 713, 752 [146] (Gummow and Bell JJ); 760–1 [196] (Hayne J); 815 [498], 816 [506] (Crennan J); 830 [591], [594] (Kiefel J).

Similarly, the States, through their local government bodies, have constructed and maintained roads since the inception of local government. The combination of State grants and local government own-source revenue makes up approximately 91.5% of local government revenue, with Commonwealth contributions coming to approximately 8.5%.<sup>154</sup> It is really not plausible to claim that the construction and maintenance of local roads ‘cannot otherwise be carried on for the benefit of the nation’ except by direct Commonwealth funding.

**(c) Convenience**

Crennan J observed in *Williams* that:

the fact that an initiative, enterprise or activity can be ‘conveniently formulated and administered by the national government’, or that it ostensibly does not interfere with State powers, is not sufficient to render it one of ‘truly national endeavour’ or ‘pre-eminently the business and the concern of the Commonwealth as the national government’.<sup>155</sup>

The mere fact that it might be regarded by local government as ‘convenient’ to receive direct funding from the Commonwealth rather than through s 96 grants is most unlikely to trigger the application of the nationhood power.

**(d) Section 96**

A number of Justices in *Williams* regarded s 96 of the Constitution as indicating that Commonwealth executive power is not unlimited. They considered that s 96 should not be rendered otiose by a broad interpretation of Commonwealth executive power.<sup>156</sup> They exhibited concern that s 96 was being bypassed for no adequate reason,<sup>157</sup> and they noted the importance of the ‘consensual’ aspect of s 96 which arises from the fact that it is up to the States whether to accept or reject funding upon the conditions made.<sup>158</sup>

The Commonwealth has funded roads through s 96 grants since 1923. It continues to give ‘untied’ roads funding under s 96 grants in addition to the Roads to Recovery program. There appears to be no adequate reason why s 96 has been bypassed other than the political reason of the Commonwealth seeking to obtain greater credit for its expenditure on local roads. Such a reason would not be likely to hold sway in the High Court. Given the long history of the funding of local roads through s 96 grants, it would be very difficult indeed to justify why s 96 is being bypassed in favour of direct funding, and why Commonwealth executive power (combined with legislative power under s 51(xxxix)) extends to such expenditure.

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<sup>154</sup> Productivity Commission, ‘*Assessing Local Government Revenue Raising Capacity*’, April 2008, xxii.

<sup>155</sup> (2012) 86 ALJR 713, 816 [504]. See also 829 [587] (Kiefel J).

<sup>156</sup> (2012) 86 ALJR 713, 770 [243], 771 [247] (Hayne J); 815 [501] (Crennan J); 830 [592]–[593] (Kiefel J). See also *Pape* (2009) 238 CLR 1, 199 [569] (Heydon J).

<sup>157</sup> (2012) 86 ALJR 713, 751 [143], 752 [146] (Gummow and Bell JJ); 816 [503] (Crennan J).

<sup>158</sup> (2012) 86 ALJR 713, [148] (Gummow and Bell JJ); 772 [248] (Hayne J); 815 [501] (Crennan J).

**(e) No Competition**

It had previously been suggested by the High Court that in matters purely involving the grant of Commonwealth funds, this could not amount to competition with the States. For example, Deane J observed in the *Tasmanian Dam Case* that

[e]ven in fields which are under active State legislative and executive control, Commonwealth legislative or executive action may involve no competition with State authority: an example is the mere appropriation and payment of money to assist what are truly national endeavours.<sup>159</sup>

This approach was also followed in a more limited fashion by French CJ in *Pape*, where he contended that ‘it is difficult to see how the payment of moneys to taxpayers, as a short-term measure to meet an urgent national economic problem, is in any way an interference with the constitutional distribution of powers.’<sup>160</sup> Only Heydon J expressed concern that Commonwealth laws regulating the expenditure of money, or regulating a ‘national economy’ might override State laws.<sup>161</sup>

In *Williams*, Hayne J contended that the ‘provision of funding to an organisation to provide chaplains to schools involves direct competition with State executive and legislative action’.<sup>162</sup> This was reinforced by the Queensland Government’s chaplaincy program.<sup>163</sup> Kiefel J focused on the fact that both governments ‘require adherence to their respective guidelines as a condition of funding’ and that ‘there is clearly the potential for some disparity or inconsistency in what is required’.<sup>164</sup> She concluded that ‘it cannot be said that no competition may be involved between the State and Commonwealth Executives.’<sup>165</sup>

In the case of the funding of local roads, there is certainly the potential for Commonwealth conditions on funding to clash with State requirements (eg regarding priorities in road building and maintenance). It may be, for example, that for reasons of safety, a State might wish to prohibit signs upon roads that do not deal with road safety warnings. Even the condition that existing funding be maintained potentially interferes with State budgetary priorities.

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<sup>159</sup> *Commonwealth v Tasmania* (1983) 158 CLR 1, 252–3.

<sup>160</sup> (2009) 238 CLR 1, 60 [127].

<sup>161</sup> (2009) 238 CLR 1, 182–3 [522].

<sup>162</sup> (2012) 86 ALJR 713, 773 [257].

<sup>163</sup> (2012) 86 ALJR 713. Note also the rejection by Gummow and Bell JJ of the ‘false assumption’ that funding agreements are non-coercive in nature. They pointed out that ‘[f]inancial dealings with the Commonwealth have long attached to them the sanctions of federal criminal law.’: at 754 [158].

<sup>164</sup> (2012) 86 ALJR 713, 830 [590].

<sup>165</sup> (2012) 86 ALJR 713.

### ***The vulnerability of the Roads to Recovery program to constitutional challenge***

Taking into account all the above arguments, it is unlikely that Part 8 of the *Nation Building Program (National Land Transport) Act 2009* (Cth), which currently contains the Roads to Recovery program, would be supported by a ‘nationhood’ power. In the absence of another available head of legislative power, the constitutional validity of the Roads to Recovery program would appear to be vulnerable to constitutional challenge if anyone had the standing and motivation to take such an action.<sup>166</sup>

### **Current local government funding**

#### ***Specific purpose funding***

There are many specific purpose grants made directly to local government bodies. Most occur in the area of infrastructure. They include \$268.5 million in 2010-11 for the Regional and Local Community Infrastructure Program, approximately \$98 million in 2010-11 for road, rail and supplementary ‘off-network’ projects in the Nation Building Program<sup>167</sup> and \$30 million in 2011-12 for affordable housing services under the ‘Building Better Regional Cities’ program.<sup>168</sup> In 2012-13 \$15.2 million was allocated directly to 92 local government areas for the ‘Healthy Communities’ initiative and \$6.5 million for ‘Liveable Cities’.<sup>169</sup> In some cases funding is directed to a specific council for a specific purpose, such as \$30 million for the Townsville Convention and Entertainment Centre over 2012-15 and \$3.8 million for a car park at Penrith.<sup>170</sup> Other projects that provide for direct funding to local government include the ‘Water for the future’ program (\$11.3 million in 2010-11 and \$47.6 million in 2011-12) and the ‘Digital regions initiative’ (\$0.4 million in 2010-11).<sup>171</sup> By far the largest direct program, however, is the Roads to Recovery program costing \$349.8 million per annum over the four years from 2010-13.

Many payments to local government now come under the broader rubric of national partnership payments, in addition to specific programs aimed at local government. For example, the South Australian Office of Local Government made the following estimations of the grants received by local councils in South Australia in the 2010-11 financial year:

- \$31.5 million under the Roads to Recovery component of the National Partnership (NP) on the Nation Building Program;

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<sup>166</sup> Spigelman too has concluded that the Roads to Recovery program is more probably than not constitutionally invalid: James Spigelman, ‘Constitutional Recognition of Local Government’, Address to the Local Government Association of Queensland, 116<sup>th</sup> Annual Conference, Brisbane, 24 October 2012, 9.

<sup>167</sup> Commonwealth, *Budget Paper No 3*, 2011-12, p 75.

<sup>168</sup> Commonwealth, *Budget Paper No 3*, 2011-12, p 70.

<sup>169</sup> Commonwealth, *Budget Paper No 3*, 2012-13, pp 51 and 91.

<sup>170</sup> Commonwealth, *Budget Paper No 3*, 2011-12, p 75.

<sup>171</sup> Commonwealth, *Budget Paper No 3*, 2011-12, p 87 and p 94.

- \$9.6 million under the National Water Security for Cities and Towns Program component of the NP on Water for the Future;
- \$3.1 million for Community Wastewater Management Systems under the NP on Water for the Future;
- \$15.3 million for community infrastructure projects under the Regional and Local Community Infrastructure Program; and
- an extra allocation of \$15.5 million for local road funding. The supplementary local road funding of \$15.5 million was a continuation of arrangements that recognise the current inequitable share of untied local road grants being received by South Australia under the *Local Government (Financial Assistance) Act 1995*.

In addition, depending on the success of applications under a nationally competitive process, South Australian Councils are expected to have received grant funding in 2010-11 under the NP on the Natural Disaster Resilience Program, the Jobs Fund covering infrastructure employment projects, the Healthy Communities Program, the National Affordable Housing specific purpose payment and the NP on the Local Government Reform Fund Program. The Reform Fund Program was established to accelerate the implementation of Local Government and Planning Ministers' Council agreed asset and financial management frameworks, build capacity and resilience in Local Government and increase collaboration between Councils in planning and service delivery. In 2010-11, grant funding of \$1.65 million was allocated for a joint OSLGR/LGA project under the Reform Fund Program.<sup>172</sup>

There are risks, however, with specific purpose payments. Where they are used to establish an ongoing program, there is no certainty that they will be continued.<sup>173</sup> Local government, therefore, faces the risk that once it has established a program using money from specific purpose grants, it may have to fund that program itself in the future or axe it if the Commonwealth funds for it cease to flow.

### ***General purpose financial assistance grants***

The Commonwealth Government's Budget Paper No 3, 2012-13, noted that in 2011-12, the Commonwealth gave \$2,722,866,000 in financial assistance grants to local government, which passed through the States.<sup>174</sup> In the same financial year it made direct payments to local government in the sum of \$623,786,000, being approximately 23% of its overall funding of local government. The 2011-12 Budget Paper also noted that the 'Commonwealth will conduct a review into the equity and efficiency of the current

<sup>172</sup> Office for State/Local Government Relations, South Australian Department of Planning and Local Government, 'Local Government Finances': [http://www.localgovt.sa.gov.au/local\\_government\\_finances](http://www.localgovt.sa.gov.au/local_government_finances).

<sup>173</sup> PriceWaterhouseCoopers, 'National Financial Sustainability Study of Local Government', (November 2006), p 56.

<sup>174</sup> Commonwealth, *Budget Paper No 3, 2012-13*, p 158, Table C.1. Note that some of this amount was brought forward from the 2012-3 allocation.

funding provided through the Financial Assistance Grants program' which is to be completed in 2012-13.<sup>175</sup>

The financial assistance grants continue to be allocated amongst the States in accordance with the *Local Government (Financial Assistance) Act 1995* (Cth). The general purpose grants are allocated upon a population basis while the identified local road grants continue to be allocated according to fixed percentages that have an historic basis but no current relevance. In 2011-12, the allocation was as follows:<sup>176</sup>

States and Territories	Distribution of general purpose grants	Distribution of identified roads grants
NSW	32.4	29.0
Qld	20.3	18.7
SA	07.3	05.5
Tas	02.3	05.3
Vic	24.9	20.6
WA	10.3	15.3
ACT	01.6	03.2
NT	01.0	02.3

Within the States, the general purpose grants continue to be allocated, in accordance with the recommendations of Local Government Grants Commissions, on an equalisation basis, subject to a minimum 30% per capita grant. In New South Wales, 23 Councils, all in metropolitan Sydney, received only the minimum entitlement in 2011-12.<sup>177</sup>

### The level of financial autonomy of local government

Commonwealth financial assistance, whilst substantial in amount, still only makes up around 8% of local government operating revenue.<sup>178</sup> In contrast, Commonwealth grants make up about 50% of State revenue.<sup>179</sup> The Productivity Commission has recorded that in 2005-6, 83% of local government revenue was 'own-source' revenue and the other

<sup>175</sup> Commonwealth, *Budget Paper No 3*, 2011-12, p 101: <http://cache.treasury.gov.au/budget/2011-12/content/download/bp3.pdf?v=2>.

<sup>176</sup> Victoria Grants Commission Annual Report 2010-11: [http://www.dpcd.vic.gov.au/\\_data/assets/pdf\\_file/0010/82477/2010-11-VGC-Annual-Report-Part-1.pdf](http://www.dpcd.vic.gov.au/_data/assets/pdf_file/0010/82477/2010-11-VGC-Annual-Report-Part-1.pdf).

<sup>177</sup> NSW Local Government Grants Commission, 'Highlights: 2011-12 Local Government Assistance Grants': <http://www.dlg.nsw.gov.au/dlg/dlghome/documents/Information/Highlight%20Sheet%202011-12.pdf>.

<sup>178</sup> In 2006-6 the Productivity Commission estimated this amount at 8.5%: Productivity Commission, 'Assessing Local Government Revenue Raising Capacity', April 2008, p xxii. ALGA has since stated that 'Commonwealth general purpose grants represented around 5.2 per cent of total local government revenue in 2006-7 and represent around 7 per cent of local government's total income per annum... in 2008-09': Australian Local Government Association, Submission to the Senate Select Committee Inquiry into Reform of the Australian Federation', 20 August 2010, p 8.

<sup>179</sup> Commonwealth Grants Commission, 'Commonwealth-State Financial Relations': [http://www.cgc.gov.au/fiscal\\_equalisation/commonwealth-state\\_financial\\_relations](http://www.cgc.gov.au/fiscal_equalisation/commonwealth-state_financial_relations).

17% came from grants (8.5% from State and Territory Governments and 8.5% from the Commonwealth Government, including general purpose grants and specific purpose grants, such as the Roads to Recovery scheme).<sup>180</sup> While there were variations across the States, at least 80% of total revenue for local government in every State in 2005-6 was own-source revenue.<sup>181</sup> More recent figures bear out the same message. For example, in 2011 South Australian local government bodies raised 85% of their operating revenue themselves (largely through rates and user fees).<sup>182</sup> In New South Wales in 2007-8, only 8% of total local government revenue came from grants and subsidies, with the rest coming from local governments' own sources, including taxation (37%), sale of goods and services (34%), interest (4%) and other revenue (17%).<sup>183</sup>

The big picture shows that local government in Australia is far more financially autonomous than in other countries and in a far better position than the States in terms of financial autonomy. It is therefore initially surprising that there is so much agitation by local government about the need for more Commonwealth funding and direct Commonwealth funding when it amounts to such a small proportion of overall local government revenue.

It should be noted, however, that dependence upon Commonwealth grants varies between States and more significantly within States, with some local government bodies being highly dependent upon Commonwealth grants, while others are not dependent at all.<sup>184</sup> As the Productivity Commission noted in 2008:

Insights into the significance of own-source revenue can be obtained by examining the ratio of own-source revenue to total revenue from all sources (including grants). For 20 per cent of councils, own-source revenue accounts for more than 86 per cent of their total revenue. For 50 per cent of councils, own-source revenue accounts for at least 72 per cent of their total revenue...

On the other hand, 20 per cent of councils are significantly dependent on grants, which account for at least 48 per cent of their total revenue. A small number of councils (10 per cent) are highly dependent on grants, with grants accounting for more than 58 per cent of their total revenue... However, these councils represent only about 0.4 per cent of the total resident population of all councils.

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<sup>180</sup> Productivity Commission, 'Assessing Local Government Revenue Raising Capacity', April 2008, p xxii. For a break-up of Commonwealth and State grants see p 25 of the same report. See also PriceWaterhouseCoopers, 'National Financial Sustainability Study of Local Government', (November 2006), p 92.

<sup>181</sup> Productivity Commission, 'Assessing Local Government Revenue Raising Capacity', April 2008, p 29.

<sup>182</sup> South Australian Department of Planning and Local Government, 'Local Government Finances 2011': [http://www.localgovt.sa.gov.au/data/assets/pdf\\_file/0006/157785/Local\\_Government\\_Finances\\_September\\_2011.pdf](http://www.localgovt.sa.gov.au/data/assets/pdf_file/0006/157785/Local_Government_Finances_September_2011.pdf)

<sup>183</sup> IPART, 'Revenue Framework for Local Government', December 2009, p 26.

<sup>184</sup> Graham Sansom, 'Commonwealth of Australia' in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, Montreal, 2009) 8, 19.

Finding 3.3: *For the majority of local governments, own-source revenue is the principal revenue source. However, for 20 per cent of councils, which represent only one per cent of the population, grants account for 48 per cent or more of total revenue.*<sup>185</sup>

This finding is backed up by PriceWaterhouseCoopers, which found in a study in 2006 that:

intergovernmental transfers accounted for 10% of local government revenue in 2004-05, with a relatively even split between state/territory governments and Australian Government grants. However, individual councils' dependence on grants varies from less than 2% to more than 70% of revenue.<sup>186</sup>

Hence although the number of councils that are dependent upon grants is significant, the proportion of the population affected is not as great. This is also reflected in the allocation of grants. Metropolitan and urban councils tend to receive the minimum grant available (which is 30% on a per capita basis) while rural and remote councils receive significantly more because of their higher needs and relative disadvantage. The Productivity Commission found that:

Rural and remote councils receive substantial grants on a per person basis. Fifty per cent of remote councils receive grants in excess of \$3816 per person, compared with \$441 per person for 50 per cent of all councils. Ten per cent of remote councils receive in excess of \$10 841 per person, compared with \$3059 per person for 10 per cent of all councils.<sup>187</sup>

In terms of the functions performed by local government, those with greater financial resources and greater financial autonomy have tended to expand their services into non-traditional areas of services to people, while those with more limited means, particularly in rural and regional areas, have tended to confine their services to the more traditional, property-based services.<sup>188</sup>

The other observation that is often made is that while local government financial assistance grants are indexed, so that they at least maintain 'real' value, they have steadily been decreasing as a proportion of GDP since it was 1.01% in 1996.<sup>189</sup> While this is so, the direct grants given under the Roads to Recovery program have offset that decline and when added to the financial assistance grants, have restored Commonwealth funding of local government to 'about the same proportion of GDP as grants were late in

<sup>185</sup> Productivity Commission, 'Assessing Local Government Revenue Raising Capacity', April 2008, p 38.

<sup>186</sup> PriceWaterhouseCoopers, 'National Financial Sustainability Study of Local Government', (November 2006), p 92.

<sup>187</sup> Productivity Commission, 'Assessing Local Government Revenue Raising Capacity', April 2008, p 44.

<sup>188</sup> IPART, 'Revenue Framework for Local Government', December 2009, p 27.

<sup>189</sup> Australian Local Government Association, Submission to the Senate Select Committee Inquiry into Reform of the Australian Federation', 20 August 2010, p 10. See also: PriceWaterhouseCoopers, 'National Financial Sustainability Study of Local Government', (November 2006), pp 54-5.

the 1990s'.<sup>190</sup> The difference is essentially the move towards tied grants given directly to local government and away from general purpose grants given to local government through the States. This has an impact upon the equalising capacity of general purpose grants.

A further observation that is sometimes made is that the 'provision of financial support may have a negative impact on the financial capacity of Local Government over the longer term'.<sup>191</sup> This is because local government bodies tend to become reliant upon external grants that do not set performance requirements, rather than pursuing efficiency through improved financial and work practices and the sharing of resources. Ultimately, grants from a higher level of government diminish the democratic accountability and the policy autonomy of the recipient. They centralise power and have the potential to undermine the efficient operation of the federal system. As the Senate Select Committee on the Reform of Australia's Federation noted:

FAGs are an example of centralisation: that is, the national government determining budgetary entitlements of the other government over matters not expressly stated in sections 51 or 52 of the Constitution.<sup>192</sup>

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<sup>190</sup> Richard Webb, 'Commonwealth general purpose financial assistance to local government' Parliamentary Library Research Paper No 9, 2007-08, 14 September 2007, p 14.

<sup>191</sup> Richard Webb, 'Commonwealth general purpose financial assistance to local government' Parliamentary Library Research Paper No 9, 2007-08, 14 September 2007, p 23, quoting from the former National Office of Local Government.

<sup>192</sup> Senate Select Committee on the Reform of the Australian Federation, 'Australia's Federation: An Agenda for Reform', June 2011, p 84.

#### IV LOCAL GOVERNMENT FUNDING – INTERNATIONAL COMPARISONS

In other federations, while there are significant differences in the methods of funding of local government, similar issues arise about the allocation of expenditure and revenue within the federal system. While federations tend to be based upon an acceptance of the economic benefits of the decentralisation of functions and expenditure,<sup>193</sup> ‘the case for decentralizing revenue-raising responsibilities is much less clear-cut than for expenditures’.<sup>194</sup> On the one hand, the decentralisation of revenue-raising makes governments more accountable to their people, as they are forced to justify revenue-raising against expenditure needs. This makes governments more ‘vigilant and cost-conscious’.<sup>195</sup> It also protects their autonomy against interference from higher levels of government through conditional grants and the financial risk and instability resulting from reliance on funding from other governments that may change unilaterally from time to time. On the other hand, the decentralisation of revenue-raising can result in inefficient taxes, inequity amongst governments in revenue-raising capacities, high tax administration costs, distortion of the taxation system and wasteful tax competition.<sup>196</sup> These issues will be discussed further below.

A consequence of these conflicting arguments is that the amount of revenue decentralisation does not tend to match the amount of expenditure decentralisation. In most federations there is a degree of vertical fiscal imbalance, where the federal government earns greater revenue than needed to fund its expenditure and the States earn insufficient revenue on their own to support their expenditure. While vertical fiscal imbalance tends to flow through to local government, in some cases local governments earn a greater proportion of their revenue through their own sources than the States. This is the case in Australia where local government, on average, receives 80% of its revenue from its own sources, whereas the Australian States only receive 55% of their revenue from their own sources.<sup>197</sup> Boadway and Shah note that on ‘average in industrial countries, 50 percent of local revenues come from taxes, 20 percent from user charges, and 30 percent from transfers from higher levels’.<sup>198</sup>

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<sup>193</sup> For a discussion of the economic and social benefits to Australia of further decentralization, see: A Twomey and G Withers, *Australia’s Federal Future*, April 2007: [www.caf.gov.au/Documents/AustraliasFederalFuture.pdf](http://www.caf.gov.au/Documents/AustraliasFederalFuture.pdf).

<sup>194</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 157.

<sup>195</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 165.

<sup>196</sup> See further: Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) pp 157-9.

<sup>197</sup> Cth Treasury, *Australia’s Future Tax System – Architecture of Australia’s Tax and Transfer System*, 10 December 2008, section 10.6: [http://taxreview.treasury.gov.au/content/Paper.aspx?doc=html/publications/papers/report/section\\_10-06.htm](http://taxreview.treasury.gov.au/content/Paper.aspx?doc=html/publications/papers/report/section_10-06.htm).

<sup>198</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 277.

The sources of local government revenue largely fall into two broad categories: (a) own-source revenue, being the revenue raised by local government bodies themselves; and (b) external revenue, being revenue received from other governments.

Own-source revenue may include:

- taxes imposed by local government;
- user charges, fees and fines; and
- commercial activity.

One of the distinct advantages of own-source revenue is that what is raised by a local government area is kept by that local government area and can usually be spent according to its wishes<sup>199</sup> (subject to any overriding State financial controls). It is not usually subject to principles of horizontal fiscal equalisation. It is rare for prosperous local government bodies to be required to transfer a proportion of their funds to less prosperous local government bodies.<sup>200</sup> Hence, as a general proposition, the higher the proportion of own-source revenue, the greater the level of autonomy of local government bodies. This means that local governments can be more responsive and can customise the quantity and quality of services they provide to the needs and wishes of their own residents. It has been argued that ‘economic efficiency is maximised by the provision of public goods that best reflects the preferences of citizens’.<sup>201</sup>

The down-side, however, is that greater autonomy in imposing taxes is likely to result in different tax rates and bases. As municipalities tend to be geographically small, this creates incentives for tax-payers to undertake transactions in different municipalities, depending upon their tax structures. ‘This incentive then leads to distortions in markets for resources and commodities that are mobile across states, especially capital and tradable goods’.<sup>202</sup> Different tax structures also increase administrative and compliance costs for persons and bodies that operate across a number of municipalities. This reduces the efficiency of the tax system. Further, if taxes are to be collected by each individual municipality, this also increases administrative costs as well as increasing the number of personnel that need to be employed with particular sets of skills. The burden of tax collection and compliance costs can be reduced if there is tax harmonization and joint collection machinery so that taxpayers do not have to file separate tax returns.<sup>203</sup>

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<sup>199</sup> Compare Brazil where 15% of municipal revenue must be spent on health and 25% on education: Luiz Cesar de Queiroz Ribeiro and Sol Garson Braule Pinto, ‘Brazil’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), p 85.

<sup>200</sup> Compare, Switzerland where such transfers do take place: Andreas Ladner, ‘Swiss Confederation’, in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), p 346.

<sup>201</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 49.

<sup>202</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 162.

<sup>203</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 164.

The other form of revenue received by local government bodies in federations is derived from State and federal governments. It may include:

- shared taxes, imposed by the federal or State government, from which a proportion of the revenue is allocated to local government;
- unconditional grants; and
- conditional grants.

This source of revenue is usually necessary, to some degree, because of the inequalities in the revenue-raising capacities of local government areas. Metropolitan and urban municipalities usually have a greater capacity to raise own-source revenue than rural, sparsely populated municipalities. Hence, grants or transfers from other levels of government, commonly distributed according to horizontal fiscal equalisation principles, are usually needed to assist less prosperous municipalities.

Another factor is that it is often more efficient for particular types of taxes to be imposed at the national or State level than at the local level. It is therefore appropriate that such taxes be imposed federally or by the States, but that the revenue be transferred to where it is needed to match spending responsibilities.

A third factor is decentralisation. The more functions that are conferred upon local government (such as education and health), the greater its need for external funding as its capacity to raise its own taxes is insufficient to fund high-cost services. The resulting reliance on inter-governmental transfers and the conditions placed upon how they are spent, however, are seen as having a centralising effect, even though the allocation of greater functions to local government is intended to achieve decentralisation.<sup>204</sup>

There are problems, however, associated with this form of local government funding. First, it can become a crutch that makes local government reliant on external forms of revenue and reluctant to fully exploit its own revenue-raising capacities.<sup>205</sup> It is easier to rely on hand-outs than to impose unpopular taxes.<sup>206</sup> This tends to lead to a responsibility deficit, as those who spend are not responsible for raising the money spent.<sup>207</sup> It has also been described as creating a 'poverty trap' by removing incentives for local governments

<sup>204</sup> Luiz Cesar de Queiroz Ribeiro and Sol Garson Braule Pinto, 'Brazil' in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 90.

<sup>205</sup> Note the claim that grants in Mexico have 'inhibited municipalities' fiscal efforts': Boris Graizbord, 'United Mexican States', in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 217.

<sup>206</sup> 'For example, village *panchayats* in Andhra Pradesh, Madhya Pradesh, and Rajasthan neither impose nor collect the taxes that they are authorized to levy because they perceive such actions as unpopular with the people': George Mathew and Rakesh Hooja, 'Republic of India' in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 188. 'The real and direct relationship between the municipal tax burden and opinion polls discourages local councils from any explicit increase of local taxes': Francisco Velasco Caballero, 'Kingdom of Spain', in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 316.

<sup>207</sup> Habu Galadima, 'Federal Republic of Nigeria', in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), pp 254-5.

to boost their own revenue-raising.<sup>208</sup> Secondly, grants often come with conditions, limiting the capacity of local governments to govern their budgets and allocate expenditure according to local needs and desires. Thirdly, such funding is not always stable with long-term certainty. It can be cut-off or reduced in accordance with the policy of another level of government, leaving local government vulnerable to policy changes that it cannot control.<sup>209</sup>

There are a number of common problems that arise in relation to the funding of local government. They include cost-shifting, be it the deliberate transfer of unfunded functions to local government, or the incidental effect of the policies of another level of government, such as immigration policies that give rise to social and economic problems in cities.<sup>210</sup> This can reduce the autonomy of local governments because their budgets are so tied up in dealing with delegated functions or problems thrust upon them that they have little, if anything, left for discretionary funding.<sup>211</sup>

Another common problem is the lack of money for infrastructure development and maintenance. Capital funding is often neglected when inter-governmental fiscal relations are being addressed, even though local government capital expenditure amounts to a significantly greater proportion of national capital expenditure, when compared with current expenditure at the local and national levels.<sup>212</sup>

A third common problem is the disparity of revenue raising capacity between urban and rural local government areas. This is particularly marked in countries such as India and Mexico where rural municipalities struggle to raise any significant own-source revenue.<sup>213</sup> In South Africa, the disparity is great, with metropolitan municipalities raising over 95% of their current expenditure from own source revenue, whereas rural municipalities remain dependent upon grants from the national government, rendering them 'weak participants on the intergovernmental pitch'.<sup>214</sup>

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<sup>208</sup> OECD, 'Fiscal Relations Across Levels of Government' in *Economic Outlook*, Vol 2003, Issue 2, (OECD 2003) p 154.

<sup>209</sup> This occurred in the United States during the Reagan period: Michael A Pagano, 'United States of America', in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 378.

<sup>210</sup> Julio Lopez-Laborda, *et al*, 'Kingdom of Spain', in Anwar Shah (ed), *The Practice of Fiscal Federalism: Comparative Perspectives* (McGill-Queen's University Press, 2007), p 309.

<sup>211</sup> Martin Burgi, 'Federal Republic of Germany' in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 149.

<sup>212</sup> Judy McNeill, 'Local government in the Australian federal system' in B Dollery and N Marshall (eds), *Australian Local Government: Reform and Renewal* (Macmillan, 1997) p 36.

<sup>213</sup> George Mathew and Rakesh Hooja, 'Republic of India' in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 186; and Boris Graizbord, 'United Mexican States', in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 219.

<sup>214</sup> Jaap de Visser, 'Republic of South Africa' in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 283.

## Own-source revenue

### *Own-source taxes*

The primary tax that tends to be imposed by local governments is some form of property tax, usually known as ‘rates’. One reason for this is that it is not a mobile tax base. Land cannot be moved into another municipality (assuming that borders remain unchanged), hence the risk of distortion to the tax system and spillover effects on other municipalities is limited.<sup>215</sup> It does have some problems, however. Issues of cost and fairness arise in valuing property regularly<sup>216</sup> and the value of property (especially during periods where it escalates dramatically) does not necessarily correlate with the capacity of the owner to pay the tax. Other property-type taxes include: taxes on second residences (Austria and Germany), taxes on real estate transactions (Brazil) and taxes on construction, facilities and infrastructure (Spain).

In some federal countries, local government is funded by a wide variety of narrow-based taxes, including ‘entertainment’ taxes (Austria, Germany, India), taxes on advertising space (Austria, India) and taxes on vehicles (Spain) and non-motor vehicles (India). In other federal countries local government is given the power to impose taxes that have a much broader base, including personal income tax (Switzerland, United States), sales tax (United States), taxes on services (Brazil, South Africa), business profits tax (Germany, Spain), taxes on goods entering the area (India) and pay-roll tax (Austria, Mexico).

Some types of taxes, such as a value-added tax (‘VAT’), are not suited to decentralisation. This is because such a tax applies at different stages in transactions that cross borders, making the allocation of tax revenues and credits very difficult. Hence, ‘the administration of a fully decentralised VAT system [is] almost nonviable’.<sup>217</sup> This is one of the reasons why in Australia, the Goods and Services Tax is imposed and administered at the Commonwealth level, even though the proceeds are paid to the States.<sup>218</sup> Such a tax could not sensibly be applied at a municipal level.

Where local governments have the freedom to set their own level of tax, this may lead to competition. Tax competition may be beneficial, where it imposes fiscal discipline and discourages excessive public spending.<sup>219</sup> However, it can also be predatory, resulting in ‘inter-municipal fiscal wars’<sup>220</sup> between municipalities to attract businesses and residents

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<sup>215</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) pp 166-7 and p 188.

<sup>216</sup> OECD, ‘Fiscal Relations Across Levels of Government’ in *Economic Outlook*, Vol 2003, Issue 2, (OECD 2003) p 151.

<sup>217</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 171.

<sup>218</sup> The other main reason is that s 90 of the Commonwealth Constitution prohibits the States from imposing excises (i.e. taxes on goods).

<sup>219</sup> OECD, ‘Fiscal Relations Across Levels of Government’ in *Economic Outlook*, Vol 2003, Issue 2, (OECD 2003) p 153.

<sup>220</sup> Luiz Cesar de Queiroz Ribeiro and Sol Garson Braule Pinto, ‘Brazil’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), p 89.

by their lower taxes. This can be problematic if it results in all taxes being reduced and local governments being underfunded as a consequence.<sup>221</sup> Boadway and Shah described such behaviour as engaging in ‘socially wasteful beggar-thy-neighbour policies’ to attract resources away from other jurisdictions. They concluded:

If all jurisdictions engage in such policies, the end result may well be uniform state tax systems. But it will also likely be tax systems that will have inefficiently low taxes (or high subsidies) on mobile factors. This outcome provides a strong argument for retaining taxes on mobile factors at the federal level of government.<sup>222</sup>

In some cases, there is no point to competition because the effects of horizontal fiscal equalisation will negate any benefit achieved,<sup>223</sup> or differences in land prices and the cost of living counterbalance any tax difference.<sup>224</sup> In jurisdictions, such as New South Wales, rate-pegging, which has been in place since 1977,<sup>225</sup> reduces tax competition,<sup>226</sup> although this gives rise to other problems.

Local governments often seek access to a form of growth tax – one which will increase with the growth of the economy.<sup>227</sup> It is often not efficient, however, to impose such taxes at the local government level. Hence, they primarily fall into the area of ‘shared taxes’ discussed below. In some cases, however, the federal government might act as the agent of local government in collecting a tax on behalf of local government. For example, in Mexico, some taxes that were originally levied by municipalities were delegated to the federal government to impose, ‘for tax efficiency reasons’.<sup>228</sup> The revenue is returned to municipalities, according to a federal formula. In Austria, a payroll tax of 3% is imposed on the salaries of employees in municipalities. It is known as the municipal tax, but it is collected by federal authorities and refunded to the municipality in which the tax was collected.<sup>229</sup>

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<sup>221</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) pp 50-1.

<sup>222</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 162.

<sup>223</sup> Robin Boadway, ‘Canada’, in Anwar Shah (ed), *The Practice of Fiscal Federalism: Comparative Perspectives* (McGill-Queen’s University Press, 2007), p 113.

<sup>224</sup> Andreas Ladner, ‘Swiss Confederation’, in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), pp 345-6.

<sup>225</sup> Judy McNeill, ‘Local government in the Australian federal system’ in B Dollery and N Marshall (eds), *Australian Local Government: Reform and Renewal* (Macmillan, 1997) p 22.

<sup>226</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 54.

<sup>227</sup> Robert Young, ‘Canada’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), p 90.

<sup>228</sup> Boris Graizbord, ‘United Mexican States’, in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), p 216.

<sup>229</sup> Andreas Kiefer and Franz Schausberger, ‘Republic of Austria’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), p 53.

There is a very fine line between shared taxes (where the municipality simply receives a share of a federal or state tax) and own-source taxes in a harmonised tax system. One critical difference seems to be that for an own-source tax, the municipality must have some degree of control over it, such as setting the rate of the tax.<sup>230</sup> For example, the main German municipal tax is a ‘commercial tax’ on business profits. Local government sets the rate of the tax, but the base and other elements of the tax are set out in federal law.<sup>231</sup> This ensures the harmonization of the tax in its application, while the capacity to set different rates permits a degree of competition and gives greater autonomy to municipalities and control over their budgets. The other critical difference is that an own-source tax is returned to the jurisdiction that imposes it, on the basis of derivation.<sup>232</sup> In the case of shared-taxes, however, the amount received by a jurisdiction may be calculated by reference to different measures, such as principles of horizontal fiscal equalisation.<sup>233</sup>

Boadway and Shah describe this approach as the co-occupation of tax-bases. They describe a number of ways that it can be done with varying degrees of tax harmonization.<sup>234</sup> One is to use a surtax to piggyback on an existing tax, using its existing base and rate structure as well as its existing collection mechanism.<sup>235</sup> The municipality simply determines the rate of its surtax and is responsible for it to taxpayers. The other government then collects the tax (including any surtaxes) and distributes the revenue from the surtax to the municipality in which it was collected. This ‘surtax system combines a high degree of harmonization of the base, rate structure and collection machinery with the devolution of some revenue-raising responsibility’ to municipalities.<sup>236</sup> It is therefore suited to taxes such as personal income tax and corporate income taxes. However, for it to be effective, there must be sufficient tax space for local governments to add their surtax without resulting in an excessively high level of a particular tax.<sup>237</sup>

### ***Own-source fees, fines and commercial activities***

Municipalities generally obtain some revenue through imposing fees and fines or requiring people to obtain licences. These include parking fees and fines, pet licences,

<sup>230</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 80.

<sup>231</sup> Werner Heun, *The Constitution of Germany – A Contextual Analysis*, (Hart Publishing, 2011) p 79.

<sup>232</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 299.

<sup>233</sup> See, for example, the distribution of GST to the Australian States which is calculated by reference to principles of horizontal fiscal equalization rather than the jurisdiction in which the tax was paid.

<sup>234</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) pp 191-206.

<sup>235</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 79; OECD, ‘Fiscal Relations Across Levels of Government’ in *Economic Outlook*, Vol 2003, Issue 2, (OECD 2003) p 153.

<sup>236</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 201.

<sup>237</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 86.

market fees and road tolls. Municipalities also routinely charge for the use of their facilities, including recreation and sporting facilities, and for the use of public transport. Fees and user charges are the fastest growing source of own-source revenue for municipalities in the United States<sup>238</sup> and have grown in importance across the OECD since the 1980s.<sup>239</sup>

Fees and user-charges are generally imposed where the recipients of services receive personal benefits, rather than benefits to the community at large.<sup>240</sup> One advantage is that ‘poor service delivery cannot be disguised by fixed financial support from taxation or grant revenues, and local authorities must adjust service production to match the preferences of constituents’.<sup>241</sup> This form of funding is more transparent and easier to adjust to meet the genuine needs and wishes of residents.

Some local government bodies engage in commercial activities. This is particularly the case where they supply electricity and water or provide waste and sewage disposal. Sometimes these services are run at a profit and sometimes they are conducted in conjunction with private partners. In Germany, for example, local government municipalities obtain a substantial amount of revenue through such commercial activities.<sup>242</sup> In South Africa in 2005-6, 26% of the operating revenue of local government came from the provision of electricity, 12% from water tariffs and 30% from sanitation and other levies.<sup>243</sup>

## External sources of revenue

### *Transfers*

Transfers, otherwise known as grants, involve the transfer of money from the revenue of one government to another. Usually, transfers come from a higher level of government to a lower level of government (eg from the federal or state government to a municipal government). Transfers are discretionary in nature – it is up to the level of government making the transfer to decide how much it is and whether any conditions should be placed upon it. Boadway and Shah have noted that the ‘existence of discretionary grants leaves open the opportunity – often seemingly irresistible – for the federal government to

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<sup>238</sup> Michael A Pagano, ‘United States of America’, in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), p 375.

<sup>239</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 70.

<sup>240</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 96.

<sup>241</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) pp 60-1.

<sup>242</sup> Marin Burgi, ‘Federal Republic of Germany’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), p 150.

<sup>243</sup> Jaap de Visser, ‘Republic of South Africa’, in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), p 284.

exercise too much control over provincial spending priorities'.<sup>244</sup> This is why tax-sharing or the co-occupation of tax bases is preferable to discretionary grants, from the point of view of the recipient. From the point of view of the grantor, transfers are preferred, as the grantor can impose his or her policy wishes through conditions on transfers.

Conditional transfers may require that the money be spent upon a particular project or that the receiving government match the amount with funding from its own revenue, or that the receiving government pursue particular policies or perform particular actions. The conditions placed upon transfers reduce the autonomy of the receiving government, particularly in relation to its control over its budget and its capacity to exercise choice in the management of its resources and development of its policies. Conditional transfers are often not cost-effective and involve high administrative costs.<sup>245</sup>

Transfers are usually necessary for three reasons. First, federal governments tend to have control over the primary sources of revenue, receiving revenue far beyond their expenditure needs, while States and municipalities tend to have greater expenditure responsibilities than they have revenue-raising capacity. As noted above, this is in part due to the fact that in many cases it is more efficient for certain types of taxes to be applied at the national level. The second reason for transfers is that the revenue-raising capacity of States and municipalities will vary and some degree of horizontal fiscal equalisation is required<sup>246</sup> if each jurisdiction is to be able to provide services at a comparable level. Hence, transfers play a role in the redistribution of revenue in almost all federations. The third reason is that the provision of services and the demand for services in local government areas is likely to be asymmetric.<sup>247</sup> Poorer municipalities will have greater demand to provide welfare services and will need to expend money on dealing with the consequences of poverty. In urban areas, those municipalities which contain major shopping centres will need to provide services that benefit people from neighbouring municipalities. Hence transfers may be needed to accommodate these imbalances in demand and responsibilities.

It has been argued that there is little difference between conditional and unconditional transfers, because a conditional transfer frees up money that can be used elsewhere or permits lower taxes to be paid.<sup>248</sup> However, there are significant practical problems with the use of conditional transfers. These include the administrative costs attached to documenting and substantiating the fulfilment of conditions, the risk that some services will be over-supplied while others will be under-funded, the consequential lack of flexibility in the management of the budget of the municipality and the fact that such

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<sup>244</sup> Robin Boadway and Anwar Shah, 'Fiscal Federalism – Principles and Practices of Multiorder Governance', (CUP, 2009) p 296.

<sup>245</sup> OECD, 'Fiscal Relations Across Levels of Government' in *Economic Outlook*, Vol 2003, Issue 2, (OECD 2003) p 154.

<sup>246</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) pp 51-2.

<sup>247</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) pp 97-8.

<sup>248</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 100.

transfers often ignore the real needs and desires of local communities. Another significant problem with conditional grants that are intended to fund particular services, is that they are usually not indexed in a manner related to the increase in the cost of provision of those services.<sup>249</sup> This means that while a grant to fund a new service might be adequate at the beginning, it frequently becomes inadequate, leaving local governments to pick up the rest of the burgeoning cost over time.

### *Shared taxes*

The sharing of the revenue from a particular tax has been described as an ‘extreme form of tax harmonization’.<sup>250</sup> Where the federal government determines the tax base, rates and structures, and simply allocates a predetermined share to the States or municipalities, then there is no real autonomy for the receiving jurisdiction. Boadway and Shah have observed that from ‘an economics point of view, revenue sharing is really equivalent to a system of unconditional grants, albeit one whose magnitude is tied to revenues raised from a particular tax source’.<sup>251</sup> It is the latter point that is relevant here.

Municipalities seek access to a growth tax for the purpose of revenue-sharing, with a view to increasing their revenue as the economy grows, at a rate higher than it would be likely to receive through discretionary grants from another government. This, however, can be something of a gamble, as revenue from taxes can fluctuate greatly over time and the receiving government may be worse-off if the tax revenue dips when there is a recession. Further, if another level of government controls the rate and base of the tax and does not receive much or any revenue from that tax, it may alter the rate and base, or leave them to stagnate, as it does not have a financial interest in the revenue raised by the tax.<sup>252</sup>

The other relevant aspect of tax-sharing is that it is formula-based rather than discretionary in nature. The municipalities receive a set percentage of revenue from a particular tax or taxes, whatever this amount might be. It is therefore not a matter of discretion for another level of government to determine each year and, critically, the proceeds are usually transferred to the receiving jurisdiction without conditions. As the receiving jurisdiction has full discretion as to how to spend the money, this ‘facilitates the decentralization of fiscal responsibility and contributes to the efficiency of the federal system’.<sup>253</sup>

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<sup>249</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 73; Andrew Johnson, ‘Financing Local Government in Australia’ B Dollery, N Marshall and A Worthington (eds), *Reshaping Australian Local Government – Finance, Governance and Reform*. (UNSW Press, 2003) p 44.

<sup>250</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 198.

<sup>251</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 199.

<sup>252</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 200.

<sup>253</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 295.

In Austria, there are joint federal taxes which account for approximately 80% of tax revenue raised. From this pool, the federal government deducts the transfers that it makes to the Länder and municipalities. The rest is then apportioned between the federal government, Länder and municipalities, with the municipalities (excluding Vienna) receiving approximately 9.8%. Every 4-5 years the federal government, the Länder and the representative organizations of the municipalities negotiate the funding of their budgets and the relevant shares of joint federal taxes.<sup>254</sup> About 38% of the revenue of Austrian municipalities is received from joint federal taxes.

In Brazil there is an extensive and complicated tax-sharing system, which is set out in detail in articles 157-62 of the Brazilian Constitution. For example, 22.5% of federal revenue from income tax and manufacturing taxes goes to municipalities, as does 25% of State VAT revenue, 50% of the federal government's rural property tax and 50% of the State motor vehicle tax. In addition, municipalities receive 70% of the proceeds of a federal tax on financial operations in gold, where its origin is within the municipality.<sup>255</sup> Federal laws also set out compensation for municipalities, through the payment of royalties, for mining and oil extraction.<sup>256</sup>

In Canada, there is little tax-sharing. However, in 2005 the federal government agreed to share the revenue from its excise on gasoline, transferring significant amounts to municipalities.<sup>257</sup> Some of the Provinces also share the proceeds of their gas taxes with municipalities. Manitoba, however, participates far more extensively in tax-sharing with its municipalities. Up until 2010, it funded infrastructure in municipalities through a proportion of provincial personal and corporate income tax and gas and diesel taxes. In 2011 this was changed so that municipalities now receive the greater of the amount estimated under the former system, or the revenue produced from 1 percentage point of provincial sales tax.<sup>258</sup>

Germany has substantial tax-sharing. The primary revenue-raising taxes are the personal income tax, the corporate income tax and the VAT. These taxes are primarily shared amongst the federal government and the Länder. Municipalities, however, receive 15%

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<sup>254</sup> Andreas Kiefer and Franz Schausberger, 'Republic of Austria' in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 52. See also: Hansjörg Blöchliger and Camila Manvalle, *Reforming fiscal relations: Going beyond the zero-sum game* (OECD Fiscal Federalism Studies, 2012) Ch 3.

<sup>255</sup> Constitution of Brazil, art 153; and Fernando Rezende, 'Federal Republic of Brazil' in Anwar Shah (ed), *The Practice of Fiscal Federalism: Comparative Perspectives* (McGill-Queen's University Press, 2007), p 88.

<sup>256</sup> Fernando Rezende, 'Federal Republic of Brazil' in Anwar Shah (ed), *The Practice of Fiscal Federalism: Comparative Perspectives* (McGill-Queen's University Press, 2007), p 90.

<sup>257</sup> It has been estimated that up to \$5 billion (CAN) will be provided over 5 years to support environmentally sustainable infrastructure projects in municipalities:  
<http://www.iea.org/textbase/pm/?mode=cc&id=2309&action=detail>.

<sup>258</sup> Building Manitoba Fund – Province of Manitoba:  
[http://web5.gov.mb.ca/mfas/grants\\_payments\\_fund.aspx](http://web5.gov.mb.ca/mfas/grants_payments_fund.aspx). See also: *Municipal Revenue (Grants and Taxation) Act 2005* (Manitoba).

of personal income tax and 2.1% of VAT.<sup>259</sup> These shared taxes together make up just under 15% of total income of municipalities, which is just less than the 17.6% of total income raised by their own-source commercial tax.

India also uses tax-sharing. Until 2000, the proceeds of only two central taxes were shared – personal income tax and excise duty. The 80<sup>th</sup> constitutional amendment replaced this system with the sharing of revenue from all central taxes. Art 280 of the Indian Constitution provides for the establishment every five years of a Finance Commission which makes recommendations concerning the allocation of the proceeds of shared taxes and the principles that should govern the allocation of grants to the States. It also addresses the measures that need to be taken to augment State revenue so that it can supplement the resources of rural and urban municipal governments, as recommended by State Finance Commissions (which are also required to be established by the Constitution).<sup>260</sup> Indian local government bodies are highly reliant on the proceeds of shared taxes and grants. Rural local government bodies (known as panchayats) raise very little own-source revenue and do not fully exploit the resources that they have.<sup>261</sup>

In Nigeria, all revenue raised by the Federal Government is paid into a ‘Federation Account’ which is then shared between the federal government, the States and the municipalities. Advice on its distribution is provided by a Commission and the final distribution is determined by the National Assembly, which must take into account a number of principles.<sup>262</sup> The administration of the Federation Account and the deductions made from it have been controversial and the subject of litigation in the Nigerian Supreme Court.<sup>263</sup> Greater complication is added by the constitutional requirement that the share of the Federation Account intended for local government be paid into a ‘State Joint Local Government Account’, into which is also paid a proportion of State revenue. The State controls payment out of this account and there have been complaints that it does not fully pass on the allocated money to local government. In response the Federal Government established the ‘State Joint Local Government Account

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<sup>259</sup> Lars P Feld and Jürgen von Hagen, ‘Federal Republic of Germany’ in Anwar Shah (ed), *The Practice of Fiscal Federalism: Comparative Perspectives* (McGill-Queen’s University Press, 2007), p 142. Note that the share of tax is distributed to municipalities on the basis of the amount of tax paid by their residents: Oliver M Hartwich, ‘Beyond Symbolism: Finding a Place for Local Government in Australia’s Constitution’, 22 January 2009, *Issues Analysis No 104*, Centre for Independent Studies, p 9: <http://www.cis.org.au/images/stories/issue-analysis/ia104.pdf>.

<sup>260</sup> Govinda Rao, ‘Republic of India’, in Anwar Shah (ed), *The Practice of Fiscal Federalism: Comparative Perspectives* (McGill-Queen’s University Press, 2007), pp 164-5.

<sup>261</sup> Angela Frascini, ‘Fiscal federalism in big developing countries: China and India’, (Working Paper no 66, January 2006) pp 11-12: <http://polis.unipmn.it/pubbl/RePEc/uca/ucapdv/frascini66.pdf>; George Mathew and Rakesh Hooja, ‘Republic of India’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), p 186.

<sup>262</sup> Habu Galadima, ‘Federal Republic of Nigeria’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, 2009), p 251.

<sup>263</sup> See further: Akpan Ekpo, ‘Federal Republic of Nigeria’, in Anwar Shah (ed), *The Practice of Fiscal Federalism: Comparative Perspectives* (McGill-Queen’s University Press, 2007), pp 215-7.

Allocation Committee' to ensure that amounts paid into the Joint Account are distributed to local government bodies in accordance with the Constitution and the law.<sup>264</sup>

In South Africa, local government is entitled to receive a share of nationally collected revenue. The allocation is made by an Act of the Federal Parliament, which also sets out an equalisation formula for the distribution of this revenue amongst municipalities. In 2006-7 municipalities were entitled to 7.2% of shared revenue (with the federal government receiving 50.4% and the provinces receiving 42.4%).<sup>265</sup>

In Spain, the municipalities receive up to 32% of their revenue from tax-sharing of both federal taxes (personal income tax, the VAT and excise taxes) and taxes of the autonomous communities.<sup>266</sup> The distribution works differently for larger cities (taking into account the location of the derivation of the tax) and other smaller municipalities.<sup>267</sup>

### **Local government in Australia as compared to other federations**

Local government in Australia is quite different from that in other federations (and indeed, other countries generally) on a number of grounds. The first is that local government has fewer and less cost-intensive functions and responsibilities in Australia than in most other countries. This is, in part, a consequence of the historical development of local government in Australia. Early attempts to introduce local government in the Australian colonies failed due to its top-down imposition and the reluctance of the people to pay for it through local rates.<sup>268</sup> This influenced the scope of the functions of local government when it was finally established. They were largely confined to property-services, and did not pick up local policing, schooling or health,<sup>269</sup> as in other countries.

Boadway and Shah made the following international comparison, using Australia as one extreme of the spectrum:

In infrastructure, Australian local governments command 27 percent of total expenditures, compared with 62 percent in the United Kingdom and 47 percent

<sup>264</sup> See further: Akpan Ekpo, 'Federal Republic of Nigeria', in Anwar Shah (ed), *The Practice of Fiscal Federalism: Comparative Perspectives* (McGill-Queen's University Press, 2007), pp 222-224.

<sup>265</sup> Jaape de Visser, 'Republic of South Africa' in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 295, n 65.

<sup>266</sup> Francisco Velasco Caballero, 'Kingdom of Spain', in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen's University Press, 2009), p 316.

<sup>267</sup> See further: Julio Lopez-Laborda, *et al*, 'Kingdom of Spain', in Anwar Shah (ed), *The Practice of Fiscal Federalism: Comparative Perspectives* (McGill-Queen's University Press, 2007), p 309. Note also the additional reforms of December 2009: Hansjörg Blöchliger and Camila Manvalle, *Reforming fiscal relations: Going beyond the zero-sum game*' (OECD Fiscal Federalism Studies, 2012) Ch 10.

<sup>268</sup> See further: A Twomey, *The Constitution of New South Wales* (Federation Press, 2004) pp 32-3; and Judy McNeill, 'Local government in the Australian federal system' in B Dollery and N Marshall (eds), *Australian Local Government: Reform and Renewal* (Macmillan, 1997) p 18.

<sup>269</sup> Note that the original British plan for local government in the Australian colonies, as set out in the *Australian Constitutions Act (No 1)*, 5 & 6 Vic, c 76 (1842), provided for local policing and for local government to establish and support schools. This attempt failed due to popular resistance.

and 41 percent in the EU and the OECD. People-oriented services show more variation. In education, local government has no role in Australia but takes up more than 60 percent of expenditure share at local levels in Canada, the United Kingdom, and the United States. In the OECD, it averages about 46 percent. In health, local governments have no role in Australia and the United Kingdom but a predominant role in Denmark (about 92 percent); EU and OECD average expenditure shares are 28 percent and 19 percent respectively....

Overall, local governments in Nordic countries perform the maximal range of local services, encompassing a wide range of people – and property – oriented services. Local government in Southern Europe and in North America fall in a median range and are more focused on property-oriented services. Australian local governments are engaged in the most minimal property-oriented services...<sup>270</sup>

As McNeil has also noted, local government in Australia still primarily provides ‘services to property’. While it has moved into ‘a wide range of relatively minor welfare and other “services to persons” in recent decades’, it has not done so to ‘any significant degree’.<sup>271</sup> This can be seen by the standard expenditure allowances used by the NSW Local Government Grants Commission. While per capita spending on areas such as aged person’s services, children’s services, cultural facilities, community services and health and safety services is relatively low, the highest level of expenditure is on services to property, such as the maintenance of roads, street and gutter cleaning, stormwater drainage and flood control, planning and building services, noxious plants and pest control and street lighting. Recreation facilities and libraries also involve substantial expenditure.<sup>272</sup>

This is not an argument that local government should necessarily have greater functions and responsibilities. Rather, it provides at least one explanation for the lower status that local government holds in Australia than in many other countries and recognition that the revenue-raising problems of local government in Australia are insignificant in comparison to the difficulties facing local government in other countries where they carry highly cost-intensive functions. It also explains why local government in some countries has access to broad based taxes such as personal and corporate income taxes, as this is necessary to support cost-intensive functions. While Australia is ‘unique among federated OECD countries in its total dependence on property as the only form of local government taxation’,<sup>273</sup> this is a reflection of the uniquely limited functions of local government in Australia. Hence, property taxes have been largely sufficient to support local government expenditure, at least in urban areas.

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<sup>270</sup> Robin Boadway and Anwar Shah, ‘Fiscal Federalism – Principles and Practices of Multiorder Governance’, (CUP, 2009) p 276.

<sup>271</sup> Judy McNeill, ‘Local government in the Australian federal system’ in B Dollery and N Marshall (eds), *Australian Local Government: Reform and Renewal* (Macmillan, 1997) p 29.

<sup>272</sup> NSW Local Government Grants Commission, *Annual Report 2009-10*, pp 41-2: <http://www.dlg.nsw.gov.au/dlg/dlghome/documents/Reports/Grants2009-10AR.pdf>.

<sup>273</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 92.

If, however, other substantial functions and responsibilities were to be devolved upon local government in Australia, then this would boost the argument for access to taxes beyond property taxes. As long as property taxes are used to fund services which primarily benefit property owners, there is a clear match between the tax burden and the service benefits. However, ‘a wider mandate for local government offers grounds for a wider and geographically broader tax base’.<sup>274</sup>

Another major difference is that Australian local government areas are relatively small, in population terms, when compared with those of other countries. PriceWaterhouseCoopers has noted that in population terms, UK councils are on average 5.4 times larger than average Australian councils and New Zealand councils are on average 1.7 times larger than Australian councils.<sup>275</sup> In Australia, over half of all councils have a population of fewer than 10,000 people.<sup>276</sup> This is in part due to the fact that in order to encourage the establishment of local government areas, States originally provided grant assistance. This resulted in a proliferation of small local government areas with insufficient population to make them economically viable. While there have been many attempts since to amalgamate local government areas, most notably in Victoria during the Kennett era and in Queensland during the Beattie era, this has been ‘fiercely resisted’ and ‘largely unsuccessful until very recently’.<sup>277</sup>

Local government areas with small populations tend to lack the necessary resources to act in an autonomous fashion due to their small economic base and tend to be reliant for survival on grants from state or federal governments.<sup>278</sup> The great dispersion of population in rural areas in Australia has resulted in many local government areas being highly dependent upon federal and State funding, as has the fracturing of urban areas into many smaller councils, which has occurred in all of Australia’s capital cities, except Brisbane.

### **Relevance of international examples to Australian financial constitutional recognition of local government**

The argument behind the ‘financial’ recognition of local government in the Commonwealth Constitution is largely based upon a desire to increase local government funding, particularly in relation to capital expenditure on infrastructure. The amendment

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<sup>274</sup> Brian Dollery, Lin Crase and Andrew Johnson, *Australian Local Government Economics* (UNSW Press, 2006) p 83. See also: Judy McNeill, ‘Local government in the Australian federal system’ in B Dollery and N Marshall (eds), *Australian Local Government: Reform and Renewal* (Macmillan, 1997) p 38.

<sup>275</sup> PriceWaterhouseCoopers, ‘National Financial Sustainability Study of Local Government’, (November 2006), pp 34-6.

<sup>276</sup> Graham Sansom, ‘Commonwealth of Australia’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, Montreal, 2009) 8, 11.

<sup>277</sup> Judy McNeill, ‘Local government in the Australian federal system’ in B Dollery and N Marshall (eds), *Australian Local Government: Reform and Renewal* (Macmillan, 1997) p 20.

<sup>278</sup> Nico Steytler, ‘Comparative Conclusions’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, Montreal, 2009) p 401.

of the Commonwealth Constitution to permit the Commonwealth to fund local government directly, upon such terms and conditions as the Commonwealth chooses to impose, is not necessarily the best way to achieve this outcome. Such an amendment is likely to increase local government's dependence upon the Commonwealth and result in the diminution of its relative autonomy, both financially and in terms of policy. The likely consequence of direct Commonwealth funding is that much of it will be given upon terms and conditions that direct local government policy, limiting the capacity of local governments to accommodate the special needs and interests of their own communities. This would negate the advantage held by local government of being 'closer to the people' and being more responsive to local needs than State or Commonwealth governments.

Ideally, a better response would be to recalibrate fiscal relations to increase local government financial and policy autonomy by ensuring that municipalities have adequate capacity to raise their own revenue. As noted above, overall local government in Australia has a high level of financial autonomy. However, this is unevenly distributed, with many rural and regional municipalities being highly dependent upon grants while many urban municipalities are largely self-sufficient. Consideration should therefore be given to whether there are potential sources of revenue that are particularly relevant to rural and regional municipalities.

International experience in countries such as Brazil and Canada shows that one possibility would be for rural and regional areas to gain some benefit from natural resources captured in their areas, be they minerals, coal-seam gas, forestry or other resources. If local communities benefitted more uniformly from local mining or other resource exploitation, then they might be more accepting of it within their areas. Wind-farms, for example, that benefitted not just the owner of the land on which they are situated, but the entire community, would be less likely to be the subject of objections and complaints.

One of the major problems with taxes on resources is that they are very unevenly spread across jurisdictions and highly lucrative, leading to inequities. For this reason, taxes or royalties on mining are usually collected at a higher level, so the benefits can be redistributed.<sup>279</sup> However, there would appear to be no reason why local governments could not share in the proceeds of resource taxes, royalties or licence fees, to an appropriate degree. This could be adjusted so that those local government areas in which the natural resources are exploited could receive additional benefits, while other local government areas that would otherwise be highly dependent upon grants could generally share in the rest of the proceeds.

This could occur through a form of tax-sharing or the co-occupation of a tax-base, in which local government bodies piggy-back on an existing Commonwealth or State tax.<sup>280</sup> Similarly, charges and fees could be applied by local government bodies with respect to

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<sup>279</sup> See further: Robin Boadway and Anwar Shah, 'Fiscal Federalism – Principles and Practices of Multiorder Governance', (CUP, 2009) pp 187-8.

<sup>280</sup> If local government were to impose the additional tax, care would have to be taken to ensure that it was not an excise.

such activities, as long as they did not amount to excises. This would reduce local government reliance upon Commonwealth transfers, increase local government financial and policy autonomy, permit local government to be more responsive to local needs and be more conducive to uniting rather than dividing communities, as all would benefit from resource development, rather than particular land owners.

Another alternative might be the establishment of a broader reform of fiscal federalism, with tax-sharing involving the Commonwealth, States and local government bodies, as occurs in many federal countries.

Neither of these options requires the passage of a constitutional amendment and all can be dealt with through ordinary political processes. They would appear to be better tailored to achieve the aims of local government than a constitutional amendment that permits the Commonwealth to make tied grants directly to local government, which in itself would not increase funding to local government by one cent.

## V EFFORTS TO RECOGNISE LOCAL GOVERNMENT IN STATE AND COMMONWEALTH CONSTITUTIONS

### The 1974 referendum

The 1974 referendum on local government arose out of the failure of a Premiers' Conference in October 1973. One of Whitlam's plans was that local government be represented on the Australian Loan Council and that the Commonwealth be permitted to lend money to local government. These two propositions were put to the October 1973 Premiers' Conference and rejected by the Premiers, who saw this as another attempt to by-pass the States. Whitlam responded by announcing that he would hold a referendum to give the Commonwealth power to make direct agreements with local government bodies on loan funds. It was largely a threat intended to lever the Premiers into agreement about a change in the composition of the Loan Council.

Whitlam argued that from the States' point of view, having a local government representative on the Loan Council was far less significant than a referendum that would allow the Commonwealth to deal directly with local government concerning loans. He is reported as saying that: 'The States might be more co-operative about having local government on the Loan Council if they realise that the Government will be in a position to make direct agreements with local government'.<sup>281</sup> Local government bodies expressed initial support for this proposal, arguing that they wanted to be able to make direct loan agreements with the federal government because they could achieve lower interest rates than they could get in dealing with banks and insurance companies.<sup>282</sup>

The Premiers were not prepared to back down, so Whitlam went ahead with a referendum proposal. He added to it, for good measure, an additional provision which would have given the Commonwealth power to fund local government directly, rather than through the States. The *Constitution Alteration (Local Government Bodies) 1974 (Cth)* proposed two amendments to the Commonwealth Constitution:

51(ivA) The borrowing of money by the Commonwealth for local government bodies.

96A The Parliament may grant financial assistance to any local government body on such terms and conditions as the Parliament thinks fit.

The referendum bill was rejected twice by the Senate and became a double dissolution trigger for the 1974 election. As s 128 of the Commonwealth Constitution permits a referendum bill to be put to a referendum, even though it has been rejected twice by one House, it was put at a referendum at the 1974 election.

<sup>281</sup> 'PM to hold Local Government Loans Poll', *Sydney Morning Herald*, 12 October 1973, p 2.

<sup>282</sup> 'Councils intent on loan access', *Sydney Morning Herald*, 13 October 1973, p 3.

The official ‘Yes’ case for this referendum proposal stressed the need for increased funding for better roads, sewerage, health and childcare services, recreation facilities and cleaner rivers and beaches, without increasing rates. It argued that it is ‘unnecessary for national money to be provided to local government through middle-men, the States, particularly as this only increases administrative costs’. It concluded that the Commonwealth should be able to ‘deal with local government on the same terms as with the States’.<sup>283</sup>

The official ‘No’ case stressed that grants to local government would be made on ‘terms and conditions’ allowing ‘Canberra’s bureaucratic fingers into every one of Australia’s 1,000 Council Chambers’. It argued that local government would not ‘get money for nothing’. It claimed that such an amendment would require the creation of another expensive administration in Canberra that would examine the affairs of 1000 municipalities to ascertain how much assistance they needed. The ‘No’ case accepted that local government needed more money, but argued that it should be done under the current mechanism of s 96 of the Constitution, with grants passing to local government via the States. It concluded that the Commonwealth should seek ‘co-operation instead of confrontation’ and that this referendum was ‘completely unnecessary’.<sup>284</sup>

In the Parliament, the Opposition waged a comprehensive attack upon the proposal. The points made by the Leader of the Opposition, Billy Snedden, included the following:

- The Bill anticipated the work of the Constitutional Convention, which should be left to make a proper study of the issue.
- This was part of the Whitlam Government’s centralism policy, to destroy the States by cutting down their powers and watching them decay. Local government was being deceived into thinking that it would benefit from the demise of the States, but in the end, all power would be concentrated in Canberra and local government would lose too.
- If the Commonwealth is to borrow for local government as well as the States, there will either be a shortfall in borrowed funds, affecting the capacity of the States and local government to provide services, or the terms of lending would have to be made more attractive by raising interest rates. The likely consequence would be increased interest rates for the people of Australia as well as local government and the States.
- The Commonwealth would presumably fund local government on an equalisation basis. This would mean the Commonwealth would have to create a ‘monster body’ to assess the needs and operations of nearly 1000 councils. It is much more efficient for the States to do this, as local government bodies are the creatures of the States and the States have the relevant information to make such assessments.

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<sup>283</sup> F L Ley, Chief Australian Electoral Officer, Yes/No Case for the 1974 Referendums, (26 March 1974, Canberra), p 14.

<sup>284</sup> F L Ley, Chief Australian Electoral Officer, Yes/No Case for the 1974 Referendums, (26 March 1974, Canberra), p 16.

- The term ‘local government body’ in the Constitution is not defined and cannot be defined. Local government bodies are the creatures of the States and their number and nature could be changed any time by a State. ‘Here is a proposal to have a referendum which asks the people to give this Parliament power in respect of something we cannot describe. The only description of it that we can give is to say that we know what it is today but we do not know what it will be next week, next year or in 10 years time. Quite clearly, that is not the basis upon which the Constitution should be altered.’<sup>285</sup>

The States also entered the attack. The New South Wales Government, for example, took out full page advertisements in the *Sydney Morning Herald* arguing for the rejection of the referendum. The advertisement made the following points:

- ‘Under existing arrangements there is nothing to prevent the Commonwealth making finance available for Local Government through normal State channels’.
- The key words are ‘on such terms and conditions as the Commonwealth thinks fit’ ‘(eg, large scale amalgamations into regional bodies – or no money)’.
- ‘Local Government would be tied to the Commonwealth’s financial apron strings and would be under Commonwealth domination. The States would be by-passed. There would be no place for local initiative, local participation or local decision-making. Complete control would be exercised by the Federal Government’.<sup>286</sup>

Even academics entered the fray, with Professor Pat Lane of the University of Sydney also focusing on the words ‘on such terms and conditions as the Parliament thinks fit’. He observed that: ‘In Commonwealth-State financial relations this tailpiece has become something of a scourge to bring the States to heel.... Like education, housing and transport, local government will queue up for the Canberra hand-out with strings attached.’<sup>287</sup>

The editorial in the *Sydney Morning Herald* on election and referendum day was highly critical of the standard of argument in the Yes/No case and the level of question-begging involved. It described the referendum campaign as a ‘depressing exercise in sloganeering’. The editorial characterised the local government referendum question as ‘relatively innocuous’. However, it went on to say:

But it implies that the Commonwealth cannot now financially help local government. Of course it can, channelling the money through the States. And it ignores the very real prospect that the money it hands out directly in future (if a “yes” vote is registered) will have very tight strings attached to it. How

<sup>285</sup> Commonwealth, *Parliamentary Debates*, House of Representatives, 15 November 1973, pp 3436-41.

<sup>286</sup> R W Askin, NSW Premier, ‘An important message from the Government of NSW to the people of NSW’, *Sydney Morning Herald*, 15 May 1974, p 14.

<sup>287</sup> P H Lane, ‘You can’t tell a book by its cover’, *Sydney Morning Herald*, 20 April 1974.

responsive, then, will local government be to local (as distinct from Canberra) opinion?<sup>288</sup>

The referendum failed nationally by a margin of 458,053 votes, and in all States except New South Wales.<sup>289</sup>

### **Recognition of local government in State Constitutions**

Ever since the defeat of the 1974 referendum upon the direct funding of local government, there has been agitation by local government bodies for the constitutional recognition of local government. The Hobart session of the Australian Constitutional Convention in 1976 passed a resolution inviting the States to consider the formal recognition of local government in State Constitutions.<sup>290</sup>

Victoria was the first State to recognise local government in its Constitution in 1979, followed eventually by all the other States.

As Saunders has pointed out, there is an inherent tension in the recognition of local government in State Constitutions. This tension lies between the responsibility of elected local government bodies to their electors and the responsibility of State governments for the performance of local governments which are their creations and therefore their responsibility.<sup>291</sup> This tension is most obviously reflected in the requirement in State Constitutions that local government bodies be 'elected', but at the same time the exceptions that allow local government bodies to be suspended or dismissed and to have their functions fulfilled by administrators.

It has been argued that the recognition of local government in State Constitutions 'is weak because they are flexible constructions that can be changed easily by a majority in the states' parliaments'.<sup>292</sup> It is true that State Constitutions, unlike the Commonwealth Constitution, are not rigid. They can be amended by ordinary legislation except where a valid manner and form constraint applies. Section 6 of the *Australia Acts* 1986 (Cth) and (UK) permits the States to entrench laws in such a way that they cannot be amended or repealed by a law respecting the constitution, powers or procedure of the State Parliament without following the specified manner and form requirements, such as a referendum or a special majority. However, it is very doubtful that laws respecting local government,

<sup>288</sup> 'Questions begged', *Sydney Morning Herald*, 18 May 1974.

<sup>289</sup> For the more detailed statistics, see: House of Representatives Standing Committee on Legal and Constitutional Affairs, *Constitutional Change*, (February 1997) p 102.

<sup>290</sup> Australian Constitutional Convention, *Proceedings of the Australian Constitutional Convention*, Hobart 1976, (Government Printer, Melbourne) pp 157-62 and 208.

<sup>291</sup> Cheryl Saunders, 'Constitutional recognition of local government in Australia', in N Steytler (ed), *The place and role of Local Government in Federal Systems* (Konrad-Adenauer-Stiftung, 2005), 47, 55.

<sup>292</sup> Oliver M Hartwich, 'Beyond Symbolism: Finding a Place for Local Government in Australia's Constitution', 22 January 2009, *Issues Analysis No 104*, Centre for Independent Studies, p 5: <http://www.cis.org.au/images/stories/issue-analysis/ia104.pdf>.

even when they are placed in a State Constitution, can be effectively entrenched.<sup>293</sup> Hence the NSW Government took the view that it would be misleading and inappropriate to purport to entrench local government, when that entrenchment was most likely to be ineffective. An amendment to entrench s 51 in the NSW Constitution was defeated.<sup>294</sup> Other States have made half-hearted attempts at entrenchment, some of which are clearly ineffective because the entrenching provisions are not themselves entrenched and can therefore be amended or repealed by ordinary legislation. Only the Victorian provision has a chance of being effectively entrenched, and only then if the High Court develops a new source of manner and form entrenchment.

Sub-section 51(1) of the *Constitution Act* 1902 (NSW) provides that:

There shall continue to be a system of local government for the State under which duly elected or duly appointed local government bodies are constituted with responsibilities for acting for the better government of those parts of the State that are from time to time subject to that system of local government.

It has been criticised for requiring the continuation of a system that includes ‘duly appointed’ local government bodies.<sup>295</sup> The fact that it recognises that such bodies might be ‘appointed’ rather than elected, has been regarded as undermining the democratic status of local government. The reason, however, was that it was considered necessary to pick up the Western Lands Commissioner, who is appointed, but who fulfils local government functions for the unincorporated parts of the State.<sup>296</sup> It was also intended to cover circumstances in which councils were dismissed and replaced with administrators. Other States have included similar exceptions, but have avoided criticism by not stating as clearly that local government bodies may be appointed.

The Victorian provisions in Part IIA of the *Constitution Act* 1975 (Vic), while giving the appearance of creating greater protection and independence for local government than the NSW provision, do not in practice go much further. Section 74A states that ‘local government is a distinct and essential tier of government’ but it quickly takes away any suggestion of an independent tier of government by stating that its functions and power are determined by Parliament. It also refers to ‘democratically elected Councils’ and to councils that are ‘constituted by democratically elected councillors’, but this is subject to there being no need for an elected council in sparsely populated areas and does not impede the functions of local government being carried out on a large scale by a non-

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<sup>293</sup> For a more detailed analysis, see: A Twomey, *The Constitution of New South Wales* (Federation Press, 2004), Chapter 5. See also: N McGarrity and G Williams, ‘Recognition of local government in the Commonwealth Constitution’ (2010) 21 PLR 164, 167-8.

<sup>294</sup> NSW, *Parliamentary Debates*, Legislative Assembly, 12 November 1986, p 6231; and Legislative Council, 18 November 1986, pp 6498-9.

<sup>295</sup> Graham Sansom, ‘Commonwealth of Australia’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, Montreal, 2009) 8, 12; Cheryl Saunders, ‘Constitutional recognition of local government in Australia’, in N Steytler (ed), *The place and role of Local Government in Federal Systems* (Konrad-Adenauer-Stiftung, 2005), 47, 55.

<sup>296</sup> A Twomey, *The Constitution of New South Wales* (Federation Press, 2004), p 37. Note that the Lord Howe Island Board was also appointed, rather than elected.

elected public statutory body.<sup>297</sup> Further, the democratic election requirements are made subject to s 74B, which permits the suspension and dismissal of a council and its administration by non-elected persons during the period of suspension or dismissal. As the Victorian Supreme Court has pointed out, no time limit is imposed regarding when new elections must be held.<sup>298</sup> A law which dismissed the City of Melbourne Council and left it to the Governor-in-Council to determine when an election should occur, was upheld as valid. It was also held that the requirement for democratic elections did not entail a requirement that the council control its own finances. Councils may only exercise those powers granted to them by legislation.<sup>299</sup>

The only substantial protection provided to local government in Part IIA of the Victorian Constitution is that a ‘Council cannot be dismissed except by an Act of Parliament relating to the Council’.<sup>300</sup> This means that both Houses of Parliament would have to support dismissal of the Council, making it much more difficult to achieve. The rest of s 74B is comprised of meaningless statements that the Parliament has power to make various types of laws with respect to local government. This is unnecessary, given that the States have plenary legislative power (subject to the Commonwealth Constitution).<sup>301</sup> Perhaps these statements were included to prevent a court from giving any substance to the opening statement of s 74B that local government ‘is a distinct and essential tier of government’.

Sections 74A and 74B are purportedly entrenched by s 18 of the *Constitution Act 1975* (Vic), which requires a referendum for them to be amended or repealed. Whether this requirement is effective is doubtful, as a law amending these provisions is unlikely to be one respecting the ‘constitution, powers or procedure’ of the Parliament and s 6 of the *Australia Acts 1986* is therefore unlikely to give effect to the purported entrenchment.

In South Australia, s 64A of the *Constitution Act 1934* (SA) preserves the continuation of a system of local government with elected local governing bodies. As in New South Wales and Victoria, not all parts of the State are required to be subject to that system of local government. No reference is made in the provision to the dismissal of councillors or the appointment of administrators. Nor does it appear to be a requirement that each local governing body be elected – just that the system of local government be one under which elected local governing bodies are constituted.

Section 64A provides that no bill to abolish the system of elected local government may be presented to the Governor for royal assent unless it is passed by an absolute majority of each House of Parliament. This is a low burden, but in any case it is ineffective, as s

<sup>297</sup> *Constitution Act 1975* (Vic), s 74A(2).

<sup>298</sup> *South Melbourne Corporation v Hallam* [1995] 1 VR 247, 257.

<sup>299</sup> *South Melbourne Corporation v Hallam* [1995] 1 VR 247, 258.

<sup>300</sup> *Constitution Act 1975* (Vic), s 74B(2).

<sup>301</sup> In *South Melbourne Corporation v Hallam* [1995] 1 VR 247, the Supreme Court concluded at p 254 that there was no intention at the time of the insertion of Part IIA in the *Constitution Act 1975* (Vic) that it be the sole repository of State legislative power regarding local government, and at p 259 that the Parliament could still legislate for local government under its general legislative power in s 16. See also: Greg Taylor, *The Constitution of Victoria*, (Federation Press, 2006) p 12.

64A is not doubly entrenched. This means that a bill passed by a simple majority could remove the requirement for an absolute majority, rendering the purported entrenchment ineffective.

In Queensland, s 70 of the *Constitution of Queensland 2001* (Qld) requires the continuation of a system of local government and s 71(1) states that a local government body is an elected body. However, s 71(3) notes that administrators may be appointed where a local government body is suspended or dissolved, until a new election is held. The Minister may make an instrument to dissolve a local government body, but it only has the effect of suspending that body until it is ratified by the Legislative Assembly. If it is not ratified within the requisite period, the suspension is lifted and the local government body is restored. Section 77 also provides for consultation with a body representing local government in relation to bills that are to be administered by the Minister for Local Government where the bill affects local government. If a Bill proposes to abolish local government, s 78 provides that a referendum is required. This requirement, however, is legally ineffective, as it has not been doubly entrenched.<sup>302</sup> This means that s 78 can be amended by ordinary legislation, removing the referendum requirement.

In Western Australia, s 52 of the *Constitution Act 1889* (WA) requires the continuation of 'a system of local governing bodies elected and constituted in such manner as the Legislature may from time to time provide'. Section 53 then undercuts s 52 by providing that it does not extend to laws prescribing the circumstances in which local government offices become and remain vacant. This presumably covers the dismissal of councillors and the continuation of any vacancy in their offices while administrators are in place. Section 52 also does not affect any law concerning the administration of parts of the State not covered by local government or the administration of councils where the offices of councillors are vacant (eg because they have been dismissed).

In Tasmania, sections 45A and 45B of the *Constitution Act 1934* (Tas) are effectively the same as those in Western Australia, with the same exceptions regarding administrators and unincorporated areas. The main difference is s 45C, which provides that any division of Tasmania into municipal areas is not to be changed without a recommendation of the Local Government Board. Such a provision is ineffective to the extent that it purports to abdicate legislative power. It may, however, be effective in limiting the powers of the executive or statutory officers to act without such a recommendation.

None of these State Constitutions specifies the content of the powers or functions of local government. This is left to the States to determine.<sup>303</sup>

Given that local government has been recognised now in all State Constitutions, the question may therefore be asked as to whether this has enhanced the standing of local government in the community in the way suggested by those who advocate constitutional

<sup>302</sup> Gerard Carney, *The Constitutional Systems of the Australian States and Territories*, (CUP, 2006) p 33.

<sup>303</sup> Cheryl Saunders, 'Constitutional recognition of local government in Australia', in N Steytler (ed), *The place and role of Local Government in Federal Systems* (Konrad-Adenauer-Stiftung, 2005), 47, 55.

recognition of local government. As Hartwich has observed, ‘we can hardly conclude that the mere mentioning of local government [in State Constitutions] has effectively strengthened the institution’.<sup>304</sup> Some have argued that recognition of local government in State Constitutions needs to be strengthened and suggested ways of achieving this outcome.<sup>305</sup> However, there does not appear to be any evidence that constitutional recognition of local government in State Constitutions has made any difference to the public standing of local government.

### **The 1988 referendum**

Despite the fact that by 1988 some of the State Constitutions had already recognised local government in their Constitutions, constitutional recognition of local government in the Commonwealth Constitution was one of four referenda put to the Australian people in 1988. The question asked was: ‘Do you approve of an Act to alter the Constitution to recognise local government?’ The question was added as a non-controversial bit of sugar to aid support for the other referendum questions by harnessing the campaigning power of local government. The referendum question was comprehensively defeated.

The form of this recognition was more ‘symbolic’ in nature than the 1974 referendum proposal, although it had some underlying substantial aspects. It was derived from a recommendation of the Constitutional Commission. The Commission regarded issues concerning financial grants to local government and local government taxation and borrowing as matters that were ‘best resolved at political level’.<sup>306</sup> It instead focused upon the ‘constitutional’ aspects of local government. It recommended the insertion of a new s 119A into the Constitution, which would provide:

Each State shall provide for the establishment and continuance of local government bodies elected in accordance with its laws and empowered to administer, and to make by-laws for, their respective areas in accordance with the laws of the State.

The Commission, in discussing the potential effect of this provision, stated:

We believe that the proposed provision would require:

- (a) that the people of each State are represented by an elected Local Government body;
- (b) that Local Government bodies shall not be dismissed arbitrarily; and

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<sup>304</sup> Oliver M Hartwich, ‘Beyond Symbolism: Finding a Place for Local Government in Australia’s Constitution’, 22 January 2009, *Issues Analysis No 104*, Centre for Independent Studies, p 7: <http://www.cis.org.au/images/stories/issue-analysis/ia104.pdf>.

<sup>305</sup> Submission by Professor Aroney, Professor Prasser and Mr Mitchell, Submission No 641, [http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/641\\_Local\\_Government\\_Submission\\_on\\_Aroney\\_Prasser\\_and\\_Birks.pdf](http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/641_Local_Government_Submission_on_Aroney_Prasser_and_Birks.pdf). See also Submission No. 565 by the City of Sydney.

<sup>306</sup> Constitutional Commission, *Final Report of the Constitutional Commission*, (AGPS, 1988) Vol 1, p 435.

(c) that, if a Local Government body in any area is lawfully suspended pursuant to a State law, it will be restored within a reasonable period by elections.<sup>307</sup>

These implications would presumably be drawn from the reference to the ‘continuation’ of local government bodies and the fact that they must be ‘elected’. What would be regarded as an ‘arbitrary’ dismissal or a ‘reasonable period’ for an election to be held would be matters for the courts to decide. Further, the mere recognition that such implications might be drawn from the provision opened the question of what other unforeseen implications might also arise. What might the High Court decide would be the essential minimum characteristics of a ‘local government’? Potential implications and other objections to constitutional recognition of local government were discussed in more detail by the Constitutional Commission’s Advisory Committee on the Distribution of Powers.<sup>308</sup>

This proposed provision was altered by the Commonwealth Government by inserting the words ‘a system of local government, with’ after the first ‘of’. This interference undermined the value of the provision being recommended by an independent review body, giving it instead a party-political flavour.<sup>309</sup> It might also have affected the interpretation of the provision. Saunders has noted that the constitutional requirement for the ‘establishment and continuance’ of ‘local government bodies’, rather than a ‘system’ of local government, might have been more effective ‘in deterring arbitrary dismissal’ of particular local government bodies.<sup>310</sup>

Early on in the campaign, it looked like the referendum would be successful. Opinion polls in South Australia and Victoria put support at 69% and in New South Wales at 74%.<sup>311</sup> Moreover, the proposal originally had bipartisan support. The Opposition had supported the constitutional recognition of local government during its 1987 election campaign and the Commonwealth Attorney-General recorded that he had received a letter from the Opposition Leader supporting the inclusion of a chapter on local government in the Constitution.<sup>312</sup>

Nonetheless, when the formal proposal was announced, the Opposition decided to campaign against it. The Shadow Cabinet had apparently decided to support the question on the recognition of local government, but this was rejected by the joint Liberal and

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<sup>307</sup> Constitutional Commission, *Final Report of the Constitutional Commission*, (AGPS, 1988) Vol 1, p 443.

<sup>308</sup> Advisory Committee on Distribution of Powers, *Report to the Constitutional Commission*, (AGPS, 1987) pp 119-25.

<sup>309</sup> George Williams and David Hume, *People Power – The History and Future of the Referendum in Australia* (UNSW Press, 2010), p 168.

<sup>310</sup> Cheryl Saunders, ‘Constitutional recognition of local government in Australia’, in N Steytler (ed), *The place and role of Local Government in Federal Systems* (Konrad-Adenauer-Stiftung, 2005), 47, 57.

<sup>311</sup> Michael Antrum, ‘Local Government will fight for recognition’ (1988) Vol 43(6) *Local Government Bulletin*, 6.

<sup>312</sup> See further, Bob Hawke, ‘Keeping the Constitution relevant’, (1988) Vol 43(6) *Local Government Bulletin*, 11, 13; and Barry O’Keefe, ‘The foundation of democracy’ (1988) Vol 43(6) *Local Government Bulletin*, 14, 17-18.

National party meeting.<sup>313</sup> The Prime Minister, Bob Hawke, characterised this approach as opposing the referendum ‘simply for the sake of opposing it’ and described it as a ‘case study in political opportunism’.<sup>314</sup> While there continued to be dissent upon the issue within the Opposition, with four liberal back-benchers abstaining from voting against this referendum question in the Parliament, the Opposition was successful in its campaign opposing it.

The Opposition took a two-pronged attack upon the proposal. On the one hand it dismissed it as derisory and mere tokenism – not achieving for local government any of the protection that it really sought. On the other hand, it characterised the proposal as one to centralise power and ‘erode the federal structure... to bring about a shift in power and influence away from the states’.<sup>315</sup>

Local government representatives sought to rebut these arguments. They contended that it was not an exercise in tokenism and that they should be the ones to judge whether the referendum satisfied their needs. Further, they pointed out the logical flaw in the Opposition’s two-pronged approach, arguing that the Opposition ‘can’t have it both ways, it can’t be tokenism on the one hand and an interference with states’ rights on the other hand’.<sup>316</sup>

As the Constitutional Commission had admitted, however, the intention behind the proposal went beyond mere symbolism. The Commonwealth’s Explanatory Memorandum also noted that while it was not intended to ‘preclude laws providing for the dismissal of local councils in appropriate circumstances’, this would be ‘subject to a new local government body being elected within a reasonable period’.<sup>317</sup> Local government took up the argument that the constitutional amendment would provide ‘a guarantee that in the case of a council dismissal, fresh elections will be held within a reasonable period’.<sup>318</sup> The Australian Local Government Association (‘ALGA’) in setting out the case for voting ‘Yes’ at the referendum, stated that ‘State legislative responsibility for Local Government will not alter (except in respect of a dismissal in which case fresh elections will have to be called within a reasonable time)’.<sup>319</sup> The President of ALGA added that a local community should be able to go to the High Court to seek redress if its council has been dismissed and a new election has not been held within a ‘reasonable time’.<sup>320</sup> While local government pushed these arguments as benefits, others saw them as ways to prevent the use of administrators to clean out

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<sup>313</sup> Michael Antrum, ‘Local Government will fight for recognition’ (1988) Vol 43(6) *Local Government Bulletin*, 7; and George Williams and David Hume, *People Power – The History and Future of the Referendum in Australia* (UNSW Press, 2010), p 170.

<sup>314</sup> Bob Hawke, ‘Keeping the Constitution relevant’, (1988) Vol 43(6) *Local Government Bulletin*, 11, 13.

<sup>315</sup> Michael Antrum, ‘Local Government will fight for recognition’ (1988) Vol 43(6) *Local Government Bulletin*, 7, quoting from the Leader of the Opposition, John Howard.

<sup>316</sup> Peter Kyle, ‘Last Chance for proper recognition’ (1988) Vol 43(6) *Local Government Bulletin*, 8, 10.

<sup>317</sup> Explanatory Memorandum, *Constitution Alteration (Local Government) Bill 1988*, p 3.

<sup>318</sup> Michael Antrum, ‘Local Government will fight for recognition’ (1988) Vol 43(6) *Local Government Bulletin*, 6, quoting the Secretary of the Local Government and Shires Association, Mr Bill Henningham.

<sup>319</sup> ALGA, ‘Why Australia should vote “Yes”’ (1988) Vol 43(6) *Local Government Bulletin*, 19.

<sup>320</sup> Peter Kyle, ‘Last Chance for proper recognition’ (1988) Vol 43(6) *Local Government Bulletin*, 8, 10.

corruption from local government areas and others still were concerned that it would move control over local government away from the States to the courts, as it would be the courts that ended up deciding what was a ‘reasonable time’.

Curiously, the official ‘No’ case did not take up most of the criticisms that might genuinely have been made of the proposal. Instead, it took the peculiar approach of criticising the proposal for not preventing things that could happen already under the status quo. The ‘No’ case claimed:

1. This proposal is detrimental to Local Government and ratepayers;
2. This proposal will not stop either arbitrary dismissals or amalgamations of local government bodies; and
3. This proposal is uncertain and vague.<sup>321</sup>

The first argument was based on the ‘loose phrase’ that requires the States to maintain ‘a system of Local Government’. The No case argued that this left undefined the structure, role, rights and responsibilities of local government and would permit different forms of local government including ‘regional authorities’ over which the Commonwealth would exert substantial powers.<sup>322</sup> The status quo would also permit such an outcome, but the constitutional amendment would have limited it by requiring that local government be established and continued *by the States* and that local government bodies be *elected in accordance with the laws of the State*. Hence, if the concern raised by the No case was genuine, the logical response would have been to vote ‘Yes’.

The second point made by the No case was that the proposal would not prevent the arbitrary dismissal or forced amalgamation of local government bodies. It stated that the Minister for Justice had admitted that under this proposal a State Government could dismiss a council and never reinstate it.<sup>323</sup> Again, the status quo would ensure that this was the case, but the constitutional amendment would at least have a chance of being interpreted as not permitting the arbitrary dismissal of a local government body. Again, the logic of the argument ought to have supported the Yes case, rather than the No case.

The third point made by the No case was the only one with any substance. It pointed out that the phrase a ‘system of local government’ would end up being interpreted by the High Court and there was uncertainty as to how the Court would define such a system, given the significant differences in different jurisdictions. Such an argument would be even more powerful in the current day, given the constant stream of High Court jurisprudence identifying new essential characteristics of State ‘courts’<sup>324</sup> which has the

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<sup>321</sup> Australian Electoral Commission, ‘Yes or No? – Referendums, Saturday 3 September 1988 – The cases For and Against’, pp 18-19.

<sup>322</sup> Australian Electoral Commission, ‘Yes or No? – Referendums, Saturday 3 September 1988 – The cases For and Against’, p 18.

<sup>323</sup> Australian Electoral Commission, ‘Yes or No? – Referendums, Saturday 3 September 1988 – The cases For and Against’, p 19.

<sup>324</sup> See, for example: *International Finance Trust Co Ltd v NSW Crime Commission* (2009) 240 CLR 319; *Kirk v Industrial Relations Commission* (2010) 239 CLR 531; *South Australia v Totani* (2010) 242 CLR 1; *Wainohu v New South Wales* (2011) 243 CLR 181; and *Hogan v Hinch* (2011) 243 CLR 506.

effect of limiting state legislative power with respect to State courts and rendering the scope of State legislative power uncertain.

The No case also made a number of subsidiary points. It argued that the amendment ‘would encourage the Federal Government to use the open-ended “external affairs” power to intrude into Local Government by entering into international treaties’.<sup>325</sup> Again, that could certainly occur under the status quo, but if anything the constitutional amendment might impede the application of the external affairs power to the extent that it required local government bodies to be established, elected and empowered in accordance with *State* laws. The No case also pointed out that the Commonwealth was ignoring some of its own expert advisers, being the Advisory Committee on the Distribution of Powers, which opposed the recognition of local government.<sup>326</sup>

Despite the fact that the arguments in the ‘No’ case were, from a logical point of view, contradictory and weak, they managed to initiate sufficient doubt and fear for the referendum proposal to be comprehensively rejected. The referendum failed in all States and Territories and failed overall by a substantial margin of 3,084,678 votes.<sup>327</sup> Only a third of voters supported it, with two-thirds opposing it.

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<sup>325</sup> Australian Electoral Commission, ‘Yes or No? – Referendums, Saturday 3 September 1988 – The cases For and Against’, p 19. Saunders has described this argument as ‘so obviously designed simply to scare voters into rejecting the proposal that it is almost embarrassing to recite as an argument in an official pamphlet’: Cheryl Saunders, ‘Constitutional recognition of local government in Australia’, in N Steytler (ed), *The place and role of Local Government in Federal Systems* (Konrad-Adenauer-Stiftung, 2005), 47, 59.

<sup>326</sup> Australian Electoral Commission, ‘Yes or No? – Referendums, Saturday 3 September 1988 – The cases For and Against’, p 20.

<sup>327</sup> See the statistics in: House of Representatives Standing Committee on Legal and Constitutional Affairs, *Constitutional Change*, (February 1997) p 113.

## VI THIRD TIME LUCKY? – THE LATEST CAMPAIGN FOR CONSTITUTIONAL RECOGNITION

### Local Government’s continuing campaign for constitutional recognition

The campaign by local government for constitutional recognition has continued unabated through two failed referenda and many official inquiries. The basis for the campaign has changed over time. More recently it has latched onto the *Pape* and *Williams* decisions as giving rise to the ‘problem’ that needs to be ‘fixed’ by constitutional recognition. However, the first of these High Court judgments, *Pape*, was handed down in 2009, well after the campaign for the constitutional recognition of local government was already in full swing. ALGA had already held a Local Government Constitutional Summit in December 2008 which concluded with a declaration that:

any constitutional amendment put to the people in a referendum by the Australian Parliament (which could include the insertion of a preamble, an amendment to the current provisions or the insertion of a new Chapter) should reflect the following principles:

- The Australian people should be represented in the community by democratically elected and accountable local government representatives;
- The power of the Commonwealth to provide direct funding to local government should be explicitly recognised; and
- If a new preamble is proposed, it should ensure that local government is recognised as one of the components making up the modern Australian Federation.<sup>328</sup>

The *Williams* decision reinforced that Commonwealth direct funding to local government was vulnerable to constitutional challenge if it was not supported by a valid statute.<sup>329</sup> It showed that the High Court’s judgment in *Pape* should be taken seriously, as should the relevance of ‘federal considerations’ in the interpretation of the scope of executive power.<sup>330</sup> But neither case threatened, at all, the *capacity* for the Commonwealth to fund local government, as this may still validly occur through s 96 grants.

ALGA is well aware from its own polling and that of others that a referendum on the constitutional recognition of local government is unlikely to succeed unless it can establish that there is a real problem that can only be fixed by a constitutional

<sup>328</sup> ‘Constitutional Recognition of Local Government Summit Declaration’, 11 December 2008: [http://www.councilreferendum.com.au/site/misc/alga/downloads/CONSTITUTIONAL\\_SUMMIT\\_08/Final\\_Declaration.pdf](http://www.councilreferendum.com.au/site/misc/alga/downloads/CONSTITUTIONAL_SUMMIT_08/Final_Declaration.pdf).

<sup>329</sup> (2012) 86 ALJR 713.

<sup>330</sup> (2012) 86 ALJR 713, 727–8 [37]–[38] (French CJ); 751–2 [142]–[147] (Gummow and Bell JJ); 759–61 [192]–[199], 770 [240], 773 [256]–[257] (Hayne J); 815–16 [497]–[503] (Crennan J); 830 [594] (Kiefel J).

amendment.<sup>331</sup> As a general principle, the Australian people are unwilling to amend the Constitution unless it is both necessary and will produce tangible benefits.<sup>332</sup> The *Pape* and *Williams* cases appear to be being used to manufacture a ‘problem’ which constitutional amendment can purportedly fix. The implication is that this will also bring tangible benefits to local government – i.e. greater funding for local government and better services to residents. Whether there is a genuine ‘problem’ (given that the same Commonwealth funding can currently be given to local government through s 96 grants via the States) and whether an amendment will give rise to any tangible benefits (given that the Commonwealth can already grant as much money as it wants to local government) remain matters of debate.<sup>333</sup>

Beyond the direct funding arguments, doubts have also been expressed as to the need for constitutional recognition for local government and whether or not it would actually achieve anything in practical terms. Sansom has observed that:

Many in local government see recognition in the federal Constitution as fundamentally important to its future, but to date there is little evidence that lack of such recognition has hampered local government’s expanded role and growing stature. As Nico Steytler points out constitutional recognition in and of itself does not create effective local government; local self-government is embedded in practice.<sup>334</sup>

### **Submissions to the Expert Panel**

The Commonwealth’s Expert Panel received a large number of submissions concerning the constitutional recognition of local government. Approximately half were from private individuals, the vast majority of whom opposed the constitutional recognition of local government. Around 43% were from local councils, the vast majority of which

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<sup>331</sup> Local Government Association, SA, ‘Constitutional Recognition of Local Government’, June 2008, [http://www.lga.sa.gov.au/webdata/resources/files/Constitutional\\_Recognition\\_of\\_Local\\_Government\\_-\\_McGregor\\_Tan\\_Research\\_-\\_Final\\_Report.pdf](http://www.lga.sa.gov.au/webdata/resources/files/Constitutional_Recognition_of_Local_Government_-_McGregor_Tan_Research_-_Final_Report.pdf); ALGA Submission to the House Legal and Constitutional Affairs Committee Review of the Effectiveness of Legislation Administering the Conduct of Referendums, 9 October 2009, [http://www.alga.asn.au/submissions/2009/pdf/ALGA\\_Ref\\_submission\\_9\\_October2009.pdf](http://www.alga.asn.au/submissions/2009/pdf/ALGA_Ref_submission_9_October2009.pdf).

<sup>332</sup> This conclusion was also reached by the Newspoll polling undertaken on behalf of the Expert Panel: Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, pp 10, 43 and 64.

<sup>333</sup> Note Spigelman’s response to the argument that there is no ‘problem’ because s 96 grants can substitute for direct grants. He contended that direct grants were working well and that it was preferable not to make them subject to the politics of Commonwealth-State inter-governmental negotiations: James Spigelman, ‘Constitutional Recognition of Local Government’, Address to the Local Government Association of Queensland, 116<sup>th</sup> Annual Conference, Brisbane, 24 October 2012, p 16.

<sup>334</sup> Graham Sansom, ‘Commonwealth of Australia’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, Montreal, 2009) 8, 29.

supported local government constitutional recognition. The remaining 7% were from governments, politicians, academics and advocacy groups, giving mixed views.<sup>335</sup>

Previous referendum campaigns, however, have shown that it is critical for any proposal to receive both bipartisan support and support from the States. The submissions to the Expert Panel made by political parties and the States are therefore significant.

The Leader of the federal Opposition, Mr Tony Abbott, stated in a submission to the Expert Panel that:

[T]he Coalition will only support a referendum that is limited to facilitating direct Commonwealth funding of local government. A referendum that sought to usurp the role of the States, or otherwise change the current order of governance of Australia, would be highly problematic and is not something the Coalition would be likely to support.<sup>336</sup>

The New South Wales Government, however, appeared reluctant to support the direct funding of local government. It argued that:

[F]inancial recognition of local government could raise expectations that the Commonwealth will intervene in local government administration, thereby creating confusion about Federal, State and local government responsibilities and blurring the lines of accountability that exist between governments and their constituents.<sup>337</sup>

It also expressed concern that direct Commonwealth funding would sidetrack or undermine major State government policies regarding local government.

The Victorian government took a stronger line against constitutional recognition of local government. It argued that constitutional reform should be a last resort when there is no reasonable alternative and that it should not be used 'to resolve funding issues that can be dealt with through existing mechanisms'.<sup>338</sup> With respect to the financial recognition of local government, it stated:

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<sup>335</sup> Overall, 42.8% of submissions were from local councils that supported constitutional recognition and 42.3% were from private individuals who opposed it. In addition a small number of individuals offered support for constitutional recognition and two local councils opposed it. See: Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 27.

<sup>336</sup> Letter by the Hon Tony Abbott to the Hon James Spigelman, 7 December 2011, Submission No. 695: <http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/TonyAbbott15122011.pdf>.

<sup>337</sup> Letter by the Hon Barry O'Farrell to the Hon James Spigelman, 25 November 2011, Submission No. 694: <http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/NSWGovernment.pdf>.

<sup>338</sup> Victorian Government Submission to the Expert Panel on Constitutional Recognition of Local Government, Submission No 654: [http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/3\\_November\\_CRLG\\_Expert\\_Panel\\_Victorian\\_Government\\_Submission.pdf](http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/3_November_CRLG_Expert_Panel_Victorian_Government_Submission.pdf).

The Victorian Government opposes any proposed amendment to the Commonwealth Constitution to allow the Commonwealth Government to fund local government directly in a similar manner to which it currently funds States under section 96 of the Commonwealth Constitution.

The effect of the extreme level of VFI [vertical fiscal imbalance] in blurring roles, responsibilities and accountabilities in the Australian Federation would be exacerbated by the Commonwealth Government having Constitutional power to provide further direct funding to local government.

Enhanced Commonwealth Government ability to provide direct funding to local government means an enhanced ability to provide tied funding (that is, funding that carries specific conditions)....

While the local government sector is hopeful that financial recognition under the Commonwealth Constitution will provide a solution to financial and service delivery pressures, the experience of the States and Territories is that direct funding from the Commonwealth will not resolve these issues.

In fact, the Victorian Government has concerns about how further direct funding from the Commonwealth to local government would be allocated between jurisdictions (given issues relating to horizontal fiscal equalisation) and the impact this may have on the local government sector in some jurisdictions, including Victoria.

The Victorian Government is also concerned about the potential for the Commonwealth to change the distribution of funding to local government within a State in a manner that would disadvantage one or more councils, whether through bilateral agreements with individual councils or otherwise. Victoria opposes any approach that discourages local councils from striving for higher performance and increased productivity.<sup>339</sup>

The Western Australian Government also expressed strong objections to financial recognition of local government in the Commonwealth Constitution. It argued that proposed amendments to s 96 would ‘both constitutionally and practically downgrade and circumvent the States’. It pointed out that even if the *Pape* case resulted in the Commonwealth not being able to fund local government directly, it did not prevent the Commonwealth from funding local government through s 96 grants to the States. It also noted that to the extent that local councils are ‘trading corporations’ they can already be directly funded by the Commonwealth.<sup>340</sup>

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<sup>339</sup> Victorian Government Submission to the Expert Panel on Constitutional Recognition of Local Government, Submission No 654:  
[http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/3\\_November\\_CRLG\\_Expert\\_Panel\\_Victorian\\_Government\\_Submission.pdf](http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/3_November_CRLG_Expert_Panel_Victorian_Government_Submission.pdf).

<sup>340</sup> Letter by the Hon Colin Barnett to the Hon James Spigelman, 2 November 2011, Submission No. 572:  
[http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/572\\_WA\\_Govt\\_Submission.pdf](http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/572_WA_Govt_Submission.pdf).

The Tasmanian and South Australian governments expressed general sentiments in favour of some form of constitutional recognition but reserved their positions until they could see and study a final recommendation.<sup>341</sup> The Queensland government also reserved its position. However, it expressed ‘in-principle’ support for a referendum with the objective of allowing the Commonwealth to provide direct funding to local government, provided that any amendment ‘should maintain, not diminish, the state’s primary constitutional responsibility for local government’, including the State’s supervisory powers over local government.<sup>342</sup>

### **The Expert Panel’s finding**

In December 2011 the Expert Panel on the Constitutional Recognition of Local Government presented its report to the Commonwealth Government. ‘A majority of panel members concluded that financial recognition is a viable option within the 2013 timeframe indicated by the terms of reference’.<sup>343</sup> Unusually, the Report does not state which members of the Panel formed part of that majority and who dissented from the recommendation of the Report.

The reluctance on the part of Panel members to declare their hand also appears to be reflected in the diffidence shown in the recommendation. On the one hand it gives the appearance of being a recommendation in favour of the holding of a referendum. On the other hand, it is made subject to two conditions, at least one of which is likely to be unachievable. It is therefore in substance, rather than form, a recommendation against a referendum. The report stated:

The majority of panel members support a referendum in 2013 subject to two conditions: first, that the Commonwealth negotiate with the States to achieve their support for the financial recognition option; and second, that the Commonwealth adopt steps suggested by ALGA necessary to achieve informed and positive public engagement with the issue... Steps include allocating substantial resources to a major public awareness campaign and making changes to the referendum process.<sup>344</sup>

The second condition would involve the Commonwealth in substantial expenditure above and beyond the cost of a normal referendum. The last time an ‘education’ campaign of

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<sup>341</sup> Submissions No. 683 (Tasmania) and 682 (South Australia):

<http://www.localgovrecognition.gov.au/content/submissions-received>.

<sup>342</sup> Letter by the Hon Andrew Fraser to the Hon James Spigelman, 11 November 2011, Submission No 675: <http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/QueenslandGovernmentSubmission.pdf>.

<sup>343</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 2.

<sup>344</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 2.

this kind was held was for the republic referendum in 1999, which was unsuccessful.<sup>345</sup> Other elements of this condition include an inquiry by a Joint Select Committee of the Commonwealth Parliament, the removal of the legislative limit on spending during the referendum campaign and the allocation of funds to the ‘Yes’ and ‘No’ cases ‘based on those parliamentarians voting for and against the Bill’, being funding equivalent to that ‘provided for elections’ (whatever that might mean). The latter recommendation will be particularly controversial, as it will entrench funding in favour of a ‘Yes’ vote at referenda.

The Panel has noted that without such substantial Commonwealth funding the referendum is likely to fail. It stated in its Report:

The panel has no information as to whether the Commonwealth Government would be prepared to adopt and appropriately fund the awareness campaign advocated above. In the absence of such a campaign, however, the panel is of the view that there is a very real risk that any referendum will fail and that the possibility of local government being recognised in the Constitution would be removed from the political agenda for decades.<sup>346</sup>

The first condition, that State support be ‘achieved’,<sup>347</sup> is extremely unlikely to be achievable. The submissions show that Western Australia and Victoria are clearly opposed to the direct Commonwealth funding of local government and that NSW has strong reservations. The other States reserved their positions. Given the various arguments that may be made against the direct funding of local government (discussed below), it would appear unlikely that all, or a majority of States would support such a referendum.

The report notes that several members of the panel do not think that there is sufficient support for a successful referendum, even if the two conditions are met, and that ‘proceeding to another unsuccessful referendum would damage rather than advance the interests of local government’.<sup>348</sup>

### **The wording of the proposed amendment**

After suggesting a number of alternatives in its Discussion Paper, the Expert Panel concluded in its Final Report that it would be preferable to make the following italicised amendment to s 96 of the Commonwealth Constitution:

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<sup>345</sup> The education campaign cost \$4.5 million, while the ‘Yes’/‘No’ media campaigns cost \$15 million: House of Representatives Standing Committee on Legal and Constitutional Affairs, *A Time for Change: Yes/No?* (2009) 20 [3.31]-[3.32].

<sup>346</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 17.

<sup>347</sup> Note Spigelman’s stress upon the need for such support to be ‘achieved’: James Spigelman, ‘Constitutional Recognition of Local Government’, Address to the Local Government Association of Queensland, 116<sup>th</sup> Annual Conference, Brisbane, 24 October 2012, pp 5-6.

<sup>348</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 2.

the Parliament may grant financial assistance to any State *or to any local government body formed by State or Territory Legislation* on such terms and conditions as the Parliament sees fit.<sup>349</sup>

The Panel was particularly concerned not to cause interpretative difficulties. It noted the risk that a reference to local government in the Commonwealth Constitution ‘could be held by the High Court to prohibit a state from altering the fundamental characteristics of the system of local government and the High Court could determine what those characteristics were’.<sup>350</sup> This is what has occurred with respect to other constitutional terms, such as references in the Constitution to ‘courts’ and ‘juries’.<sup>351</sup> Hence the High Court might find that a fundamental characteristic of ‘local government’ is that it is an ‘elected’ body, and that this does not permit dismissal of elected councillors or the appointment of administrators. However, this risk would be most significant if the Constitution required that a system of local government continue to exist, as had been suggested under the ‘democratic recognition’ proposal. Such a requirement would have obliged the States to maintain a system of local government which satisfied minimum characteristics implied by the High Court from the meaning of the constitutional term ‘local government’. The Panel considered that it had avoided this trap in relation to financial recognition:

It does not appear that there is any significant risk with respect to the panel’s majority proposal for financial recognition. If, in the future, the system of local government of a particular State were to be changed in such a manner that it no longer answered the constitutional concept of ‘local government’, the effect would be that the Commonwealth would not be able to make grants to the local councils of that State. Nothing in the existing jurisprudence of the High Court suggests that a State is obliged to create a system that complies with the constitutional expression.<sup>352</sup>

While this may be true and a State could have a system of local government which did not meet the minimum requirements implied by the High Court, the effect would be that its local governments could not receive direct Commonwealth funding. There would therefore be enormous pressure on a State to ensure that its system of local government complied with any minimum characteristics identified by the High Court in order to avoid missing out on direct funding programs, such as the Roads to Recovery program. This would be particularly so if, as is likely, (a) all Commonwealth funding to local government were shifted to direct funding; and (b) the Commonwealth refused to provide funding to local government through the States where the local government system in a State did not satisfy the High Court’s assessment of the minimum characteristics of local government. Accordingly, the High Court’s interpretation of the term ‘local government’ would still be of critical importance to both States and local government bodies.

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<sup>349</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 8.

<sup>350</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 16.

<sup>351</sup> See the further analysis in Appendix E: Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 92.

<sup>352</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 16.

## The Expert Panel's Reasoning

The Panel had started with four potential options for constitutional recognition of local government. It dismissed symbolic recognition in a preamble and recognition as part of a broader package of cooperative federalism, as extending beyond the Panel's terms of reference. This was because both options raised much wider issues.<sup>353</sup> It rejected the idea of 'democratic recognition' on the ground that it received little support and considerable opposition and had 'no reasonable prospect of success at a referendum'.<sup>354</sup>

Financial recognition was accepted as the preferred option on the basis that it 'has the broadest base of support among the political leadership at both federal and State levels', even though it was recognised that there was opposition to such a proposal from Victoria, Western Australia and New South Wales.<sup>355</sup> It also has the support of a majority of local councils<sup>356</sup> and a substantial level of support in the broader community (although 'polling also suggests that such support may not carry through to a referendum').<sup>357</sup> The Panel noted that the general community might support a 'form of limited recognition that addresses a perceived problem, such as the current uncertainty arising from the *Pape* case'.<sup>358</sup>

Apart from assessments of support for the financial recognition proposal, there is little in the Panel's Report to suggest *why* such an amendment would be a good thing.<sup>359</sup> The only reasoning provided arises in the following obscure sentence:

All members of the panel consider that it is appropriate that the Commonwealth's right to have a direct funding relationship with local government, when it is acting in the national interest, be acknowledged in the Constitution.<sup>360</sup>

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<sup>353</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, pp 1 and 10-11.

<sup>354</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, pp 1 and 8-9.

<sup>355</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, pp 1-2.

<sup>356</sup> Of those local government bodies that made submissions to the Expert Panel, only two did not support financial recognition. One council suggested that there was not a compelling case for constitutional change and the other was concerned that financial recognition might 'enhance Commonwealth dominance over the States, and future dominance over Local Government': Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 14.

<sup>357</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 2. See also pp 18-19 where it is suggested that the polling results are 'fragile' and that without a major education campaign there is real doubt whether the polling results could 'translate into a majority at a referendum.'

<sup>358</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 2.

<sup>359</sup> The Panel's terms of reference asked it to assess 'the level of support for constitutional recognition' and to provide options for that recognition. It did not expressly ask the Panel to assess the merit of those options, although it was asked to 'have regard to the benefits and risks of different options as well as outcomes that may be achieved': Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 24.

<sup>360</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 2.

It is not clear from this sentence how this is a Commonwealth ‘right’ and how this is consistent with the existing federal system. Nor is it clear who decides whether something is done ‘in the national interest’ and how this notion would act as a fetter on the proposed constitutional amendment (which makes no reference to the national interest).

The Panel also accepted that ‘there is a very real doubt about the constitutional validity of direct grant programs that do not fall under a head of Commonwealth legislative power’,<sup>361</sup> but acknowledged that it is constitutionally possible to make the same grants to local government through the States under s 96 of the Constitution.

The Panel noted that local government provided a number of arguments as to why direct Commonwealth funding is preferable to funding via the States under s 96 of the Constitution. These arguments included the following:

1. ‘The Commonwealth may prefer to use local government as a means to implement its own priorities, even when those differ from State priorities’.<sup>362</sup> Indirect funding of local government through s 96 grants reduces the capacity of the Commonwealth to use local government to impose its policies over those of the States.
2. The Constitution should recognise local government ‘as a legitimate third tier of government in the Australian system’.<sup>363</sup>
3. Funding via the States ‘is inefficient, ineffective and may result in a reduction of the money flowing to local government by reason of deductions for administrative expenses’.<sup>364</sup>
4. The Commonwealth is more likely to fund local government if it can do so directly ‘with all the political advantages that entails’.<sup>365</sup>
5. Direct funding ‘can create a relationship that supports, facilitates and drives collaboration among all three levels of government’, unlike funding via the States.<sup>366</sup>

Of these arguments, numbers 1 and 2 raise issues of federalism that are of serious concern to the States. Arguments 3 and 4 raise funding issues that, when more closely examined, expose flawed reasoning and arguments that the Commonwealth might not wish to take to a referendum. These arguments are discussed below. Argument 5 is simply inexplicable. The use of direct funding to allow the Commonwealth to by-pass the States and deal directly with local government, especially where this is done to implement Commonwealth policies against the wishes of the States, would not seem to involve collaboration among all three levels of government. On the contrary, Commonwealth grants to local government through the States are the most obvious way

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<sup>361</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 4.

<sup>362</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 4.

<sup>363</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 4.

<sup>364</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 5.

<sup>365</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 4.

<sup>366</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 6.

of establishing cooperation and collaboration amongst all the participants. Direct funding is used to cut out the States.

## **The Federalism Arguments**

### *The use of Commonwealth grants to implement Commonwealth policies*

The first argument – that the Commonwealth seeks to use local government as a tool to implement its own policies, even when they are contrary to State policies – raises to the fore a genuine issue of concern to the States and one that should also be of concern to local government. The Expert Panel, in an understated manner, described this as giving rise to a ‘tension’:

There is a tension between accepting local government as an instrument of national policy in whichever manner the Commonwealth decides, on the one hand, and the traditional subordination of the activities and powers of local government to State decision-making, on the other hand.<sup>367</sup>

Many would describe this as more than a mere ‘tension’. A constitutional amendment that permitted the Commonwealth to make grants to local government, ‘on such terms and conditions as the [Commonwealth] Parliament thinks fit’, would provide a further means for the Commonwealth to interfere with and potentially override State policies. It would therefore undermine the federal system of government.

It would also shift government further away from the people, reducing the capacity of local government to implement the policies desired by local residents and the capacity of the State Governments to implement the policies that they were elected to fulfil. Instead, Commonwealth policies would prevail through conditions placed upon grants to local government.

Another problem is that direct funding of local government is likely to damage the federal system by blurring lines of accountability, leaving local government accountable to all and none. Hartwich described this scenario as follows:

[I]f in practice the recognition of local government only meant that the Commonwealth government could interact directly with the local level, be it under general schemes or on a case-by-case basis, then this would only confuse the nature of local government. Either local government is a creature of the states – in which case the states should be the Commonwealth’s sole point of contact. Or local government is independent of the states, but in such a case all the states’ constitutions would need to be changed to reflect this. At a time when local government is still in a clearly subordinate position to state governments both

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<sup>367</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 7. See also: James Spigelman, ‘Constitutional Recognition of Local Government’, Address to the Local Government Association of Queensland, 116<sup>th</sup> Annual Conference, Brisbane, 24 October 2012, p 17.

politically and financially, local councils should not be able to bypass their state governments and engage directly with the Commonwealth. This would only result in blurred powers and responsibilities. Ultimately, it would make accountability impossible in any reasonable sense. A council would then be simultaneously accountable to both its state and the Commonwealth, while democratic accountability would remain with the local electorate. There is a danger that this kind of recognition would in the end strengthen the Commonwealth government and weaken federalism...<sup>368</sup>

It would be naïve of local government to assume that if it had a direct relationship with the Commonwealth it would be treated better than the Commonwealth treats the States. As Fenna has noted, the decline of the States may create an opportunity for the rise of local or regional government, but that this would be unlikely to achieve a long term benefit for local government. Fenna has observed that ‘[b]y and large the centralising dynamics that are adversely affecting the constituent units of federal systems [i.e. the States] are going to have a similar effect on local government’.<sup>369</sup> Hence, the use of tied grants to interfere in policy would be a phenomenon likely to affect local government, if the Commonwealth was entitled to make direct grants to local government.

Professors Aroney and Prasser and Mitchell Birks in their submission to the Expert Panel also raised federalist concerns. They argued that:

[A]ffirming the power of the Commonwealth to make financial grants to local government, though superficially attractive, will not necessarily strengthen local government, but have every potential, especially in the long term, to increase the power of the Commonwealth (and of the High Court) over local government. Local government may appear to benefit from a relatively greater level of independence from the States and from the establishment of a constitutionally secure source of funding, but it would do so at the expense of greater subordination to the Commonwealth, a much more distant government that is inherently less likely to be responsive to the concerns of particular local communities than the governments of the States. Moreover, the prospect of having the State and federal governments effectively sharing responsibility for local government will have the potential to create an even more uncertain environment for the effective and democratically responsible management of local government affairs. The federal constitution is not the appropriate place to recognise local government, and any attempt to do so would be inconsistent with the fundamental principles of its design and structure, and would be liable to give rise to all manner of unintended consequences, no matter how carefully drafted.<sup>370</sup>

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<sup>368</sup> Oliver M Hartwich, ‘Beyond Symbolism: Finding a Place for Local Government in Australia’s Constitution’, 22 January 2009, *Issues Analysis No 104*, Centre for Independent Studies, p 9: <http://www.cis.org.au/images/stories/issue-analysis/ia104.pdf>.

<sup>369</sup> Alan Fenna, ‘Federalism and Local Government in Australia’, *Public Administration Today*, January-March 2008, 47, 48.

<sup>370</sup> Submission by Professor Aroney, Professor Prasser and Mr Mitchell, Submission No 641, [http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/641\\_Local\\_Government\\_Submission\\_Aroney\\_Prasser\\_and\\_Birks.pdf](http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/641_Local_Government_Submission_Aroney_Prasser_and_Birks.pdf). See also Submission No. 606 by Professor Greg Craven.

Local government bodies would be left in the invidious position of being slaves to two masters. They would be subject to the conditions imposed by the Commonwealth on its funding (which conditions could extend well beyond the use of the grants to any other type of policy that the Commonwealth wished local government to pursue) as well as being subject to State laws, ministerial directions and policies.

Interesting constitutional questions would arise as to how to deal with the likely conflict between the requirements of the Commonwealth and those of the States. Any amendment to s 96 of the Constitution which gave the Commonwealth power to make grants to local government on such terms and conditions as the Commonwealth Parliament thinks fit, would also give rise to a legislative power under s 51(xxxvi) of the Constitution to make laws with respect to such grants and under s 51(xxxix) to make laws with respect to matters incidental to the making of such grants. The Commonwealth could therefore pass legislation that appropriated money for these grants to local government and set out the terms and conditions of the grant.<sup>371</sup> If a local government body accepted a Commonwealth grant which was made subject to conditions set out in Commonwealth legislation (eg requiring the local government to implement a particular policy) and if State legislation prohibited the local government body from implementing that policy, a question would arise as to whether 109 of the Commonwealth Constitution would be triggered and whether the conditions set out in the Commonwealth law would override the State legislation.<sup>372</sup> If so (and one would need to assess both laws in each particular case to see if there is a s 109 inconsistency), this would amount to a further shift in the federal balance towards the Commonwealth, allowing it to implement its policies in relation to State matters by using its financial power over local government.

### ***Local Government as a Third Tier of Government***

The second argument is that local government should be recognised in the Constitution 'as a legitimate third tier of government in the Australian system'.<sup>373</sup> If the intention is to give local government its own status, independent of the States and as an equal participant in a tripartite federal system, then this would potentially have far-reaching consequences. As Hartwich noted above, all the State Constitutions would need amendment if this were intended.

There would also be significant ramifications for the application of the Commonwealth Constitution. To start with, local government may lose some of the protection that it currently gains by being part of a State. Section 114 of the Commonwealth Constitution

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<sup>371</sup> See, eg, the *States Grants (Income Tax Reimbursement) Act* 1942 (Cth), which contained the condition that the State not impose a tax upon incomes. Its validity was upheld by the High Court in *South Australia v Commonwealth* (1942) 65 CLR 373.

<sup>372</sup> Note that this issue has not arisen in relation to grants to a State, because a State can simply refuse to accept a grant which comes with conditions that it does not wish to implement. The difficulty in relation to local government is that if the local government body accepts the grant, then a s 109 issue potentially arises as to the status of the conditions as part of a Commonwealth law and whether a State law is inconsistent with the Commonwealth law.

<sup>373</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 4.

provides that the Commonwealth may not ‘impose any tax on property of any kind belonging to a State’. The High Court has held that a ‘State’ includes a local government body.<sup>374</sup> Hence, under the existing Constitution, the Commonwealth cannot tax the property of a local government body. However, if local government became a third level of government, rather than being part of a State, it would lose this protection unless s 114 were amended or reinterpreted to accommodate it.

If local government were to become a third level of government in the Australian constitutional system, then issues would arise with respect to its powers and what rule would apply when local government by-laws were inconsistent with Commonwealth or State laws. The existing rule set out in s 109 of the Commonwealth Constitution would not necessarily apply and some kind of implication would need to be drawn. This could potentially lead to limitations on the operation of Commonwealth and State laws. This has, indeed, occurred in South Africa. Section 40(1) of the South African Constitution states that in South Africa, ‘government is constituted as national, provincial and local spheres of government which are distinctive, interdependent and interrelated’.<sup>375</sup> The consequence is that local government can call on the Constitutional Court to protect its autonomy. Hence, the South African government cannot restructure its electricity industry because local government’s power to sell electricity is constitutionally protected.<sup>376</sup>

Constitutional implications derived from federalism would also need to be adjusted to accommodate a third level of government. For example, at present the constitutional recognition of the Commonwealth and the States as separate levels of government whose existence and independence is constitutionally mandated, has given rise to constitutional implications, often described as the *Melbourne Corporation* and *Cigamic* principles, concerning inter-governmental immunities and the capacity of one sphere of government to legislate in a manner that binds the other.<sup>377</sup> These complex principles would be even more difficult to apply to three levels of government if each were to retain its independence and its constitutional powers unhindered by other levels of government.

If local government were to be made a genuine third, independent tier of government within our federal system, it would make that system extraordinarily complex and would most certainly ‘make intergovernmental relations more complicated than they need... to be’.<sup>378</sup>

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<sup>374</sup> *Sydney Municipal Council v Commonwealth* (1904) 1 CLR 208, 239, 240-1.

<sup>375</sup> Nico Steytler, ‘Comparative Conclusions’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, Montreal, 2009) p 408.

<sup>376</sup> Jaap de Visser, ‘Republic of South Africa’ in N Steytler (ed), *Local Government and Metropolitan Regions in Federal Systems* (McGill-Queen’s University Press, Montreal, 2009) p 275.

<sup>377</sup> *Melbourne Corporation v Commonwealth* (1947) 74 CLR 31 (as reinterpreted in *Austin v Commonwealth* (2003) 215 CLR 185); and *Commonwealth v Cigamic Pty Ltd* (1962) 108 CLR 372 (as reinterpreted in *Re Residential Tenancies Tribunal (NSW); Ex parte Defence Housing Authority* (1997) 190 CLR 410).

<sup>378</sup> Oliver M Hartwich, ‘Beyond Symbolism: Finding a Place for Local Government in Australia’s Constitution’, 22 January 2009, *Issues Analysis No 104*, Centre for Independent Studies, p 7: <http://www.cis.org.au/images/stories/issue-analysis/ia104.pdf>.

It is doubtful that those who seek constitutional recognition of local government in order to establish it as a ‘third level of government’ have ever seriously thought through this proposition and how it would operate under the present dualist federal Constitution. Unless a constitutional amendment makes it abundantly clear that local government remains a subordinate level of government of the States and not a third level of government in its own right, it would appear that a major constitutional upheaval was intended and significant work would have to be done to clarify how existing constitutional limitations, prohibitions, conflict rules and implications would accommodate a third level of government.

The Expert Panel recognised the risk that:

the very insertion of an express reference to local government in Australia’s foundational political and legal document, even of this limited character [i.e. financial recognition] provides recognition of local government as the third tier of government in Australia.<sup>379</sup>

However, in its proposed wording for a constitutional amendment, the Expert Panel appears to have sought to ameliorate this risk by referring to ‘any local government body formed by State or Territory Legislation’.<sup>380</sup> This indicates that the local government bodies to which the Constitution gives recognition are those established by State or Territory laws. Such a constitutional amendment would not appear to confer upon local government bodies any status beyond that of a creature of the States. It is unlikely that the Expert Panel had any intention of establishing local government as a third level of government, given the potential constitutional consequences which its report does not even address.

## **The financial arguments**

### ***The inefficiency and cost of State ‘middlemen’***

The third argument presented by local government for direct funding of local government is that funding via the States is inefficient and ultimately results in reduced amounts flowing to the local government. This argument has previously been put a number of ways, including assertions that:

- the States ‘cream off’ a proportion of the grants from the Commonwealth, so that local government does not receive the full amount – it would therefore receive more money if it were directly funded by the Commonwealth;<sup>381</sup> and

<sup>379</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 7.

<sup>380</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 8.

<sup>381</sup> A J Brown and Ron Levy, ‘Trust the people on constitutional change’, *The Australian*, 2 October 2010. The Leader of the National Party, the Hon Warren Truss, has also noted that ‘Councils believe that if

- the costs of the State as the ‘middleman’ are deducted from the Commonwealth grants before they reach local government – so if the middleman were eliminated, local government would receive more funding.<sup>382</sup>

A typical statement, made by a local councillor to his local newspaper is ‘Federal Government gives money to the States, State gives money to us, and, of course, they all get their cut-off’.<sup>383</sup>

There does not appear to be any evidence to back up these assertions, despite the fact that they are often repeated and seem to be entrenched beliefs. First, the vast bulk of money given by the Commonwealth to local government through the States takes the form of FAGs. The FAGs are given to the States as tied grants, with the condition that the full amount goes to local government. The States are required to pay the grants in full, without undue delay, and this must be certified by the Auditor-General.<sup>384</sup> There is no evidence that the States ‘cream off’ any of this money. They cannot legally do so.

In some cases, States receive grants for purposes that are partly fulfilled by local government and partly by States. For example, local roads in unincorporated areas of a State may be constructed or maintained by a State as there is no local government body. The States are therefore entitled to receive money for this purpose, and this does not affect grants made to local government bodies. In other cases, Commonwealth funding for dealing with a larger problem, such as floods or bushfires, might have to be shared between local government and the States. There might be genuine arguments about how this money should be allocated. However, it is clear that in making s 96 grants to the States, the Commonwealth has full control over how the money is allocated. The Commonwealth may impose conditions on grants that ensure that every cent is passed on to local government. Accordingly, if this is a problem at all (and there does not appear to be any evidence that it is) it is not a problem that requires a constitutional solution. It can be resolved simply by changing the conditions imposed by the Commonwealth.

The Expert Panel also sought evidence from local government associations across Australia to substantiate such allegations. Those of New South Wales, Victoria, Western Australia and Queensland asserted that they were unaware of any such problem.<sup>385</sup> Others pointed to issues such as delays in receiving funding for ‘urgent or new programs which lack existing processes and structures to distribute the funds to councils’, which no doubt would also have occurred if the Commonwealth had been providing the funding

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Federal money for Local Government is provided through the States, the States may not pass all the money through to them’: Letter by the Hon W Truss to the Hon J Spigelman, 2 November 2011, Submission No. 550: <http://localgovrecognition.gov.au/sites/localgovrecognition.gov.au/files/Truss.pdf>.

<sup>382</sup> John Kane, ‘Constitutionalising Local Government’ *Public Administration Today* July-September 2006, 24, 25; and N McGarrity and G Williams, ‘Recognition of local government in the Commonwealth Constitution’ (2010) 21 PLR 164, 184.

<sup>383</sup> Andrea Davy, ‘Push to access more funding’, *Daily Mercury*, 13 December 2012, p 5, quoting Cr Casey of MacKays Regional Council.

<sup>384</sup> *Local Government (Financial Assistance) Act 1995* (Cth), s 15.

<sup>385</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 5.

directly, and the fact that national competition payments made to the States were not always shared with local government, despite there being no obligation to do so. The Panel concluded that:

Although there may be delays, nothing presented to the panel suggests that these are substantial. Nor was the panel able to conclude that there has been a significant diminution of funds by reason of State deduction of administrative charges.<sup>386</sup>

The argument about cutting out the ‘middleman’ also appears to be based upon intuitive assumptions rather than facts. The research conducted by Newspoll on behalf of the Expert Panel noted that because the people surveyed could not see any tangible benefits arising from the financial recognition of local government in the Constitution, they conjured up benefits including:

possibly ‘cutting out the middle man’ (i.e. state government) resulting in less red tape, fewer delays and fewer opportunities for states to ‘take their cut’ out of it’.<sup>387</sup>

Academic commentators have tended to direct such arguments at FAGs and the complexity of the horizontal fiscal equalisation process undertaken by the State Local Government Grants Commissions. Kane has argued, in reference to State Local Government Grants Commissions, that:

Councils resent the fact that around \$18 million a year is absorbed by State administrative and resource costing. One of the advantages they anticipate from Constitutional recognition is an increase in revenue brought about by cutting out the State’s middleman role.<sup>388</sup>

The assumption appears to be that the administration involved in undertaking the horizontal fiscal equalisation process is time-consuming and costly, and that these costs are deducted from the Commonwealth’s grants before they are passed on to local government. Again, there is no evidence to support this assumption. The costs of running the State Local Government Grants Commissions are borne by the States and are not deducted from the grants given to local government.<sup>389</sup> Local government does not bear the cost of the ‘middleman’. Moreover, assuming that the horizontal fiscal equalisation process would be continued under a direct funding process, the cost of administering it would be passed to the Commonwealth if direct funding were instituted

<sup>386</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 5.

<sup>387</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 64.

<sup>388</sup> John Kane, ‘Constitutionalising Local Government’ *Public Administration Today* July-September 2006, 24, 25. The same point was repeated in: Nicola McGarrity and George Williams, ‘Recognition of local government in the Commonwealth Constitution’ (2010) 21 PLR 164, 184.

<sup>389</sup> House of Representatives Standing Committee on Economics, Finance and Public Administration, *Rates and Taxes: A Fair Share for Responsible Local Government* (2003), para 6.113 and p 206; PriceWaterhouseCoopers, ‘National Financial Sustainability Study of Local Government’, (November 2006), p 53.

as a result of a successful referendum. The Commonwealth might well take the view that it should deduct its own administrative costs from any grants it makes (as the Commonwealth currently does in relation to its costs in administering the GST). Hence, direct funding could have the reverse effect of reducing Commonwealth funding to local government because of the shift of administrative cost to the Commonwealth.

The ‘efficiency’ of having a central distribution system is also doubtful. In order to make the relevant assessments, the central agency will need information about every different local government body. This information is known by States because they establish, monitor and oversee local government bodies. However, if the Commonwealth agency had to deal with each local government body separately in order to collect the information that it needed, this would appear to be both expensive and inefficient. As the Commonwealth Grants Commission has noted, it would also be extremely difficult to establish a central formula for an equalised distribution of funds to local government that takes account of the vast differences between local government bodies across different States.<sup>390</sup>

It has also been claimed that ‘a centralised system means that there will be less potential for cost and blame shifting between the tiers of government’.<sup>391</sup> It is not clear why this should be so. Local government would still receive grants from two different sources: the Commonwealth and the States. Each could still blame the other for insufficient funding and each could still shift responsibilities on to local government which are not adequately funded. Indeed, the existence of two separate sources of funding would appear more likely to blur responsibility and accountability, exacerbating cost and blame shifting.

### ***The relationship between Commonwealth funding and vote-buying***

The fourth argument – that the Commonwealth might give more money to local government if it could give it directly – might have more substance to it. On a logical basis, there would appear to be no reason why the Commonwealth would give one cent more to local government if it could give the money directly, rather than through the States. Arguments that constitutional recognition of local government is ‘required to guarantee Commonwealth funding of local government’<sup>392</sup> are flawed, because the mere fact that the Constitution is amended to *permit* the Commonwealth to make grants directly to local government, rather than through the States, does not in any way *guarantee* that it will give more money, or indeed, any money. It is not an obligation to fund local government, or to fund it to a particular level.

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<sup>390</sup> Commonwealth Grants Commission, ‘Special Report 1979 on Financial Assistance for Local Government’ (AGPS, 1979) p 18.

<sup>391</sup> Nicola McGarrity and George Williams, ‘Recognition of local government in the Commonwealth Constitution’ (2010) 21 PLR 164, 184.

<sup>392</sup> Senate Select Committee on the Reform of the Australian Federation, ‘Australia’s Federation: An Agenda for Reform’, June 2011, p 94, referring to the submission of the Naracoorte Lucindale Council and Regional Development Australia Sunshine Coast Inc. See also: Harvey Grennan, ‘Public warned against “no” vote in push to pass referendum’ 4 December 2012, *Sydney Morning Herald*, p 14.

The Expert Panel noted that through its consultations it found that there was a ‘widely held assumption that ensuring the Commonwealth can directly fund local government would result in increased funding for local government.’<sup>393</sup> ALGA’s submission to the Expert Panel also seemed to be based upon the assumption that direct funding will result in *more* funding for local government and *secure* funding.<sup>394</sup> It is not clear why either should be the case, as even if such an amendment were passed, the Commonwealth could still increase or reduce its funding to local government as it does now. The Expert Panel observed that ‘the level of Commonwealth funding to local government will always depend on Commonwealth political and policy decisions’. Merely permitting direct funding will not necessarily change the level of funding. The Panel also pointed out that ‘the Commonwealth had long acted on the basis that it could make direct grants on any subject matter, and continues to do so’.<sup>395</sup> Hence it would be unrealistic to expect any significant increase in Commonwealth funding to local government as a consequence of a constitutional amendment which entrenches a position that the Commonwealth Government believes already exists.

However, the usually unexpressed argument is that the Commonwealth Government is more interested in buying votes than properly distributing public revenue to the States and local government so that they can fulfil their responsibilities. The underlying contention is that the Commonwealth is therefore more likely to provide additional funds to local government if it can get the benefit of public appreciation by erecting signs everywhere claiming Commonwealth benevolence. The Expert Panel coyly referred to this as the ‘political advantages’ of direct funding.<sup>396</sup> Persistent pork-barrelling through regional funding programs by all sides of politics<sup>397</sup> and the littering of Australian roads and schools with signs proclaiming Commonwealth funding would seem to give such an argument some credence.

However, a problem arises if this is the true argument that underpins a proposed constitutional amendment. Which Commonwealth Minister will publicly proclaim that a constitutional amendment is necessary because the Commonwealth Government is not prepared to give adequate financial support to local government unless it can buy sufficient votes and kudos by doing so directly (with signs), rather than through the States? If this is the *real* reason for the constitutional amendment, how can it ever be put to the people? Again, the preparedness of the Commonwealth to distribute its revenue is ultimately a political issue. It is not one that ought to be resolved by a constitutional amendment.

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<sup>393</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 6.

<sup>394</sup> Australian Local Government Association, Submission to the Expert Panel on the Constitutional Recognition of Local Government, October 2011, pp 15-16.

<sup>395</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 6.

<sup>396</sup> Expert Panel on Constitutional Recognition of Local Government, *Final Report*, December 2011, p 4.

<sup>397</sup> See, for example: Australian National Audit Office, *Performance Audit of the Regional Partnerships Programme*, (ANAO, Audit Report No 14, 2007-8, Vol 1), pp 21-26.

## Potential financial consequences of direct Commonwealth funding

If the Constitution were to be amended to permit the Commonwealth to fund local government directly, it is likely that all Commonwealth funding to local government would be allocated directly and that allocation of financial assistance grants through the States would cease. A further likely consequence is that a per capita distribution to the States would cease and that instead the Commonwealth would make the distribution amongst local government bodies on an equalisation basis.

Back in 1991 the Commonwealth Grants Commission considered that the distribution of local government general purpose grants amongst States should eventually move to an equalisation basis.<sup>398</sup> However, the potential results of its redistribution according to different methods would have had an extreme effect on some States. For example, its redistribution of funds according to ‘institutional relativities’ would have resulted in the NSW distribution of \$243.1 million in 1990-91 being reduced to \$74 million – a loss of \$169.1 million. Victoria would have lost \$142.2 million and Queensland would have gained \$172.6 million.<sup>399</sup> The Commonwealth Grants Commission concluded:

In principle, we believe it would not be appropriate to continue indefinitely an interstate distribution of general purpose assistance for local government on a basis (equal per capita) which departs so markedly from fiscal equalisation.

In practice, however, there are several considerations which governments would need to take into account in considering any change to the present basis of distribution. They include the following:

- (i) The per capita basis of distribution is simple and predictable. An equalisation basis would be much more complex and would deliver less predictable outcomes, particularly in the early years.
- (ii) A change to an equalisation system would entail extra administrative costs for both the Commonwealth and the States. These costs have to be considered in relation to the relatively small size of the pool.
- (iii) A move to an equalisation basis would be very disruptive to local authorities in New South Wales and Victoria.<sup>400</sup>

Despite these issues, the House of Representatives Standing Committee on Economics, Finance and Public Administration proposed that ‘FAGs should be distributed on the

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<sup>398</sup> Commonwealth Grants Commission, *Report on the Interstate Distribution of General Purpose Grants for Local Government 1991*, (AGPS, 1991), p xxv.

<sup>399</sup> Commonwealth Grants Commission, *Report on the Interstate Distribution of General Purpose Grants for Local Government 1991*, (AGPS, 1991), p 58. See also the table setting out the losses for NSW and Victoria under a ‘complementary relativities’ approach at p 65.

<sup>400</sup> Commonwealth Grants Commission, *Report on the Interstate Distribution of General Purpose Grants for Local Government 1991*, (AGPS, 1991), p xxv.

basis of equalisation principles and not on a per capita basis'.<sup>401</sup> Others, however, have taken a different view:

The disruption attendant on a move towards equalisation – there would be winners and losers – and uncertainties about outcomes militate against any attempt to adopt equalisation.<sup>402</sup>

Given that the most likely consequence of a successful constitutional amendment allowing direct funding of local government is that the Commonwealth will move to a direct funding formula, and given that such a formula will most likely be an equalisation one, the most likely result would be a very significant loss of funding for local government in New South Wales and Victoria (which are the States that benefit most from the current per capita distribution). Once the people of those States became aware of these prospects during a referendum campaign, it is doubtful whether majorities in either State would support such a referendum. It would only require the failure of the referendum in one other State, such as Western Australia, for it to be lost overall.

## VII CONCLUSION

Perhaps the reason why the constitutional recognition of local government has proved so difficult to achieve is that constitutional recognition is often regarded as an end in itself that lacks a cogent rationale. Most supporters of the campaign, who are by and large members of local government bodies, appear to think that constitutional recognition will improve their status and the respect accorded to local government and that it will give rise to rivers of gold. Yet, respect is earned by deeds, not by constitutional recognition, as most State governments would acknowledge.

As for the rivers of gold, they might yet turn to rivers of tears for local government bodies in the more populous areas if an equalisation approach to direct funding was taken by the Commonwealth as a consequence of a successful referendum. Funding would also most likely become tied to conditions that impose uniform Commonwealth policies on local government bodies, reducing their autonomy and their capacity to serve the particular interests of their own communities.

A further problem with this referendum proposal is that it is difficult to find any compelling reason for it. Even if direct Commonwealth funding of local government is in peril, exactly the same amount of funding can still be given to local government using s 96 grants. If additional funding is desired from the Commonwealth, then additional funding may also be given through s 96 grants. There is no cost to local government and no 'inefficiency' in these grants being made through the States. Indeed, it is likely to be

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<sup>401</sup> House of Representatives Standing Committee on Economics, Finance and Public Administration, *Rates and Taxes: A Fair Share for Responsible Local Government* (October 2003), p 112.

<sup>402</sup> Richard Webb, 'Commonwealth general purpose financial assistance to local government' Parliamentary Library Research Paper No 9, 2007-08, 14 September 2007, p 15.

more costly and more inefficient if they are centralised in a Commonwealth body which does not have the relevant information and understanding of local government.

The most plausible argument that can be made out is that the Commonwealth will inadequately fund local government unless it can gain the political benefits attached to funding it directly. It is unlikely, however, that the Commonwealth would wish to make this argument in support of a constitutional referendum. Indeed, there is much to be said for the argument that Australian voters should not be exhorted to change the Constitution to accommodate poor behaviour on the part of the Commonwealth.

Finally, the Attorney-General, Nicola Roxon, in a speech on constitutional reform, has pointed to the fact that ‘constitutional reform is a high stakes contest’ where ‘the potential benefits need to be carefully weighed against the certain costs’, both financial and in time and effort.<sup>403</sup> She warned with respect to the constitutional recognition of local government that there is ‘a very real prospect that to proceed and lose would be a final death knell for local government recognition — future governments would just not waste the time and effort on a fourth attempt’. She added that ‘support needs to come from a broad base of the community’ and that so far there has not been sufficient leadership and engagement from the community with respect to local government constitutional recognition.<sup>404</sup> It is equally arguable that there has not been sufficient leadership from the Commonwealth to support a referendum for change. While grass-roots support is necessary, so is leadership from the top. A referendum is most unlikely to pass if political leaders stand back and leave it to local government to make its case at the local level.

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<sup>403</sup> Nicola Roxon, ‘A Static Constitution? — A Very Australian Standoff’ (Speech delivered at the Melbourne University Centre for Comparative Constitutional Studies 2012 Conference on Recent Developments in Constitutional Law, Melbourne, 19 July 2012) <<http://www.attorneygeneral.gov.au/Speeches/Pages/2012/Third%20Quarter/19July2012-AstaticConstitutionAVeryAustralianStandoff.aspx>>.

<sup>404</sup> Ibid.

## **COUNCIL RATES – A TAX OR A FEE FOR SERVICE?**

By George Reynolds. Vice-president, Ratepayers Victoria Inc.

### **ABSTRACT.**

Municipal Councils came to us from the common law of England and Scotland when the Colony of Victoria was established on 28th July 1828. Prior to 1828, Councils were empowered to collect a property tax, a sewer tax and a municipal tax. In the 1856 Constitution (a schedule to an Act of the Imperial Parliament), certain limitations were placed on rates, taxes and similar public charges. These limitations produce the conclusion that, post 1856, any taxes, collected by Municipal authorities, are limited to those taxes which may be initiated in the House of Assembly during the budget session. We have an example of such taxes at work in the Fire Services Levy.

Taxation ruling ATO ID 2012/87 defines a general rate (as a tax) as “a compulsory extraction of money by a public authority for public purposes, enforceable by law, and is not a payment for services rendered”. This distinction makes “rates as taxes” and “rates as fees for service”, mutually exclusive. Thus, in setting rates, Municipal Councils must be cognisant of the nature of the economic goods that are to be supplied. A range of different rates, licence fees and charges are able to be levied, all with their individual requirements on those who should pay the fee for the delivered services. Public goods, which are paid for from the Consolidated Fund, need separate identification. Hence, taxes raised to support the payment for public goods, are identifiable by being raised in the same manner as the Fire Services Levy.

It is quite clear that fines and penalties, fees for licences and fees for service are a form of rate which may be applied by Councils, without the assistance of the Parliament. Thus, **COUNCIL RATES MAY BE EITHER A TAX OR A FEE FOR SERVICE OR A LICENCE TO ACT. IF RATES ARE LEVIED AS TAXES THEY ARE IDENTIFIABLE IN THE MANNER OF THE FIRE SERVICES LEVY. IT IS NOT POSSIBLE TO APPLY A COMMON RATE TO SUPPLY BOTH PUBLIC GOODS AND PRIVATE GOODS .... and, THEY MUST BE IDENTIFIED IN SEPARATE GROUPS IN THE ACCOUNTS.**

Municipal Councils fail to recognise the constraints that limit the application of taxes to the supply of Public Goods (under the direction of the Parliament). All other goods need to be supplied as either fees for service or fees for licences and equitably levied only on those who are able to receive the service(s) provided. Councils in Victoria have not (yet) been required (by Parliament) to raise a tax to make a contribution to the supply of Municipal Public Goods. Such goods are granted “supply” from the Consolidated Fund without a contra taxation obligation. This leaves all Council rates and charges having to meet the criteria of, fees for service, licences to act, or fines and penalties.

Many Councils in Victoria act as though they are taxing bodies. They then distort their accounts to conceal the improper use of ratepayer funds. Using Bayside Council as an example, the annual accounts of such Councils may be found to be false and misleading, particularly in the treatment of the surplus. Both budgeted and unbudgeted surpluses need to be credited as payments in advance for use in the following year. In Bayside, this is not done and the money gets lost amongst revaluations of little importance or credibility. In misappropriating this money, Councils become vulnerable to legal proceedings related to the tort of conversion.

The paper concludes with a call for correction, compensation, and retribution, from Bayside City Council in particular, and any others who have distorted their accounts to conceal the retention of unused rate levies.

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## **INTRODUCTION; MUNICIPAL COUNCILS IN VICTORIA.**

**Municipal Councils came to us from the common law of England and Scotland when the colony of Victoria was established on 28th July 1828.** The laws establishing the rights and obligations of such councils passed into the laws of Victoria when the State Constitution was enacted in 1856. When the Federal Constitution was established in 1900 there was no attempt to change the status of Municipal Bodies as departments of State governments.

**Prior to 1828, councils were empowered to collect a land tax, a sewer tax and a municipal tax.** The land tax was collected from the land owner; the sewer and municipal taxes were collected, in the form of rates, from the occupier. (Note that in England the sewers also carried the storm water) Overdue and unpaid rates were collectible in the same manner as unpaid rents.

**In the 1856 Constitution (a schedule to an Act of the Imperial Parliament), certain limitations were placed on rates, taxes and similar public charges.** Notably:

- No public taxes, rates or charges were to be deemed to be an Incumbrance or charge over any land. (Art XV).
- All taxes, imposts, rates and duties ... shall form one consolidated revenue, to be appropriated for the Public Service of the Colony of Victoria. (Art XLIV).
- All bills for appropriating any part of the Revenue of Victoria, and for imposing any duty, rate, tax rent return or impost shall originate in the Assembly. (Art LVI).
- It is not lawful for the Assembly to pass any bill for the appropriation from the Consolidated Fund unless first recommended by message from the Governor during the session when the bill is to be passed. (Art LVII).
- The property tax was reserved to the State and is now represented by Land Tax.

**These limitations produce the conclusion that, post 1856, any rates as taxes, collected by Municipal authorities, are limited to those taxes which may be initiated in the House of Assembly during the budget session.** A corollary to this is that Municipal Authorities are not independent taxing bodies. If they are to collect revenue in the form of rates or taxes, the authority to do so must be initiated in the Assembly and eventually approved by the Legislative Council. The revenue collected by such taxes must be deposited in the Consolidated Fund. Any payments to Municipal Councils (from the Fund) must be identified and authorised in the annual Budget Session of Parliament.

**We have an example of such taxes at work in the Fire Services Levy.** It is initiated in the Assembly, collected by a Municipal Council and is to be paid into or on behalf of the Consolidated Fund. The total payment is allocated in the annual budget to the fire services for their discretionary use. Note that it is not a fee for any service rendered.

## **RATES WHICH ARE TAXES.**

A recent document which looks at this question is in taxation ruling ATO ID 2012/87. It quotes from an earlier 1904 decision from the High Court of Australia, where it was stated:

- Municipal Councils were an administrative body of the State, and
- Municipal Rates were a tax applied by the State, and
- The Australian Constitution barred the States from taxing Commonwealth land.

The ATO ruling, most notably defines a general rate, being a tax, as **“a compulsory extraction of money by a public authority for public purposes, enforceable by law, and is not a payment for services rendered”**.

This distinction makes “rates as taxes” and “rates as fees for service”, mutually exclusive. To add further to this distinction, the ruling further quotes from the HCA decision:

“the Statute operates as a delegation of the taxing power of the State, coupled with a direction when and how to use it”.

Hence, money raised by a public authority for the supply of public goods may be raised from taxation. However the power must be delegated by the State, (to an individual or office) with an instruction on when and how it is to be used. Proceeds must also be delivered into the Consolidated Fund. Payments from this fund are then authorised by a delegation, ( from the State Treasurer?) for whatever specific purpose (even a general purpose) that the Parliament decides.

Currently, Councils receive payments from the Consolidated Fund for nominated (public) purposes. There is, at present, no rate levied which is payable to or on behalf of, the Consolidated Fund. However, Councils collect the Fire Services Levy. This is on-sent, through the Consolidated Fund, to be used for the discretionary purposes of the fire and rescue authorities. (Council cannot use this money even if it sets up its own Fire Service).

#### **RATES WHICH ARE NOT TAXES.**

The alternative form, rates as payments for services rendered, by definition, provides for private goods. The service is targeted to the (private) user and must be accessible “to those members of the community for whom the service is intended”. (Note s208B(c) of the LGA). Hence, this form of rate is targeted at sectors of the community, and sub-groups in the community who are able to benefit from it – and must pay for it.

**In setting rates, Municipal Councils must be cognisant of the nature of economic goods that are be supplied. A range of different rates, licence fees and charges are able to be levied – all with their individual restrictions on who should pay.**

From the perspective of a Municipal Council, the HCA decision has broader implications. **It inhibits Councils from claiming that they are a third and separate tier of Government.** It also suggests that Councils need the support of Parliament - in budget session – **to raise General Rates in the form of a tax.**

Since the 1904 decision, the issue of which rates and charges are not taxes has been clearly defined in the Constitution Act 1975. While this Act, at s62, reiterates the limitations of Art LVI of the Constitution, it also lists, at s64, those charges which “shall not be taken to be a bill .... for imposing any duty rate rent return or impost.., “ i.e. it lists those rates and charges which are not to be considered as taxes.

**It is quite clear that fines and penalties, fees for licences and fees for service are a form of rate which may be applied by Councils, without the assistance of the Parliament. Thus, COUNCIL RATES MAY BE EITHER A TAX OR A FEE FOR SERVICE OR A LICENCE TO ACT. IF RATES ARE LEVIED AS TAXES THEY ARE IDENTIFIABLE IN THE MANNER OF THE FIRE SERVICES LEVY. IT IS NOT POSSIBLE TO APPLY A COMMON RATE TO SUPPLY BOTH PUBLIC GOODS AND PRIVATE GOODS.**

## **ECONOMIC GOODS – THE TEST TO SELECT WHERE TO SEND THE BILL!**

**(Based on the work of Comrie, Smirl and Sody, Reference 1.)**

The concept of the nature of economic goods may be used to distinguish the separate nature of mutually exclusive forms of rates and charges, applied by Municipal Councils.

It is possible to conclude that general rates, applied for the purpose of the supply of public goods, to all rateable land, may be levied by an ad valorem tax on that land. As taxes, such rates raised must follow the processes in s62 of the Constitution Act 1975. Conversely, a general rate, applied for the supply of private community goods, to the rateable land, may be seen as fees for service to that specific community. Rates are collectible by levy from those able to benefit from the service, e.g. a garbage rate is collectible only from those able to access the service. Most importantly, the cost to supply the service is estimated and is then shared, for example, in proportion to the individual property values, related to the total of all participating property values.

Public goods are easily identified, as are licences to act or occupy. Private goods are more varied as the term can apply to whole communities, sectors of communities, different interest groups and individuals.

**Public Goods** are supplied for the benefit of all citizens and residents within the State. Equity demands that it should not matter which municipality supplies the goods, the quality and quantity of service should be common between recipients. The equality should be provided by a common tax or rate being used to collect revenue to be paid into the Consolidated Fund. Payment from the fund (controlled by the State Treasurer) should be on a needs basis and not vary between municipalities. The fire services levy meets these standards. Welfare services are a good example of Public Goods

**Private Goods** are many and varied but may be classified by usage, into:

**Private Property Goods** are goods which, when supplied, benefit the property. Connections from the property such as roads and drains represent examples. Rates based on the Capital Improved Value (CIV) is an equitable form of service levy. Note that arterial roads meet the definition of public goods, yet toll roads are private goods - as are local roads.

**Private Occupier Goods** are those which bring a benefit to the occupier of the property. The examples are libraries, parks and open spaces, municipal buildings etc. Rates based on a common charge per unit of occupation is an equitable form of levy. However, it is common to (unfairly) use the CIV system. (The CIV system rapidly becomes inequitable where high value properties have few occupiers, e.g. recently rezoned land). When rates first came to Victoria, the rental value of the land – for the purpose for which it is used – was the common levy base. (Early rate records listed the occupier; the identity of the owner was frequently not recorded). Importantly, the LGA, at s158A, states that rates and charges (are) to be levied on each occupancy.

**Private Personal Goods** are those which bring a benefit to individuals and groups. There are three sub-groups:

- Private personal goods which benefit a group of landowners, e.g. a local roadmaking scheme, and
- Private personal goods which bring a benefit of choice to some occupiers, e.g. Christmas decorations, car parking schemes, etc., and

- Private personal goods which bring a benefit to organisations whose members are not necessarily ratepayers, such as sporting clubs, social groups and community commercial activities such as kindergartens.

Private Personal Goods obviously require Special Rates and Special Charges to be applied, to deal with the financing. However, where the members are not necessarily ratepayers, the “licence to occupy” is a more appropriate method. Note also, the ability of Municipal Enterprises to supply services to non-rateable customers.

### **RATING PRACTICE.**

The Local Government Act 1989 (The LGA) and the Constitution Act 1975, between them, provide a flexible and reasonable set of rates and charges which may be applied to support the work of Local Government. There is, in the LGA, a directive for such rates and charges to be equitably applied. Section 3C(2)(e) and (f) of the LGA imposes the obligation:

- To ensure that services and facilities provided by Council are accessible and equitable, and
- To ensure the equitable imposition of rates and charges.

Division 1 of Part 8 of the LGA provides all the flexibility needed to achieve the objective of equity between the many groups and individuals who, of necessity, must deal with their Municipal Council. On the other hand, Councils claim the omnipotence of being a tier of government with the right to raise rates, as taxes, at will. It is clear that:

**Municipal Councils fail to recognise the constraints that limit the application of taxes to the supply of Public Goods under the direction of the Parliament. All other goods, need to be supplied as either fees for service or fees for licences. Such rates and charges are to be equitably levied, only on those who are able to access the service(s) provided. THE CONSOLIDATION OF SERVICE AND USAGE FEES INTO A SINGLE RATE IS INEQUITABLE.**

### **COUNCIL PRACTICE.**

The LGA establishes a system of governance able to handle the wide range of tasks that Councils are required to carry out. To provide flexibility, the Act is permissive rather than directive. The term “may” is widely used, rather than “must”. This is fertile ground for the devious and dishonest. Simply by ignoring the conditions precedent to an action, Councils claim they have lawful permission to carry out an action or activity. Bayside Council, for example, claims the universal right to apply a tax. This of course ignores the precedent condition, that taxes must be initiated in the Parliament. The attitude of Bayside (and many others, including Local Government Victoria) avoids consideration of s3D of the LGA – the powers of Council are “subject to any limitations or restrictions imposed by or under ... any other Act”.

The attitude – all rates have the flexibility of taxes – leads Bayside Council into serious problems. Essentially, its accounts may be readily shown to be misleading; the accounts don’t balance, they omit significant items of expenditure, they provide for expenditure on items that have already been provided for and conceal the accumulation of a surplus “slush fund”.

Bayside Council, with many others, provides services which are able to be financed by a range of different rates and charges. The services which provide for Public Goods - and paid for from the Consolidated Fund – are provided as a grant directly to the cost centre providing the service. For example, Council provides a commercial service to supply meals, house cleaning, personal care etc., on a fee for service basis. It publishes the standard fee for the service. For eligible members of the

public, however, the fees are subsidised by a grant from the State. Each year, the residual fee to be paid to Council for this service, for eligible beneficiaries, is also published. Council accounts ought then to be able to demonstrate the equity of the arrangement. This accounting task is not carried out with transparency.

**Councils are not required to raise a tax to provide for the supply of Municipal Public Goods in the State of Victoria. This leaves all other rates and charges having to meet the criteria, of fees for service, licences to act or fines and penalties. An additional revenue source, the Municipal charge is also permissible, to deal with the cost of administration. It is limited to 25% of the general rate. Other revenue may be obtained from the conduct of municipal enterprises.**

### **THE FUNCTION OF THE SURPLUS**

Many, if not all Councils in Victoria, act as though they are taxing bodies, able to collect a profit in the form of a budget surplus. They then distort their accounts to conceal the improper accumulation of this title on the rate collection. It is done, in Bayside, by retaining the surplus yet taking it into the balance sheet as an accumulated asset – similar to a revaluation profit.

In a taxing body such as a government, the budget is set to produce either a surplus or deficit. The quantum of the actual surplus is retained and generally used to reduce the National Debt. Conversely, the deficit is provided for, by adding to the debt (selling Government Bonds). **Hence Income – Expenditure – Surplus = 0.** The amount of the surplus will be equal to the value of Bonds redeemed (and provided for in the National Accounts).

In municipal governance, however, there is no provision able to be made for a deficit. The provision made, when spending is likely to exceed the budget allowance, is to prepare a revised budget (s128 (1)). To reduce the likelihood of the need for a revised budget, it is considered 'prudent' to aim for a surplus to be collected from the appropriate rate. The Victorian Auditor General Office (VAGO) publishes a recommendation of "greater than 0%". There is no upper limit. Most municipalities collect both a budgeted surplus and an unbudgeted one – when the final cost is lower than the estimated cost.

There is a provision in the LGA, at s165, to deal with a surplus of this type. While this relates to a cash refund for ventures which have a finite duration, it also points to the correct accounting treatment for surplus accumulation. Hence:

**Both budgeted and unbudgeted surpluses need to be credited as payments owed to the ratepayer. It may be accounted for as an "in advance" payment for the following year. To do otherwise, Councils become vulnerable to legal proceedings related to the tort of conversion.**

A separate note looks at the 2014 accounts of Bayside City Council and questions the credibility of the council publication.

### **CORRECTION AND RETRIBUTION**

Municipal Councils are in default of their obligations under the Constitution Act and the Local Government Act. They claim to be a government but are an administration managing a (mainly) fee for service enterprise. To provide correction and retribution, this group of ratepayers seek the following:

- The forensic examination of all Council accounts to ensure that they meet the definition of "proper accounts" in s140 of the LGA, and;

- The suspension of any Council found to have prepared, issued and approved accounts which are found, after forensic examination, to be deficient, false or misleading, and;
- The appointment of Commissioners to administer all Councils so determined, until Council, and Councillors wishing to serve on the audit committee, demonstrate an understanding of how to produce “proper” accounts, and;
- The return of all funds misapplied by Councils, and still retained, to be credited as prepayments on future lawful rate demands, and;
- Compensation to ratepayers to be paid from the professional liability protection facility of Councils to restore the damage caused to individuals and organisations by the application of rate demands for years when subsequent accounts have been calculated using false or misleading accounts, and;
- Compensation to ratepayers to be paid by auditors found to have collected professional fees from the certification of false and misleading accounts of Municipal Councils, and;
- Review by the appropriate regulatory authority of the certification of auditors who declared misleading accounts “true and fair”, and;
- Review of the 2014 Regulations to ensure that accounts deal separately with different rating and contribution groups, to ensure that rates, charges and fees are equitably applied without cross subsidisation between the different forms of economic goods produced, and;
- The establishment of an independent administrator (or similar), to ensure the interests of ratepayers are protected throughout Victoria.

End of document; Author George Reynolds; COUNCIL RATES PAPER; Date 150215; Rev 6.

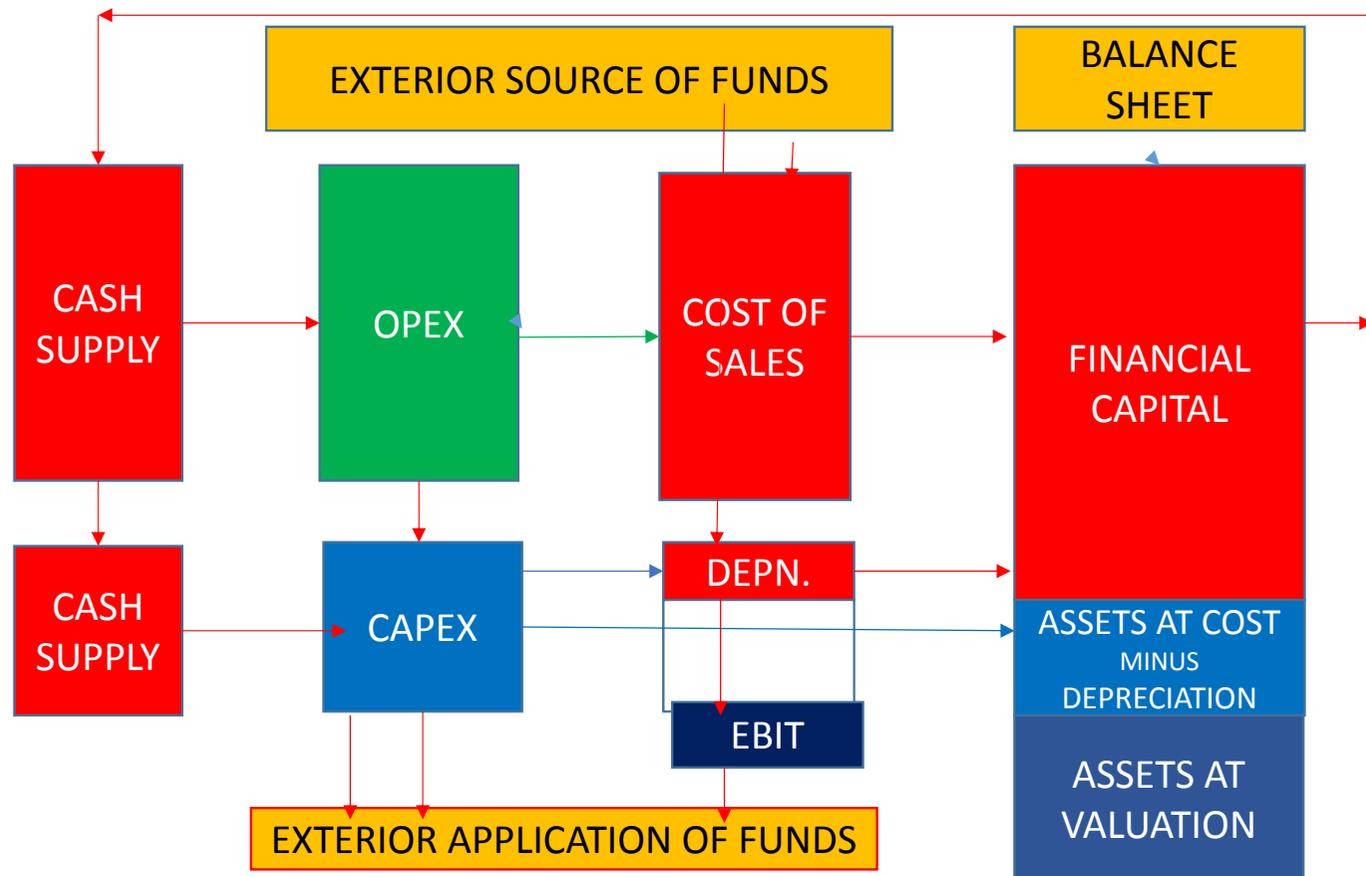
Attachment 1. Comprehensive Income Account; Bayside City Council 2014.

Reference 1. Comry, Smirl and Sody. **Rating Policies – an ad hoc or principled balancing act?**

Source unknown but ex Local Government Victoria.

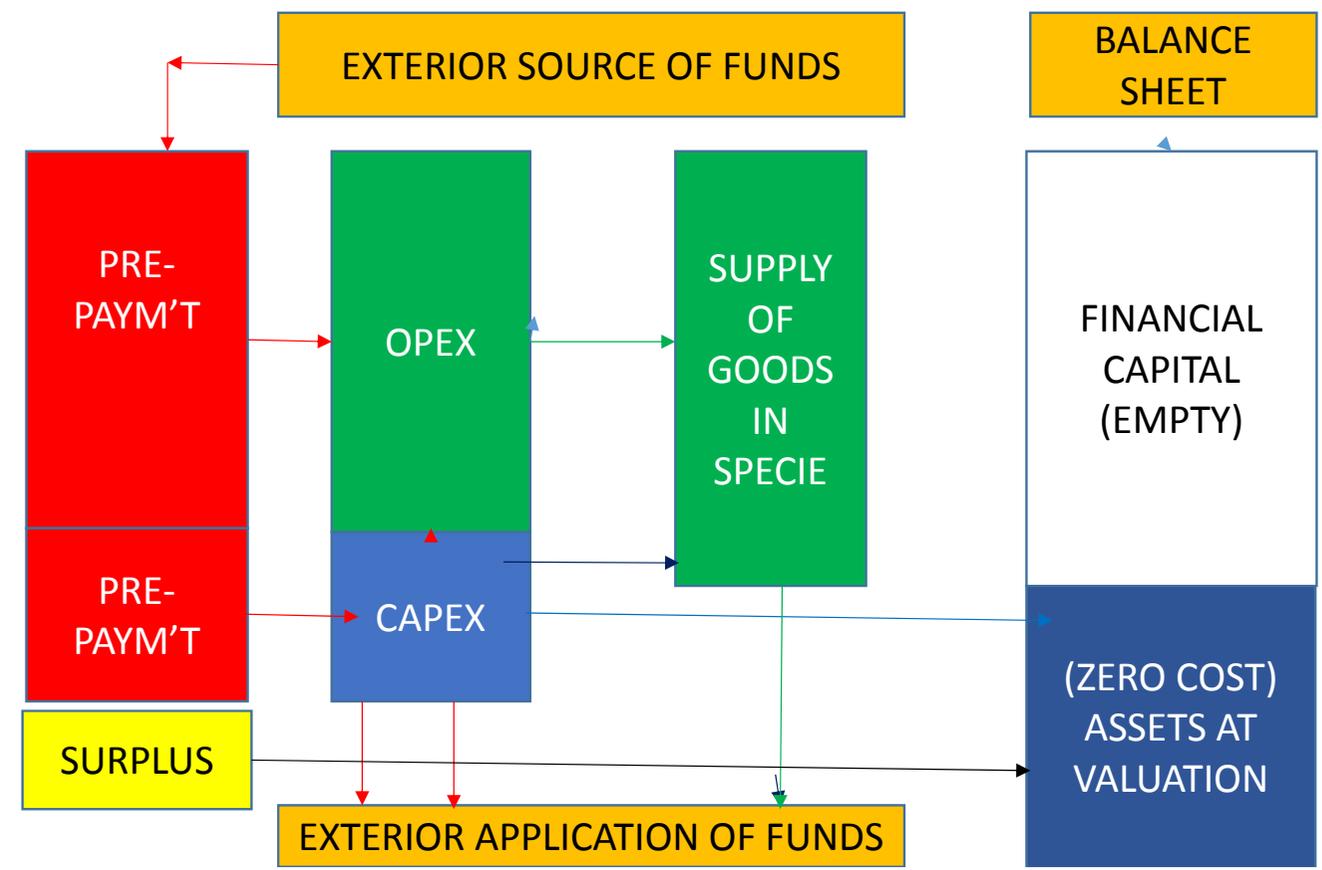
# LIMITED LIABILITY COMPANY

## ANNUAL CASH FLOW DIAGRAM



# MUNICIPAL COUNCIL

## ANNUAL CASH FLOW DIAGRAM



Slide 2

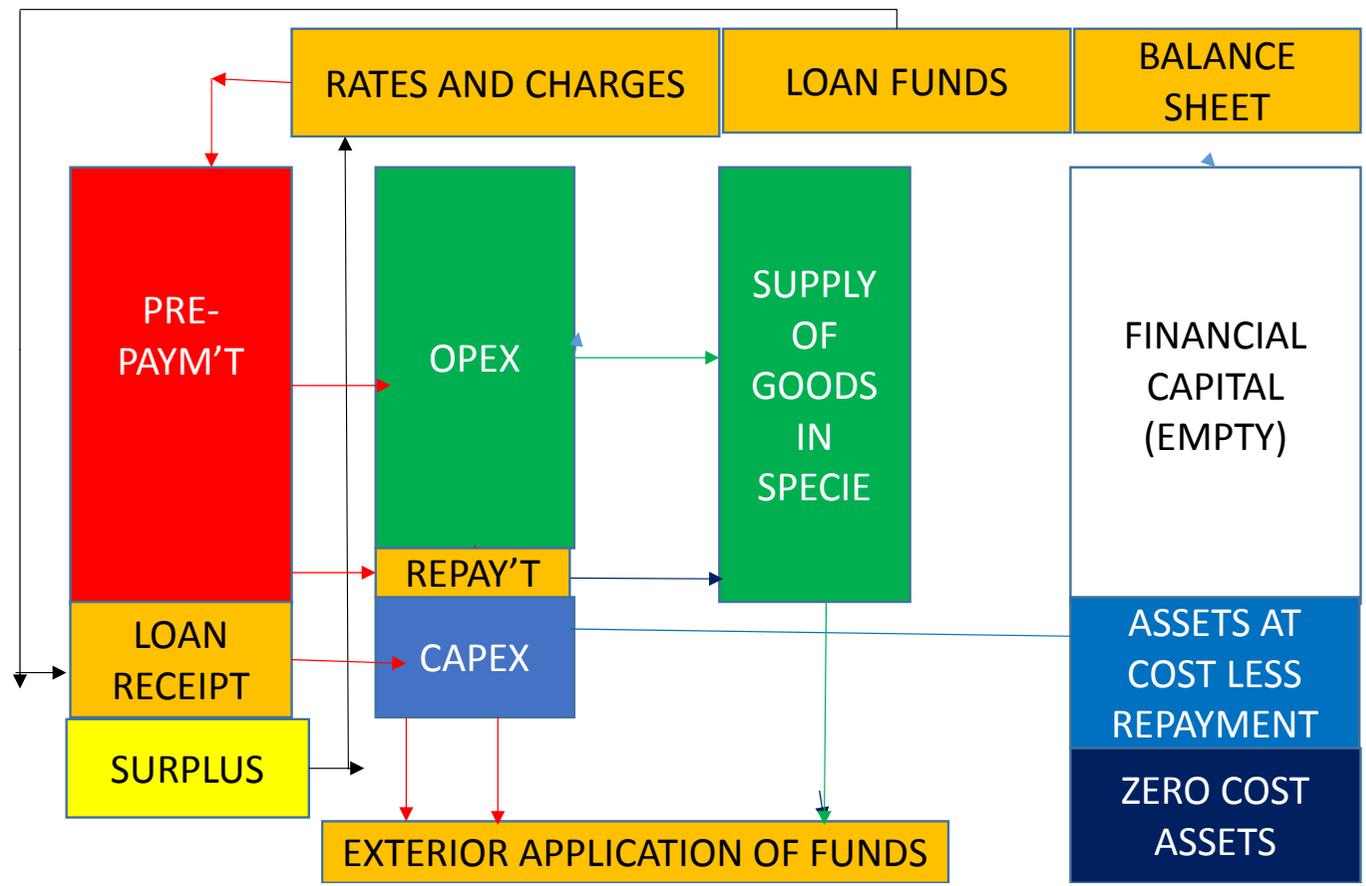
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# MUNICIPAL COUNCIL- EQUITABLE SYSTEM

## ANNUAL CASH FLOW DIAGRAM



Slide 3

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