

ROAD SAFETY COMMITTEE

Inquiry into federal-state road funding arrangements

Sydney — 16 March 2010

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Mr G. Gibbs, deputy chair, and

Mr B. Wright, executive officer, New South Wales Local Government Grants Commission.

The CHAIR — Thank you very much for being here this morning to assist the Victorian Road Safety Committee's inquiry into federal and state road funding arrangements. As you can see, we are recording the evidence taken today. There will be a transcript. You will get a copy of that transcript at the earliest opportunity. You can make corrections as you wish. You are protected by parliamentary privilege today. But anything you say outside of this building will not be afforded such privilege. Please proceed with your presentation.

Mr GIBBS — We have prepared a brief PowerPoint presentation, so at the risk of boring you with a PowerPoint presentation, we would like to go through that. This is extracted from a presentation we provide to councils when we visit them and talk about the methodology for the grants. Under federal legislation we are required to hold public hearings to explain the methodology. We usually do that by visiting each council or group of councils, which is an open meeting. That is where this is coming from. We are almost there, by the look of it.

Overheads shown.

Mr GIBBS — We can move onto the next one. I want to start off by explaining the composition of the commission. We are made up of a chairperson and chair members and two members who are part-time nominees by the New South Wales Minister for Local Government. For my position as deputy chairperson, I am also an officer of the division of local government within the Department of Premier and Cabinet. The support staff is Bruce's role.

In terms of our role, we make recommendations by the New South Wales local government minister to the federal minister on the amounts of grants. Those recommendations are then submitted for approval. The recommendations are made shortly after the federal budgeting process. As part of that, that is how we are advised of the total pool funding that is available. Then we apply the methodology and calculations to come up with the actual recommendations.

We operate under two pieces of legislation — that is, the federal act, being the Commonwealth Local Government Financial Assistance Act 1995, which talks about the way we calculate the grants and the main principles and mechanisms for the ways the grants are calculated and the purposes. We also operate under the New South Wales Local Government Act which is the machinery act that talks about the composition of the commission itself.

I might just mention that the actual costs of the New South Wales Local Government Grants Commission are met out of state government budget allocations. None of the federal grant money goes towards the operations of the grant. It must be and is always allocated to councils. In fact those calculations are required to be audited. They are audited each year by the state Auditor-General.

In terms of the federal legislation, the grants are allocated under two pools. These are identified pools — the general-purpose component and the local roads component. While they are identified separately throughout the whole process as part of the budget allocation, throughout the calculation and even in the hands of the councils when they are advised of what their individual allocations are going to be, both grants are completely untied, which means that if the council wants to spend a local roads component on something other than roads, it is allowed to do that. There is no requirement for a council to report on how that is spent. In fact that is one of the important things we emphasise with councils — the total grant is untied despite the fact we go through a fair bit of work to come up with specific factors within those grants that make up the calculation. Once they get it they can spend it on whatever they like.

Mr KOCH — Grahame, what is the percentage in those funding pools? What is the breakdown between them?

Mr GIBBS — I will come to that. We are also required within the federal legislation to consider certain principles. Firstly, we are required to assess both each council's revenue-raising capacity and its expenditure needs. We have to do that in a neutral way, which brings me to the next principle, which is effort neutrality. That means we are not able to take into account any of the actions of a council which might influence the amount of a grant. We come up with some methodologies which look at each council on a neutral basis so there is no positive impact they should be able to bring to the amount of the grant. The other principle is horizontal equalisation, which is basically that we are looking at a comparative process that compares all councils and

ranks them in some kind of continuum and compares one to another. We are not looking at the absolute requirement of each council in terms of what its needs are. It is looking at them relative to each other.

I have just covered these two things, so I guess we can skip over them. The other principle we are required to observe is minimum per capita grants, which means that every council receives a share. But that comes out of the general purpose component of the pool. It is a 30 per cent factor. It is another factor within the total calculation. We are required to ensure that each council receives some allocation.

This is important too. In terms of grants we look at, we only take into account recurrent expenditure; we do not look at capital works. We do not have the methodologies to examine capital works. Even if we did and factored that in, we might be accused of favouring councils that have done nothing about their infrastructure at the cost of those who have properly maintained it. We simply ignore capital works, which means that when we come to the roads grants, the formula does not take into account the capital condition of the roads. But that is not to say that a council could not use a grant to build a new road if that is what its purpose was.

This graph shows how the road and bridge link data has varied over the years. Currently the information we are getting back from councils for the 2009–10 year shows that councils are reporting 145 350 kilometres of local roads within New South Wales that they are responsible for and 149 310 metres of bridges on those local roads.

Mr WELLER — How many millimetres?

Mr GIBBS — We get fairly precise. You would be staggered. Once we start to talk to councils about their road grants, they get pretty precise about it. Talking about precision, you can see there that this graph shows it was all over the place in some of those early years. If we find there is some data that comes back that is inconsistent, then at our cost we will get that audited. We have an engineer who looks at road and bridge lengths data and who just makes sure that the council has not inadvertently, perhaps, reported some wrong numbers.

Mr TREZISE — I presume it is obvious that the length of roads is increasing from year to year. That would be suburban streets as compared to country roads?

Mr KOCH — Country roads by the distance.

Mr GIBBS — There are a couple of reasons. Bruce, you might want to respond.

Mr WRIGHT — Obviously it includes new subdivisions in some of the newer growth areas. I guess the issue that partly explains the spike early on is the classification of roads in New South Wales. We have local roads, those roads for which councils have full financial responsibility, and they are the roads we include in our calculations. There are also regional roads, which councils own but the Roads and Traffic Authority provides funding for, and then you have state roads. From time to time the classification of those roads is reviewed, so the RTA in consultation with local government will review the roads and changes will come about. An example of that is a new section of highway may bypass an old bit of highway. The old highway may be handed back to the council as a local road. Those sorts of issues happen.

Early on, when the change in the funding arrangements for the local roads component occurred — that is back in August 1990 at a special premiers conference up in Brisbane — a decision was made to change the funding arrangements from a tied grant for the local roads to an untied grant. That is when the funding arrangements shifted from the RTA and a tripartite committee that was used to distribute those funds across to the grants commission. In that process there were a couple of issues. There were definitional issues which were not easily understood. At the same time there was this reclassification process going through, and that is why you see that spike early on. When those sorts of issues were sorted, things began to move, as you would probably expect with new subdivisions and the like being added to the roads.

The other issue is changes in accounting standards over the years. Early on there were changes to councils' accounting methods which meant their having to value assets and all sorts of things in different ways, so councils have had an ongoing program of measuring their assets to be able to value them for accounting purposes. That in itself has brought about some changes. Historically, in a sense whether a council had 100 kilometres of road or 90 kilometres of road probably did not matter terribly much. If someone phoned the local engineer to say, 'We have a pothole' he would fix it, and whether it was part of a big network did not matter terribly much. But the change in accounting standards has brought about a closer look at the assets that

councils have, and those factors have also occurred historically. So you have all those elements happening in the background that mean these days we probably have a better handle on the road networks than we did perhaps 5 to 10 years ago.

Mr WELLER — It is only 200 to 300 kilometres a year.

Mr WRIGHT — That is right, and that is probably what you would expect. You are not putting in subdivisions of 1000 kilometres. The reality is in some parts of western Sydney in particular, the northern and western areas of Sydney where there have been some fairly massive subdivisions going in, you would expect some of those councils would have perhaps 10 to 15 kilometres of road. Similarly, that applies in the south-west of Sydney where there has been some development.

Mr KOCH — But there is a developer contribution there, too.

Mr WRIGHT — That is right. That goes towards that infrastructure.

Mr WELLER — But you would also have developments in the likes of Albury, Grafton and Dubbo and those sorts of places as well.

Mr WRIGHT — Yes, probably not quite to the extent of metropolitan Sydney, of course. But those sorts of things are happening all the time.

The CHAIR — Just in relation to the funding that is given to councils to spend on their roads, as I understand it that goes into consolidated revenue and they can spend it on anything; is that right?

Mr GIBBS — Absolutely. Yes, through our process.

The CHAIR — Through the history of, say, the last five years, what percentage of those moneys that were supposed to be used on roads were not used on roads? Would you have that data?

Mr GIBBS — No.

Mr WRIGHT — No.

The CHAIR — So you do not know? For all you know, nothing could have been spent on roads.

Mr WRIGHT — Yes, the commonwealth act is quite specific. It is paid to councils as an unconditional payment; end of story. Having said that, the amount of money that comes through the grants process is significantly less than councils across the state are spending on their road networks. We would assume that that spending is based on councils' own revenues as well as the funding they are getting through the grants process, but there is no acquittal back. We are not interested. It is not part of our deal.

Mr KOCH — From your funding formula point of view, and we look from a revenue and needs basis and the percentage built in there on a per capita basis, how does that reflect the further you get away from your main centres into regional New South Wales where we acknowledge there is a lowering of population bases that have historically been there, yet the freight component may be the same or growing? How is that being picked up in relation to the percentage on a per capita basis?

Mr WRIGHT — Do we want to move onto the next couple of slides to get onto how the distribution trickles down?

Mr GIBBS — Yes, perhaps. I will just briefly go through this slide, which shows how the general purpose and the local roads components are distributed across the state, that you are probably aware of. For this year, New South Wales gets 32.5 per cent of the general purpose component, and that is based on the projections of the federal government. The local roads component is based on that 29 per cent fixed percentage; it has always been that as far back as we are aware. So that converts into dollars; for the local roads it is \$172.4 million. Overall there is \$608 million worth of grant money for the 2009–10 year.

The next slide shows the way we assess this; we can probably skip over this one. The local roads component is distributed on road length and population and also includes a bridge length formula. I guess in answer to your question, population movements do play a part in terms of the way the road component is distributed.

Mr KOCH — As population falls away, where is the growth in component? Back to service the ongoing maintenance of your highway network?

Mr WRIGHT — I guess it goes back to when the transition occurred, to when the funding pool was a tied grant. Under that arrangement the Roads and Traffic Authority administered the funds but the distribution model that was used and was agreed to was a tripartite committee. It involved representatives from the commonwealth department of transport, the Roads and Traffic Authority and the Local Government and Shires Association of New South Wales. They developed the funding model, which essentially is the trickle-down effect that you see there, so we have really maintained that.

The state receives an allocation. A portion of that pool went to councils in the Sydney, Newcastle and Wollongong areas — essentially urban-type councils — and the balance to the rest of the state. Then there was a further trickle-down based on road lengths and population. You can see there that for the urban areas it is weighted more towards population; 40 per cent is based on population. Whereas if you flick across to the more rural areas, the heavier weighting goes to the road length and that was the model they came up with.

You will see the 5 per cent for bridge length and the 7 per cent figures there. When it was a tied grant, the funding arrangements were that the initial distribution happened and there was a pool of money that was kept aside for special works, and that is where the 5 and 7 per cent figures come from. Under those arrangements the special works were principally for bridge works, and the way the system worked was that if a council had a bridge about to fall down it would make representations through its regional RTA office. The council would have to make a case for replacement of that bridge, and on the basis of that, if the RTA gave it a tick, the council would get the funding. It was on a dollar-for-dollar basis and it had to build the bridge to the RTA specifications, which meant it had to be a concrete structure and had to be so many metres above the flood levels of the river.

When it became an untied grant, the commission took the view in New South Wales that it is inappropriate to have tied specific-purpose project funding within an unconditional allocation, because you could have the ludicrous situation of a council saying, 'We want to build or replace this bridge'. You give the council people the funding for it; they spend the money somewhere else because the grant is unconditional, and then the next year they say, 'We want to replace this bridge'. It is silly, but philosophically that was the issue. So the commission decided, on the basis of the size of the funding pools, that it would simply allocate that pool based on the length of the bridges the councils had to maintain.

The choice then was the council's. If it wanted the ongoing maintenance costs of a timber structure, so be it. If it wanted to raise a loan to replace a bridge, it could do that. It could then use the funds to amortise that loan. The council was not going to be penalised for the decisions it made as part of that effort-neutral principle. If it did decide to replace the timber bridge with a concrete structure, it would not be penalised through the funding stream. There would be consistency of funding so it could plan for the future. It is then up to the council. If it wants to replace the whole bridge with a concrete structure or simply replace a deck on a bridge, those sorts of choices are entirely up to the council and it is not rewarded or penalised through this funding approach.

The commission at the time decided to effectively just mirror what was done by the Roads and Traffic Authority at the time with that change in terms of no more special works, but we would allocate funds based on bridge length. That is how that has all fallen out. It has really been maintenance of that. The commission has not received any criticism of that approach. It is simple, does not require enormous data demands on the part of councils and they are fairly much assured of the sorts of funding they are going to receive from year to year so they can plan for the future and all those sorts of things. It fits the commonwealth objectives of horizontal fiscal equalisation, effort neutrality, all those 'you beaut' terms and words that underpin the process.

Mr GIBBS — The issue that you raised has been raised by councils in terms of declining populations and the impact of additional traffic on the roads — —

Mr KOCH — And the transfer of RTA roads back to local government and cost-shifting across to — —

Mr GIBBS — Yes, and we are sympathetic to the councils' points of view but within the framework and the data limitations that we have, this methodology is what we think is fair and equitable in terms of a statewide methodology. That is bearing in mind too that we have to have the one methodology that meets the needs of all the 152 councils; we cannot have two or more types of distribution methodologies.

Mr WRIGHT — I guess underpinning that is that once again we hark back to the unconditional nature of the funding. You could spend an awful lot of resources assessing a whole lot of factors and at the end of the process the council spends the money somewhere else. There is in a sense a trade-off between simplicity and achieving the objectives of the commonwealth legislation.

Mr KOCH — With the funds made available for your distribution, are you actually keeping up with your road network or is it running away from you, statewide?

Mr WRIGHT — You would have to talk to local government about that.

Mr KOCH — I imagine that you also case the works that they are undertaking on an annual basis?

Mr GIBBS — No.

Mr KOCH — Not at all?

Mr GIBBS — No, because it is untied and also we do not look at capital works, which is our main point. We do not assess the condition of roads. There is no standard methodology that we have to be able to assess that. Certainly from the division's point of view, we are aware that there are some councils that are quite challenged in terms of their road networks and the fact that they struggle to properly find the resources to keep pace with that. There is an underlying issue there about how well they understand the nature of their road network, whether they have properly assessed the condition — —

Mr KOCH — I guess I am coming back to your assessment. I appreciate the unfunded aspect when they get hold of it, but through application I would imagine that the grants commission has a fair idea of what funds are going where and for what reason, albeit that they may not be spent on those things that the application has been made for.

Mr WRIGHT — Sorry to disappoint, but we really do not.

Mr KOCH — I am just raising it.

Mr WRIGHT — Again I hark back to the unconditional nature of the funding. It is difficult in that framework. Let us say a council has reported to us on the condition of its assets and we have said, 'Council X has lots of potholes so we'll give that council more funds to fix up the asset' — its roads — 'and bring it to a better standard'. It would not take too long for councils to think, 'If we let our road network run down and get lots of potholes, then the grants commission will come along and fund it', so there would be an inequity then in the funding arrangements, given the untied nature of the funds, in the funding of one council's potholes against those of another council. As Grahame alluded to earlier on in his opening remarks, the council that had looked after its assets would not be getting the funding. You have got these tensions.

Mr KOCH — What would be the situation in relation to exceptional circumstances — if you were confronted with some of the flooding that has taken place in Queensland, for example?

Mr GIBBS — No, we do not have any component within the road span.

Mr WRIGHT — The state government has — —

Mr KOCH — Picked that up.

Mr WRIGHT — Picks that sort of issue up, yes. Again, in a sense the problem we have got there is that once the grants have been determined, then they are paid out. There is no saying, 'Let's rejig the numbers to help sort it out'. We are not a lender of last resort; we are not in the business of emergency relief-type funding. That is not part of the role of the commission. Even on that aspect, you could go to an awful lot of trouble measuring the soils and the different types of materials used to make roads, but it would only take a traffic

incident on a major road and the police to divert traffic onto a local road to probably have more damage done in one day than would happen in 12 months. We have got no control over that. We do not have the capacity to address those one-off situations. It becomes a tricky one. We understand the problems, but we do not see that the commission has got the resources to be able to address those issues.

Mr WELLER — You have given a very good outline of how things currently work, and I have got a good understanding from that presentation. What would you do to improve the system?

Mr GIBBS — I am not sure that we are able to answer that. We are a creature of the commonwealth legislation, so within the framework that we are given we think it is good as it is.

Mr WELLER — But obviously there would be things that you could finetune?

Mr GIBBS — Yes. We pick up on issues, but that is part of the general-purpose component. If I restrict comments to the local roads component, for the reasons that we have outlined we do not see that there is too much room to move in terms of the methodology that we have got in terms of distributing local road grants.

Mr WRIGHT — I guess with any funding arrangement more money in the bucket would be great, but that is not our call. That is the commonwealth's call.

Mr WELLER — What about the 29 per cent that is fixed?

Mr WRIGHT — That is a matter for the commonwealth to determine. They have reviewed that; there was a review by the Commonwealth Grants Commission some years ago which fell out of the cost shifting inquiry. They reviewed the interstate distribution of the funds. They made recommendations, but the commonwealth decided because of data limitations that they would stick with the existing arrangements. But that is outside of our ballpark.

In that instance New South Wales was one of the marginal states. The Commonwealth Grants Commission came up with three distribution models. I think with one of them we were a per cent or whatever below the current arrangements, and another was slightly above, so it would not have made a lot of difference in the case of New South Wales. It certainly would have made a lot of difference to particularly Tasmania — they would have lost big dollars, big time. Because of the data limitations and the different legislative arrangements that occur across states in terms of classifications of roads and all sorts of things, in fact the Commonwealth Grants Commission's model excluded the length of roads from its modelling. That was largely because of, once again, the underpinning effort-neutral principle. If the Commonwealth Grants Commission had looked at using the length of local roads as part of the measurement aspect, then a state could make a decision to change the classification of a road in order to perhaps entice more money in their direction. Because of this effort-neutral principle, which underpins what the Commonwealth Grants Commission does by way of distributing the GST revenues as much as it underpins what we do in distributing funds to local councils, they decided they really could not take into account road lengths, because the policy decision of a state could affect how the funds were going to be distributed. They did all their calculations without reference to the length of roads, as bizarre as that may seem.

But at the end of the process, whatever method they used, New South Wales really was not going to be affected terribly much one way or the other. In the case of New South Wales, had they implemented the recommendations or not? Not terribly material. At the end of the day, because of data limitations, the commonwealth decided they would stick with what we have currently got.

The CHAIR — Bruce, you said that more money would help, but chucking more money into consolidated revenue is not directly going into roads, so clearly with the methodology that currently exists the money is not going where it is intended to go.

Mr GIBBS — That is why the federal government is moving to more tied road grants.

Mr WRIGHT — Roads to Recovery funding — absolutely — which is appropriate. We have got no problems with that. We have still got to roll, whether it is distributing these untied grants or not. If the roads component suddenly slips out of our radar, it is not going to affect anything the grants commission does. In many ways, as you can see, it is a fairly simple model that we are using.

Mr WELLER — So then you are actually saying that it would be better if it was funding tied to roads rather than just untied funding for roads that does not have to be spent on roads.

Mr GIBBS — No.

Mr WRIGHT — No, we are not saying that at all, because at the moment the choice is fairly and squarely with the councils according to their local priorities. What we are saying is that if the federal government makes a decision to fund specific projects, as they are currently doing, that is a matter for the commonwealth and it is not a matter for anything that we might choose to do or not to do.

As I say, if you look at what councils are spending on their roads, the local roads component is only a small proportion of that. At the end of the day whether councils get the funding through this system — which is unconditional, but anecdotally councils are spending this money and then some — or whether they get it through a specific purpose arrangement in a sense does not terribly matter. The advantage of this method, though, is that it is simple: councils get the funding, they have got complete choice over how they spend the funds and there is no having to put in submissions, which would perhaps tend to favour the better resourced councils that have got the expertise and resources to do that as opposed to the smaller councils that do not have those same resources. It is entirely up to the council how they choose to fix the problem. As I have illustrated, when the funds were tied if they wanted to get that share of the bridge maintenance funding, they had to put in a submission and they had to match the funding dollar for dollar. They then had to report back, they had to prepare submissions — all those sorts of things — and they had to build the bridge to the RTA specifications, which you might argue is probably a good thing, but with this system they have got the choice. They can do more bridges perhaps to a lesser standard, so it is horses for courses.

The CHAIR — Depending on what the political pressure may be at the time.

Mr WRIGHT — Absolutely — within the local council area. That is right. You are exactly right. But the councils have got the choice.

Mr TREZISE — So are councils and the local government association happy with the process and accepting of the process?

Mr GIBBS — This process?

Mr WRIGHT — It would seem so.

Mr GIBBS — Each council we visit would like more money.

Mr WRIGHT — Again, if you look at the ALGA's submissions to the commonwealth in terms of the budget, they are arguing that untied grant funds should be escalated. They are wanting to link these funds to a growth factor, using a fixed percentage of total commonwealth revenues so that the funds escalate in line with other funding. They certainly would seem supportive of the funding arrangements. They just want a better share of the commonwealth revenues. But, again, that is kind of out of our control.

Mr GIBBS — It is not our role to lobby.

Mr WRIGHT — That is certainly the view of local government. It would seem as though they are supportive of the current arrangements. They are supportive of the fact that the funds should be increased. I guess because they are supportive of the current arrangements they seem to like the idea that the grants are untied and that councils then have the choices.

The CHAIR — Of course they would.

Mr WRIGHT — They can make the choices.

The CHAIR — Any further comments you would like to make?

Mr GIBBS — No. Thank you.

Mr WRIGHT — Thanks.

The CHAIR — Thanks very much.

Witnesses withdrew.