

## Submission to Productivity Study: Victorian Local Government

### General comments

- 1) The premise that a productivity figure reducing the allowable rate cap for local government as an incentive to be more efficient may be seen as disingenuous in light of the introduction of rate capping two years ago. The state government's claims were that local government increased rates by nearly 6% per annum on average over a 10 year period to 2014-15. While in the last two years local government has been limited to CPI increases of around 2.0%. Logically the rate cap in itself is more than sufficient incentive for productivity increases, and a further small productivity percentage removed from the rate cap makes no difference to the level of incentive.

A further reduction in the rate cap does mean reduction in real services to the community. For example at Boroondara a 0.05% reduction equates to the full time wage for an aged care officer, maternal child health nurse, immunisation officer, librarian or waste truck driver. These are real services that will need to be reduced if a further rate cap reduction is implemented. The assumption that there is inefficiency which can be addressed without an impact on either service provision or service quality is simply not supportable on a broad sector basis.

Additionally, for those of us who are pursuing efficiency gains through digital transformation projects as is the case at Boroondara, there is an initial increase in costs for a period of 3-4 years due to resourcing required to both drive the business transformation and maintain business as usual. In these circumstances a further reduction in revenue will simply stifle the very efficiency initiatives the concept is seeking to achieve.

### **Recommendation**

That the ESC removes reference to any productivity measure until the impact of the rate cap on local government services has been assessed.

- 2) The ESC has stated that the formulae for the rate cap is 60% CPI + 40% WPI. Since the Minister has not included WPI for the last two years local government has already been forced to endure a significant productivity burden beyond what even the ESC believes is reasonable.

The Department of Treasury and Finance's own forecasts demonstrate that wage prices are expected to increase by 0.75% more than CPI each year.

### **Recommendation**

That all discussion of a productivity figure should be removed until the income lost from the CPI based rate cap over the last two years has been reinstated.

- 3) The rate cap calculation and productivity figure should also consider revenue sources other than rates for a whole of local government productivity calculation. The specific examples included in the productivity of local government should be the level of grants provided by State and Federal governments particularly the impact of cost shifting borne by local government and the level of annual indexation in payments for services provided. When grants fall as per the freeze on the Financial Assistance Grants (FAGs) over the last four years, local government's ability to deliver services and infrastructure is severely impacted.

***Recommendation***

The ESC should have taken these factors into account in determining the overall rate cap and by association the level of any efficiency measure. An evaluation of the rate cap formulae in view of cost shifting and falling levels of government payments to councils be implemented.

- 4) Demonstrated efficiency by the State Government  
The State Government Budget for 2016-17 included an increase in revenue of 7.2% and increase in total expenditure of 8.2%, this has occurred at the same time it enforced rate caps on local government at CPI. Yet local government faces the same issues as the State with increased population driving the need for increased service provision and infrastructure.

***Recommendation***

Local government to have its rate cap set at the same level as the increases in the State Government's budgeted revenue.

**Methodology**

**Predictive Analytics Group (PAG) model - page 8**

We disagree that the PAG model captures the major outputs of local government.

When considering the more than 100 services provided by local government and to suggest that this simplistic model measuring productivity merely based on the length of roads and the number of households and businesses is totally inadequate.

We note that on page 10 that the PAG stated a decrease in productivity across the sector. This fact should be sufficient to indicate that the model is not capturing the relevant data, or that the variation is due to factors external to the model.

One of the factors explaining this stated decrease in productivity reported by this model could be the fact that for most of the last decade councils have been required to increase the capital spend on renewal and replacement of assets as the standards of asset management were eroded due to the last rate cap in the late 1990's. By inference the PAG model should show that councils with run down assets are more efficient than those with higher standards of asset renewal. Surely this is not an outcome that Victorian communities would aspire to.

We seek the ESC to examine whether those councils with low Local Government Performance Rating Framework (LGPRF) ratings for asset renewal are collectively those that are at the higher end of the PAG efficiency horizon.

The commentary on page 8 also states that the quality of services has been excluded from the PAG model. There is no doubt there is great difficulty in measuring the quality of services across the sector, but we disagree that the quality of services has a relatively minor effect on cost of service provision. The quantity of resources required to deliver high quality services is a significant factor in the productivity calculation. The ESC should compare the Community Satisfaction Survey results of councils to their position on the productivity frontier to see if there is a correlation between the two outcomes. We hypothesize that high productivity scores would correlate to low customer satisfaction results.

On what basis does the PAG model page 10 state that technological change is the reason that councils' efficiency has supposedly decreased? We contest that it is because PAG has used a model which was developed for the sole purpose of measuring technological change in developing and developed countries.

We believe that the use of the Malmquist model which measures technological efficiency has been taken out of context in the ESC's report. We ask that the ESC provide objective evidence that council's technological rate of change is the cause of the efficiency outcomes that the PAG model shows. Rather we believe it more likely, as noted above, that the PAG model itself does not adequately explain all the variables associated with measuring productivity in local government.

In summary the relevance of the PAG model should be questioned as it is not able to adequately explain the differences between council productivity due to the simplicity of the data examined.

### **Proxy method**

We agree that the proxy method is not satisfactory due to the lack of comparability between local government functions and with other sectors of the economy available.

However if this model was chosen we disagree with the treatment of negative productivity

### **Efficiency factor - negative values page 20**

We object to the recommendation that negative efficiency outcomes in the economy are ignored. The logic that IPART undertakes this approach is simplistic and as the consultation paper correctly states means that local government is required to be more efficient than the remainder of the economy. We suggest option (1) that negative economic efficiency be added to the rate cap as the only logical, balanced and impartial approach.

### **Summary**

In summary none of the models presented in the consultation paper are suitable for use.

Our position is that the impact of rate capping on local government services over the medium to long term needs to be understood before any further efficiency or productivity revenue reductions are considered for implementation. This is because rate capping, as it has been implemented, is already providing a burden on councils struggling to deliver quality services to fast growing communities, particularly in light of the increased needs of older cohorts of the population.