



**CORANGAMITE
SHIRE**

Our Ref. D/17/42990 pam

3 October 2017

Essential Services Commission
Level 37, 2 Lonsdale Street
MELBOURNE VIC 3000

Sent by email: localgovernment@esc.vic.gov.au

Dear Sir/Madam

**Re: Submission to Measuring Productivity in the Local Government Sector
Consultation Paper**

I am pleased to provide Corangamite Shire's submission to the Essential Services Commission in relation to the Measuring Productivity in the Local Government Sector Consultation Paper (September 2017).

The efficiency and effectiveness of Local Government is an important issue, however disappointingly the consultation paper prepared by the Essential Services Commission is seen as an inadequate vehicle for progressing this important discussion with the sector. There also appears to have been minimal or ineffective consultation with the sector to date.

The consultation paper is overly technical and difficult to read, and the absence of worked case studies or examples is a major problem. The paper also fails to acknowledge that there is significant debate on the merits of using Data Envelopment Analysis (DEA) in a local government setting, or adequately considers alternative models of assessing efficiency.

The paper's assertion that the models developed by Predictive Analytics Group capture the main inputs used by councils and the outputs produced is flawed. Similarly, the number of households, businesses and length of roads serviced are not reliable proxies for the bundle of services delivered by councils.

Use of Data Envelopment Analysis

Despite the strong support for DEA in the consultation paper, a brief analysis of the academic literature would suggest that there are many questions and problems with this technique when used in a local government context. For example, Drew et al (2015) note there is a dearth of empirical literature on the accurate and correct specification of DEA. They further note that "our evidence suggests that incorrect specification may well produce spurious association and lead to poor public policy making".

As will be discussed later, the output and input measures used in the consultation paper are limited and fail to recognise or account for significant differences in geographic area,

service offering or demographic profile. Allaf (2002), in his analysis of DEA in measuring the performance of American cities, found that “uncontrollable variables such as population density, unemployment and household income suppress the relative efficiency of the local government. Moreover, the findings imply that the prevalence of economies of scale in city government depend on the type of services these governments provide.”

The consultation paper does recognise that differences in councils may make comparisons difficult. However, the paper then goes on to state that DEA has been used in other sectors such as the Victorian water and energy retail sectors. This analysis fails to recognise that the water and energy retail sectors are largely homogenous and offer a very limited range of products or services. Local councils in comparison may deliver over 100 different services to residents, businesses and visitors. In this regard, the measurement of efficiency is best applied at service or activity level rather than at an aggregated level. This is not dissimilar to the model used within the Victorian public health system.

Output and Input Measures

The consultation paper identifies four models with different inputs and outputs. The paper indicated that the models use households, businesses and length of roads as proxies for the bundle of services delivered by councils. It is submitted that these are poor proxies for the bundle of services. The inputs and outputs used in the models are overly simplistic. The following are some specific issues with the inputs and outputs used in the models.

Inputs

- Council staff (\$) and EFT – As the paper notes, these are poor measures as there is significant variation in the sector in the services provided and the extent of contracting versus in-house delivery. For example, Corangamite Shire provides a number of services that generate income which other councils do not provide, such as road construction contracting to VicRoads, a regional landfill and saleyard. Additionally, Corangamite Shire provides a range of services on behalf of other tiers of Government such as kindergartens, mobile child care and HACCC.
- Capital – It is agreed that capital expenditure is a poor measure given the potential for large variations depending on carry forward projects and grants from other tiers of government.
- Capital (\$) operating expenses (excluding depreciation) (\$) – Capital operating costs excluding depreciation does not adequately recognise the lifecycle cost of an asset. Depreciation is a significant operating cost and councils must be able to fund capital renewal to remain sustainable. A council’s level of productivity is a key driver in this regard to ensure it can fund capital renewal.
- Operating expenses (excluding depreciation) (\$) + depreciation (\$) – The inclusion of depreciation in the measurement of productivity is important for the reasons mentioned above.

Outputs

- Households – The number of households does not account for shires with high visitor/tourist numbers. For example, Corangamite Shire is home to the 12 Apostles that attract approximately 2.6 million visitors per year.
- Businesses – It is unclear how business numbers will be measured. Physical presence, rate data or ABN numbers could all be used and will generate significantly different results. If physical presence or rate data is to be used it will be difficult to capture farm businesses. Use of ABN data is likely to over inflate business numbers, especially in rural areas where a single enterprise might utilise multiple ABNs.
- Roads – It is unclear what is being measured quantity (length) or quality (condition assessment data). Length is impacted by settlement patterns. For example, dairy areas are more closely settled and therefore require more roads. There are also

likely to be significant differences in the extent of arterial (VicRoads) roads and council roads between different councils.

- Waste Collected – It is agreed that this is a very poor measure of output.

Large Rural Shires

The consultation paper indicates that no Large Rural Shire, when assessed using the DEA models, is considered to be technically efficient. No consideration is given in the paper to the possibility that the DEA model might be fundamentally flawed when assessing the efficiency of Large Rural Shires. Again, some case studies and worked examples would help with analysis and understanding. The consultation paper quotes a study by Drew, Kortt and Dollery (2015) on measuring efficiency of New South Wales councils which found that population levels had a positive effect on a council's technical efficiency; the higher the population of a council, the greater the positive influence on efficiency. This is significant because it demonstrates a one-size-fits all model is not appropriate. For example, it is not reasonable to compare the efficiency or productivity of Corangamite Shire with a regional or metropolitan council. Nor is it reasonable to compare the productivity of a Small Rural Shire with Corangamite. This is also supported by the Victorian Auditor-General's Office and Local Government Victoria when measuring council performance, particularly in regard to the recently introduced performance reporting framework (LGPRF). Similarly, the Victorian public health system also recognises not all hospitals are the same. Each peer group of hospitals (Metropolitan and Regional, Subregional and Local, Small Rural) attracts a different rate of casemix funding (WIES) that inherently recognises the smaller the health service the less efficient they are likely to be.

Efficiency Factor

The consultation paper recognises that the ESC commission has previously used an arbitrary 0.05% efficiency factor. If an efficiency factor is to be used by the ESC, and ultimately the Minister, in setting the rate cap, a more evidence based approach should be used. Based on the assessment of the DEA model in the consultation paper more work is required to find such a tool.

A Way Forward

It is recognised that efficiency and effectiveness are important principles in the utilisation of public monies. Corangamite Shire is more than willing to participate in this discussion. To progress this matter the following is suggested:

- More consultation should be undertaken with the sector. This should involve a broad cross section of councils with differing geographic, economic and demographic features.
- The Consultation Paper should be re-written with more case studies, worked examples and consideration of alternative assessment methodology rather than relying just on the potentially flawed DEA model.

Yours sincerely



Andrew Mason

Chief Executive Officer

Cc Dr Graeme Emonson, Executive Director, Local Government Victoria
Mr Rob Spence, Chief Executive Officer, Municipal Association of Victoria
Cr Rob Gersch, Chairperson, Rural Councils Victoria