



13 October 2017

Dr Ron Ben-David
Chairperson
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne, 3000

Dear Sir

Re: Measuring Productivity in the local government sector

Thank you for the opportunity to respond to the consultation paper on *Measuring productivity in the local government sector*.

In reviewing what is a complex paper, Council remains of the view that the mechanisms used to consider local government productivity remain extremely arbitrary and fail to take account of the diverse nature of local government. Using an approach that simply looks at inputs in the form of employee costs, capital investments and operating expenses and assessing these against outputs such as households, businesses and road lengths provides no consideration to the individual characteristics of each Council.

In the case of the City of Greater Dandenong for example our cultural diversity plays a major role in the both the type and cost of services that this Council provides – a fact that is recognised by bodies such as the Victorian Grants Commission through its cost allocations for factors such as non-english speaking residents - but not in the approaches contained in the consultation paper.

Rather than responding to the mechanisms and conclusions in the consultation paper, Council would prefer to make the following points in relation to the ESC considering the implementation of an efficiency factor:

1. There is already an efficiency factor in place

The ESC annually provides advice to the Minister on an appropriate rate cap. For the past two years, the ESC advice has been to support a rate cap based on 60% CPI and 40% Wages Price Index as per the ESC final report – *A Blueprint for Change – Local Government Rates Capping and Variation Framework Review (September 2015)*. This report recognised the key local government cost drivers and equity of applying an approach that recognised the significance of employee costs in driving local government cost indexes.

On both occasions the Minister has rejected the ESC advice and opted for a CPI only approach which has led to lower rate outcomes as displayed in the below table.

Year	ESC Advice based on blended formula	Minister Determination based on CPI Only	Variation
2016/17	2.8%	2.5%	0.3%
2017/18	2.1%	2.0%	0.1%

As noted in the table, given the Ministers rulings in the past two years, there is already an efficiency factor that has been built into all future years rating of at least 0.4% - in reality it is greater than this due to the accrual factor.

For the ESC to consider an annual efficiency factor of 0.05% increasing annually but capping it at 0.2% fails to recognise the impact of the first two years where the Minister has elected to apply CPI only against the advice of the ESC.

As recognised in ESC's own publication, the application of CPI only to local government fails to recognise the key cost drivers in local government which is employee costs.

2. You cannot have an efficiency factor on top of another efficiency factor

Whilst the Minister for Local Government continues to apply a CPI only approach to local government rate capping, it is completely inequitable for the ESC to then be proposing to introduce a further efficiency factor on top of this approach. The ESC, in its report to the Minister on efficiency factors, must make it clear that any efficiency factor can only be applied where the blended formula is adopted by the Minister.

3. It is premature to apply an efficiency factor

Rate capping by its very nature is a blunt tool for local government productivity. It is noted in the consultation paper that productivity in local government is decreasing and that this is at odds with the broader economy. The consultation paper does acknowledge however that these conclusions have been drawn over periods leading into but not including the first year of rate capping.

Given the restrictions imposed by rate capping it is highly likely that the trends in the past two years are very different to the proceeding periods. It is therefore inappropriate for a consultation report to draw a conclusion on local government productivity based on periods up to and including 2015-16 and which fail to take account of the impacts of the past two years of rate capping.

These factors should be thoroughly explored by the ESC before drawing a conclusion on the trends of local government productivity.

4. Is it appropriate to apply a uniform efficiency factor to all?

Despite Council continuing to hold strong reservations about the economic approach to determining local government productivity and efficiency, the report identifies a number of Councils as being fully technical efficient. In the case of these Councils is it then appropriate that they also face the impact of having their rate caps further reduced via an efficiency factor?

5. Recognising the impacts of the Interim Local Government Award as an efficiency factor

As noted above in this submission, local government employee costs continue to be the most significant factor in driving local government cost indexes and therefore efficiency.

By way of example, in the City of Greater Dandenong 2017-18 Annual Budget, employee costs comprise 53% of the total of operating expenses (excluding depreciation).

Local government wages are set individually by each Council by way of entering into Enterprise Bargaining Agreements (EBA's) with the various unions that deal with the local government sectors. These negotiations are often protracted and can frequently lead to extended industrial action prior to an agreement being reached.

The introduction of rate capping has driven down the average increases within EBA's from between 3-3.5% prior to rate capping to now an average in the industry of between 2 -2.5% - better linking local government employee costs to the Wages Price Index.

What is not reflected in these EBA's is the impact of the Local Government Interim Award which provides for an eight-tiered banding structure to cover the majority of employees. Within these eight bands are typically four levels (A- D) where employees progress along the band until they reach the end.

These banding pay increases typically add between 0.5-0.7% in addition to the negotiated EBA meaning that even a Council with a 2.5% EBA outcome will be paying a minimum of 3% per annum in increased employee costs.

Whilst the ESC position is quite appropriately to recognise the Wages Price Index as a major contributor to the calculation of the rate cap, Councils then need to annually find a way (via efficiencies) to fund the gap created by the Award structure in order to achieve the same outcomes as the previous year. This in itself serves as an internal efficiency structure which has not been recognised at this point.

In summary, the introduction of the rate capping framework is already beginning to see impacts on the funding levels that Council can contribute towards the future development of this municipality. It is expected that this impact will only heighten over the next three years where Council will inherit significant new operational costs as new facilities are completed but without the ability to increase its funding sources to match.

The introduction of an efficiency factor on top of what is already a difficult framework for local government to operate within will only add to these future outcomes.

Council looks forward to the above points being considered by the ESC in it developing its final position in regard to an efficiency factor.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Jim Memeti', with a stylized, cursive script.

Jim Memeti
Mayor