

Our File: HCC08/645
Enquiries: Daryl Whitfort
Telephone: (03) 9205 2777



1079 PASCOE VALE ROAD
BROADMEADOWS
VICTORIA 3047

Postal Address:
PO BOX 119
DALLAS 3047

Telephone: 03 9205 2200
Facsimile: 03 9309 0109
www.hume.vic.gov.au

11 October 2017

Andrew Chow
Director Local Government
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne 3000

By Email: localgovernment@esc.vic.gov.au

RE: Submission to Productivity Study: Victorian Local Government

Thank you for the opportunity to provide a submission to the Consultation paper on measuring productivity in the local government sector.

Council commends the Essential Services Commission (ESC) for the level of expertise that was utilised in undertaking a study into measuring productivity in the local government sector. Council acknowledges that the ESC in advising the Minister for Local Government into the operation of the annual rate cap, introduced under the Fair Go Rates System, included an efficiency factor.

Council recognises that "the intended aim of the efficiency factor is to create incentives for councils to operate more efficiently and ensure that efficiency gains are shared with ratepayers in the form of lower rates" (page iii of the Consultation paper) and makes the following submission.

Should you wish to discuss any details of this submission please contact Mr Daryl Whitfort, Director Corporate Services on (03) 9205 2777.

Yours Sincerely

A handwritten signature in black ink, appearing to read 'D. Isola'.

DOMENIC ISOLA
CHIEF EXECUTIVE OFFICER



**OFFICER SUBMISSION TO THE
Essential Services Commission**

Measuring Productivity in the local government sector

Consultation Paper – September 2017

SUMMARY

Council supports the following approach in setting the efficiency factor:

- A value calculated using data from the data envelopment analysis (DEA) as described in both the Consultation paper and the Predictive Analytics Group report based on the following:
 - A. Model number 5 is utilised to perform the DEA;
 - B. Use of Multiple group analysis;
 - C. Variable returns to scale (VRS) production frontier is utilised;
 - D. Required efficiency gain is 2.5% with a 10-year timeframe for efficiency gains to be realised.

WHY DO WE SUPPORT THIS APPROACH

In keeping in mind the intended aim of the efficiency factor - to create incentives for councils to operate more efficiently and ensure that efficiency gains are shared with ratepayers in the form of lower rates - Council strongly urges the use of actual data. The Commission's consultant, Predictive Analytics Group utilised the Victorian Grants Commission response questionnaires provided by all 79 Victorian councils for the period of 2010/11 to 2015/16 as the primary data source.

Further, Council believes that the use of actual data (VGC returns) will most likely create the environment for councils to consider efficiencies in the level of inputs used in delivering its services.

A

The use of Model 5 to determine the efficiency factor is encouraged as this can be applied equally to all Councils, irrespective of the level of in-house or contracted-out service delivery and also combines asset management practices through the proxy measure of depreciation. For the 2016/17 Annual Budget (combined 79 Councils), Total Expenses equal \$7.9B, including \$1.4B of Depreciation.

Further Council does not support the use of Staff or Capital as inputs. Whilst Staff FTE is a better input than Staff \$, the results shown at Table 2.2 of the Consultation paper show there is only a marginal difference between these input variables. The use of Staff as an input does not adequately represent service delivery at only 42% of Total expenses. Whilst the Total Capital Works budget increases consistently over time, the types of projects vary significantly between years. Further, Capital Works does not include any new assets provided through new subdivision development and the 2016/17 Annual Budget included a total of \$0.4B. These additional assets however will be included in the Depreciation amount in the year following their construction.

B

Council believes that the assessment of the four options against the five criteria to select an approach to set an efficiency factor is reasonable (Table 4.1), however could be altered to show the DEA approach split into Single Group and Multiple Group analysis. Further, Council believes that the Applicability criteria should be considered higher for multiple group analysis than single group analysis as it takes into account the municipal differences through the grouping of councils as grouped for both VGC returns and the Local Government Performance Reporting Framework.

For example, for the 2015/16 year the actual results for Small Rural Councils (Group) across the three Sustainable Capacity population measures was:

<i>Expenses per head of municipal population</i>	\$2,745.19
<i>Infrastructure per head of municipal population</i>	\$22,397.37
<i>Population density per length of road</i>	9.74

For Interface Councils the measures were:

<i>Expenses per head of municipal population</i>	\$1,123.32
<i>Infrastructure per head of municipal population</i>	\$7,715.62
<i>Population density per length of road</i>	122.30

For All Councils, the measures were:

<i>Expenses per head of municipal population</i>	\$1,834.40
<i>Infrastructure per head of municipal population</i>	\$13,443.42
<i>Population density per length of road</i>	102.15

The above three measures highlight the significant structural and inherent differences that do and will always exist across groups of municipalities, especially due to geographic size, location and population dispersion and as a result Council believes that the use of multiple group analysis instead of single group analysis is more accurate, meaningful and comprehensive.

C

The use of Variable returns to scale (VRS), which assumes that output does not change in direct proportion to input is considered by Council to be superior to Constant returns to scale (CRS), for the same inherent reasons as outlined in B above.

D

Council would further suggest that the required efficiency gain and the timeframe to realise this gain is considered in light of the level of fixed assets that Victorian local Governments own and maintain. For the 2016/17 Annual Budget, Total Local Government assets equalled \$85.74B, with Infrastructure assets totalling \$51.2B and Land assets totalling \$31.4B and in combination represent 96% of all assets. This underlines that the capacity for local government to be agile is limited and a ten-year horizon for an efficiency gain to be realised is appropriate. As can be seen from A above total assets represent 13.2 times total expenses excluding depreciation and demonstrate how fixed asset intensive Victorian local government is.

Further Council would suggest that any industry with such a significant level of fixed assets there may be a delay in the time period to realise productivity gains from infrastructure investments.

OTHER APPROACHES

Council provides the following comments on the other three approaches considered in selecting an approach to set an efficiency factor. Again, these comments are made in consideration to incentivise Councils to generate and share efficiency gains with their communities.

Notional

Whilst this approach approximates the mid-point of the results from the DEA approach for the 2010/11 – 2015/16 years, it does not necessarily demonstrate any rigour, applicability or relationship to the level of inputs for Councils to achieve efficiencies for future years. Further it would not be consistent with the existing calculation basis of the Rate Cap, whether that be the Commission's approach of using WPI and CPI or the Minister for Local Government's option of using just CPI.

Proxy

Council believes that the Proxy approach should not be used as it does not adequately reflect the services provided by Local Government; it is not based on actual Victorian Local government data; it is difficult to align the production impact of the significant level of local government fixed assets; and finally is subject to changes or discontinuance in collection of some measures over time by the ABS. It is however recognised that changes in data collection measures could also impact on DEA, due to changes in the VGC questionnaire and also to the LGPRF.

LGPRF

Council believes that with the increasing maturity and longevity of the reporting framework that it has a limited potential, limited to some of the Sustainable Capacity measures, to be utilised as an approach. This is due to the information being based on the same actual data, albeit in a different format, as the VGC questionnaire. Further, as mentioned at B above, the LGPRF is already capable of demonstrating structural differences between groups of Councils.

COMMENTS ON THE REPORT

- [Page 7 and 10] Discussion on technological change could be enhanced with examples. The calculation of the Malmquist Index results within the PAG Report, highlights that a reduction in productivity over the 5 years to 2015/16 is due to a lack of efficiency from the adoption of new technology.
- [Page 10] Table 2.2 – the heading in the fourth column should read as “Average Malmquist index Multiple group analysis”
- [Page 13 and 14] Council suggests that Figure 2.2 should not be included in the main body of the Report and such a graphical representation should be shown for all five models and for both Single and Multiple group analysis as part of the PAG Report. By presenting Figure 2.2 only within the Consultation paper, seems to indicate that the Commission is recommending Model 1 and Single group analysis. Further, Council also recommends that Table 2.3 and the commentary should not be included in the main body of the report.
- [Page 26] Council questions if the cumulative effect of the proxy increasing in the 4-years (Table 4.2) is correctly considered. For example, if an efficiency factor of 0.05 is introduced in year one, Council believes that this factor will naturally cumulate each year thereafter, or until removed. For example, 0.05 introduced in year one will have the cumulative impact of 0.1025 in year two without increasing the efficiency factor that was introduced in year one, from 0.05 to 0.10. Council requests that the Commission review how the cumulative impact of an introduced efficiency factor would operate.

- [Page 28] Whilst Appendix A contains an overview of the Victorian Local Government Sector including both structural and discretionary differences between Councils, this does not appear to be adequately utilised within the report in consideration of the single group versus multiple group analysis.

DATA REFERRED TO IN THIS SUBMISSION

- A Councils Adopted Budget Data 2016-17 V15. xlsx – Local Government Victoria website
- 2015/16 Actual Data – Know your Council website