

Local Government Division  
Essential Services Commission  
Level 37, 2 Lonsdale Street  
Melbourne VIC 3000

12 February 2018

### **Submission to setting a local government efficiency factor – draft proposal**

Thank you for the opportunity to make submission on setting a local government efficiency factor – draft proposal.

On behalf of the LGPro Board and our members we would like to register our disappointment with the ESC's draft proposal.

As we understand it the draft proposal is based on the ESC's study on Measuring Productivity in Local Government. Rather than a study, that piece of work on productivity was undertaken based on a preconceived conclusion that the introduction of an efficiency factor was required and all the study was required to achieve was to identify the best way of doing it.

Having predetermined the need for an efficiency factor the draft proposal makes no attempt to assess efficiencies being achieved by the recent introduction of rate capping, nor does it consider that the full impact of rate capping is unlikely to be properly understood until it has been in operation for 5 or more years.

The paper provides no real evidence to support its position but seems to attempt to justify it on the basis that the proposed efficiency factor is small.

We reject the draft proposal. Instead we support the principles outlined in the Local Government Act Review where Councils have the ability to set their own budgets and long term financial strategies based on their consultation with residents, knowledge of service requirements and levels, transparency objectives and prudent financial objectives adopted by each Council to achieve sustainability targets and address community need.

LGPro is always happy to be available to provide additional information, answer any questions or to discuss.

Yours sincerely



**REBECCA McKENZIE**  
PRESIDENT, LGPro

## Setting a Local Government Efficiency Factor – LGPro Submission

LGPro is disappointed in the quality of the draft proposal, the lack of intellectual rigour and the limited understanding about Local Government it displays.

### Productivity Study

It is of concern that the ESC's study on Measuring Productivity in Local Government is an exercise in supporting a preconceived conclusion *"To identify the best way to set an efficiency factor, we have undertaken a productivity study, [Measuring productivity in the local government sector](#). The study looks at productivity trends in the sector and identifies options to estimate an efficiency factor."* \*ESC Website - Approach to setting a local government efficiency factor

### Evidence

Having predetermined the need for an efficiency factor the December 2017 draft proposal provides little evidence to support the introduction of an efficiency factor. However, it provides ample examples and evidence to suggest that the introduction of an efficiency factor is fraught, as below:

#### *Challenges in measuring productivity and efficiency*

- We found that measuring productivity and setting an efficiency factor for the local government sector is challenging. Through our analysis we found:*
- The Australian Bureau of Statistics does not collect productivity data for the local government sector. This means different industry sectors would need to be used, to act as proxy measures of local government productivity change.*
- The local government sector is diverse in terms of services delivered and quality of services.*
- This means it is difficult to identify inputs and outputs that would be common to all councils.*
- Productivity levels for the Victorian local government sector have not been measured previously.*
- It is difficult to account for some inputs. For example, the use of volunteers to deliver services may not be measured.*
- Geographic and demographic factors play a role in determining the cost (inputs) of providing services which influence productivity and efficiency.*
- There may be a delay between when an input is measured and when the resulting output is recorded. This may be addressed by measuring productivity over a longer period of time to 'smooth' out this effect.*
- There may be some influences on efficiency and productivity that are outside a council's control.*
- To date we do not have enough data to understand how productivity has been affected by rate capping.*

### *Options for setting an efficiency factor*

*Our review of each method against well-recognised regulatory criteria suggested that the data envelopment approach best meets the criteria. However, the formula used to calculate the efficiency factor using this approach needs values for the required efficiency gain and the number of years to achieve the gain over. Until the effects of rate capping on productivity and efficiency are better known it would be difficult to make an informed decision about what the values for these parameters should be.*

### **ESC's Council Compliance with the Rate Caps for 2017-18**

We were surprised and disappointed that the draft proposal failed to take into account and reflect on the ESC's own December 2017 Report – *Council Compliance with the Rate Caps for 2017-18*.

While quick to name the 3 Councils as non-compliant, only one of whom was assessed as materially non-compliant, there was no mention or attempt to report on the extent to which the other 76 Councils' average rate increases were compliant. In doing so it fails to provide a balanced perspective and denies an understanding that a number of those 76 Councils will have already delivered a further efficiency benefit greater than the 2% cap.

### **Ratepayers' Information**

Having stated in the Summary of the Draft Proposal; *"We note ratepayers were not involved in these discussions and did not make any submissions.* But then goes on to say; *Previous correspondence and comments from ratepayer representatives provided strong support for an efficiency factor."*

If "rate payers were not involved in these discussions and did not make any submissions" on what basis is it legitimate to then state that they had provided strong support for an efficiency factor? Without knowing what the correspondence received was in response to, referencing it is irrelevant. For example, if they were responding to something that implied a decrease in rates (tax) it unsurprising that they would support a decrease in their taxation. In addition, there is a key question about whether the ratepayer representatives are representative of the community and if those views are educated and informed. It may well be that if those same ratepayer representatives were asked if they would support the abolition of Local Government, privatisation of services and a reduction in the number and salaries of state and federal public servants that they would answer in the affirmative.

### **Comparison of Local Government with the Water Sector**

The Draft report also attempts to justify the need for an efficiency factor in Local Government by stating that the ESC *"have applied efficiency factors in other sectors that we regulate. While comparisons need to be made with caution, under our new water pricing framework, we are seeing water authorities volunteering efficiency savings of up to 3% per year for the next five years."*

Given the sheer number and diversity of services delivered in widely varied communities it is difficult to understand what parallels there are for comparing efficiency between the water sector and Local Government.

### **Reliability and Accuracy of the Approach**

In support of its proposed approach being robust the ESC explains that *“Predictive Analytics Group prepared five alternate model specifications. This was to test whether changing the inputs used in the data envelopment analysis changed the efficiency ratios significantly from the ratios generated under the original models. The changes included:*

- *Capital expenditure was removed from all models. This was to address stakeholder concerns about the potential for large variations in capital expenditure from year to year and the resulting effects on productivity.*
- *Depreciation was removed from all models. This was in line with the advice we received from our expert consultant that depreciation may be reported inconsistently across councils.*
- *The inputs in model one were changed from staff costs plus capital expenditure costs to staff costs plus operating expenditure (excluding depreciation costs and staff costs). This was so the model accounted for labour that was directly employed by the council and labour that was outsourced.*

*Predictive Analytics Group found that there were no material differences between the technical efficiency ratios generated under the original model specifications and the alternate model specifications.*

*Therefore, we can conclude that the original models adequately account for the inputs used by local government.*

It could just as easily be argued that rather than being robust, the approach is insensitive to the different influencing environments it is applied to.

It is suggested that using a “bundle of services delivered “approach increases the reliability of the results. If this is true it should be equally true that applying the Predictive Analytics Group data envelopment approach to a group of State services such as Corrections, Education, Public Transport and Health would deliver a valid measure of State Government efficiency.