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Andrew Chow
Director Local Government
Essential Services Commission
Via email: localgovernment@esc.vic.gov.au
RE: Response to ESC – Setting a Local Government Efficiency Factor

Dear Andrew Chow,

The City of Maroondah appreciates the opportunity to provide feedback regarding the Essential Services Commission's (ESC) Setting a local government efficiency factor draft proposal. As there is with any new piece of government legislation, there are challenges in the way controls and initiatives are implemented. The implementation of the efficiency factor – with limited benchmarks and research can easily be deemed as challenging to implement, especially given that rate capping is still in its infancy phase.

An efficiency factor, in theory and on the surface, appears to be an effective mechanism to incentivise efficiency within Local Government, if undertaken in the correct manner. The draft document has recommended the notional approach as the way forward, until rate capping impacts are better understood, at which point, the data envelopment approach may be implemented.

Overall, there appears to be gaps in resolving to implanting a notional efficiency factor across the local government sector.

The notional approach to setting an efficiency factor:

The recommendation to implement the notional approach with a 0.05 increase per year, seems to be a flawed approach and one that shouldn't be implemented, until such time that the rate capping impacts are better understood. Page 20 of the document notes:

*'Consistent with stakeholder comments, we recognise that the **notional approach does not directly reflect productivity levels of the sector**, but it is easy to understand and communicate and is cost effective to implement.'*

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This comment alone appears to be sufficient justification not to have an efficiency factor implemented until more research is undertaken and rate capping impacts are better understood over time. Implementing a notional factor would be an uninformed and ill-considered approach.

An efficiency factor increasing by 0.05 per cent each year, implemented sector wide cannot be considered a reasonable approach to encouraging efficiency in every single local government entity. The theory, as noted on page 5 of the document, states that raising the efficiency factor by 0.05 per cent each year, until it reaches 0.2 per cent is considered reasonable, as it is consistent with the highest value generated by the other three approaches – this in itself is simple, but too simple to be considered as valuable in driving positive change and efficiency in the sector when Councils are all at different stages of efficiency, with differing service level expectations by communities in differing municipalities.

To add, with the review of the Local Government Act (LGA), there has been no mention of the efficiency factor and the role it will play in determining the rate cap. It is not specifically identified in the revised Act, as part of the Ministers determination of the rate cap. This may suggest that the Government is moving away from the prospect of having specifically an efficiency factor applied to the calculation and weakens the need for such a requirement in the calculation.

The purpose of an efficiency factor:

Page two of the document states that the efficiency factor, incorporated into pricing formulas, is common in incentivizing service providers. Typically, the service providers that are incentivized implementing efficiency factors, normally deliver, more commonly, one type of service, not 130 plus service types. It also notes that it is particularly important in a local government context, as competitive pressures are rarely placed upon the services delivered by local government. However, in rebuttal to this statement, one would reasonably conceive that a competitive pressure currently being posed on Councils, would be dealing with a predicted 30% electricity price hike, within a rate capped environment. For Maroondah City Council specifically, this results in what potentially could be a \$19M gap over 10 years. The formulae for rate capping and efficiency factors doesn't necessarily capture these gaps faced by Council.

In the same instance, Council's must find ways to operate facilities, such as leisure centers, in a competitive and price effective way, and manage the electricity price hike across all facilities, whether they are income generating facilities or not.

Overall, rate capping and efficiency factors does not effectively consider the PESTLE environment, which is faced by Council's across all facets of the PESTLE model. The PESTLE model consists of Political, Economic, Social, Technological, Legal and Environmental. Without considering all components of PESTLE, it can consequentially lead to an impractical rate cap and/or efficiency factor being imposed. A clear example is, where Councils are potentially facing the 30% electricity hike as noted earlier.

To add, Councils set to achieve asset renewal targets that, depending on timing, can have a significant impact on Council cashflow. Just the asset renewal target and an unforeseen large increase in electricity charges alone, can consume what the rate increase is in any year, let alone applying an efficiency factor over and above the current restricted rate. Not to add, the current state of the recycling industry, which will impact several Councils – costing them anywhere from \$80 to \$140 per ton over and above what would have been budgeted. The cap along with the efficiency factor could then make it extremely difficult for some Councils to genuinely cope with the unpredictability of markets, along with having to consider that the rate cap for the year will be further impacted by an efficiency factor.

Challenges in measuring productivity and efficiency:

The draft report also notes on pages three and four, with a comprehensive list, that measuring productivity and setting an efficiency factor for the local government sector is challenging. The reasons noted suggest that it is too unpredictable and uninformed to set any efficiency factor yet. As noted in the Australian Government Productivity Commission *5-year productivity review Local Government, August 2017*:

'Over the past thirty years, the responsibilities of most Local Governments have moved from being simply providers of property-related services – captured in a simple expression of their functions as focused on "roads, rates, and rubbish" – to increased involvement in the provision of social services, such as health awareness and management, recreational facilities and sporting venues and active promotion of local economic development including tourism.'

However, as also noted in the report, compared to the other two tiers of government, local governments portion of revenue raising and public sector employment is only small portion, accounting for only 3.5% of Australia’s total taxation revenue, as per the Australian Government Productivity Commission *5-year productivity review Local Government, August 2017 (Productivity Commission Report)*.

As noted, any restriction to the overall rate cap, which in addition includes an arbitrary efficiency factor, can only be inhibiting Local Government from performing efficiently, more particularly those that are already considered to be functioning at a relatively efficient level. As also noted in the *Productivity Commission Report*, rate capping, including an efficiency factor, means Local Governments must:

‘either find another revenue source or reduce expenditure, which can result in more efficient delivery or could also inhibit a Local Government’s ability to respond to its community.’

Hence, on this basis, implementing an arbitrary efficiency factor can only be considered as inhibiting, when there is relatively uninformed base to start with and not sufficient data on the current impacts of rate capping in Victoria. The report goes on to suggest that there is no clear evidence about the impact of rate capping on the performance of Local Governments, with Victoria planning to review the system at the end of 2021. So, with current evidence not being substantial, one would argue that introducing a notional factor would also be unsubstantiated.

The practicality of setting an efficiency factor:

Setting an efficiency factor based upon a notional value is arbitrary, and fails to consider the complex environment in which a local government entity operates. Selection of the proxy approach is in direct contradiction with all feedback received by the ESC in relation to the rate cap formula. In the context of using the factor as an economic motivational tool, selecting a method that was mostly critiqued and rejected by the entities subjected to the tool cannot reasonably be expected to achieve its intended function.

As Victoria is in the early stages of understanding the quantitative impact of rate capping, adding an additional factor into the cap may result in a distorted understanding of the impact in the future collection of data. Future use of the data envelopment analysis approach may also be inherently flawed, as noted by the ESC, given the uncertainty of the current variables, factors and measures.

Recommended way forward

In the absence of another appropriate mechanism for setting the factor, it is impractical to impose an efficiency factor on councils when there is such little confidence in the efficacy of using such a factor. It is recommended that the rate cap formula not include an efficiency factor. More effective use of comparative indicators to measure Local Government performance would have a greater impact in improving accountability of local governments to residents and potentially, providing an incentive for local governments to improve their performance by highlighting differences between similar local government authorities; resulting in a greater incentive to improve, than an overall implementation of a notional efficiency factor.

Sincerely,



Tony Rocca