

# TRANSCRIPT

## STANDING COMMITTEE ON THE ENVIRONMENT AND PLANNING

### Inquiry into rate capping policy

Melbourne — 20 October 2015

#### Members

Mr David Davis — Chair

Ms Samantha Dunn

Ms Harriet Shing — Deputy Chair

Mr Shaun Leane

Ms Melina Bath

Mr Adem Somyurek

Mr Richard Dalla-Riva

Mr Daniel Young

#### Participating Members

Mr Jeff Bourman

Mr James Purcell

Ms Colleen Hartland

Mr Simon Ramsay

#### Staff

Secretary: Mr Keir Delaney

Research assistants: Ms Annemarie Burt and Ms Kim Martinow

#### Witnesses

Dr Ron Ben-David (affirmed), Chairperson, and

Ms Angelina Garces (affirmed), Senior Regulatory Officer, Essential Services Commission.

**The CHAIR** — I welcome the Essential Services Commission representatives to the hearing today. I indicate that this is a hearing with respect to the inquiry into rate capping policy, that things you say here today are protected by parliamentary privilege but if you say them outside, they may not be. I ask you to provide a brief introduction, and then we will ask some questions.

**Dr BEN-DAVID** — Thanks, Chair. I will keep it very brief because I am sure you are keen to ask the questions. The Essential Services Commission has no own-motion powers with regard to local government, so this work that we have done, this review, was commissioned under terms of reference issued to us earlier this year jointly by the Minister for Finance and the Minister for Local Government. In that terms of reference it states:

The government intends to promote rates and charges that are efficient, stable and reflective of services that the community needs and demands ...

It also refers to setting the rates at a level that ensures the sustainability of councils' financial capacity. That is very important. Those two references are particularly important because what it tells us in how we go about doing our work is that we are to balance the interests of ratepayers with the interests of councils and their financial viability. This is not about councils and it is not about keeping rates as low as possible; it is about getting the balance right.

The terms of reference also refer to council autonomy quite strongly, and we have been very respectful of ensuring our recommended framework does not in any way encroach on this autonomy. Again it is a matter of balance — balancing council autonomy with the role that we have been asked to play in administering the framework.

I do not want to go through the terms of reference in any detail. I just want to highlight three matters that I think are worth noting. One is that the terms of reference takes the CPI as its starting point for the cap but seeks our advice on any refinements. It also refers to the greater accountability and transparency of local government budgeting and service delivery. And finally, it seeks our advice on monitoring outcomes against any unintended consequences or 'any deterioration in the level, quality or sustainability of services and infrastructure'. So, again, the theme of balance is very important to us as we go about our work. This is about balancing present needs with the future sustainability. So it is not just about short-term wins, but it is about balancing the short term with the long term.

In April this year we released our first consultation paper. And in that paper we outlined eight principles, which are on that sheet before you. I am not going to read them; I will leave them with you to read. Those eight principles really try to capture that notion of balance that we had to bring to the work we were asked to do — the balance between the interests of ratepayers and the councils, the balance between council autonomy versus the role we were to play and the balance between the short and long-term interests. In summing up those eight principles, in the introduction to that report in April, I wrote:

While we are very mindful of the need for simplicity when designing the framework, we are also determined that the framework does not inadvertently or partially shift responsibility for rate setting from councils to the commission. Councils are responsible for the services they provide and therefore the rates they levy and the legacies they leave. The framework will clearly place the onus on councils to demonstrate that their rates have been set in line with the services they provide to their communities and in line with the long-term interests of their ratepayers.

We were commissioned to do this review earlier this year. We submitted our final report to the government on 30 September. The legislation that oversees the Essential Services Commission requires the government to release that report by the end of this month. In that report we have made a set of recommendations around a framework that comprises three elements. The first is the rate cap — I know you are familiar with that, so I will not go into it — the second element is a variation process whereby, if councils seek to or wish to increase their rates above the rate cap, it is the process by which they would go through to get that approved; and the third element, very importantly, is a monitoring and public reporting role. I will not describe these in any detail because I am sure the committee will ask lots of questions that will take us into the detail of those three things.

I expect you have heard all sorts of claims about the burden this framework will impose on councils, and I want to give you my assurance that we have designed the framework so that it creates as few new obligations as possible on local government. We have very intentionally designed the framework to rely almost entirely on

councils' existing planning, budgeting and consultation processes. If they are doing what they are telling us they are doing, then the framework, other than a bit of extra paperwork, does not require them to do anything more.

Of course for some councils even that little bit of extra work will represent a substantial demand on their limited resources. We acknowledge this, and we have done so from the outset. But when I have spoken to those councils — those small councils which will find the resourcing challenging — almost universally they agree that the challenges they confront are much more profound than anything this framework imposes on them or anything this framework can deal with. During the implementation stage of this framework we will work with all councils, and especially those small councils, to help to make the transition as smooth as possible.

**The CHAIR** — Can I thank you for your work in this area. I do not think you will be surprised at this, because you know my view on these matters, but there is, I think, an omission in the terms of reference, and specifically I think the terms of reference underplay the role of state government funding to councils. In the current year we have seen, for example, the cessation of the country roads and bridges program, hitting directly many of the smaller councils that you just referred to. And we have had lots of evidence about the impact of the cessation of the country roads and bridges program. So when I read your report carefully and many of the submissions that came in, it seemed to me on one hand that the government terms of reference were too narrow; you cannot, of course, read the mind of ministers, but they specifically excluded, in effect, state government cuts to councils. In that context it seems to me hard to come to many of the conclusions without fully factoring in the obligations placed on councils and the funding sources given to councils. I wonder if you might comment on the impact of the state government cuts to councils and the obligations that are placed on councils from time to time.

**Dr BEN-DAVID** — With regard to the first of those two things, the cuts, we certainly did not try — let me start again. In thinking about the cap, where we started off was that we needed to take into account all these other factors that affect the financial viability — the ability of councils to deliver services. We started looking at all sorts of complicated ways of taking into account these other factors, whether they be funding from external sources or whether they just be local issues, such as road networks, population growth, population decline, ageing populations et cetera. We quickly found that it became impossibly difficult, and as we recommended in our draft report, we felt that the better way to deal with individual circumstances in this regard was through the variation process rather than trying to overcomplicate — in fact impossibly complicate — the rate cap itself. So the variation process allows all councils to come forward with a proposal.

**The CHAIR** — But with great respect, the variation process is individual, whereas a cut, for example, to every country council of \$1 million a year is not an individual variation; this is a systemic challenge with a state government cut to councils at a time when capping is due to be applied shortly.

**Dr BEN-DAVID** — For example, we have analysed — and this appears in our final report — the effect of the commonwealth government's freezing of the financial assistance grants.

**The CHAIR** — That is my point. That is in there. The state government cuts — —

**Ms SHING** — Chair, the witness is getting to the answer.

**The CHAIR** — He will get to it. I am sure he will.

**Ms SHING** — If you allow him to, that would be useful.

**Dr BEN-DAVID** — What that shows is that the impact varies enormously across councils. I cannot remember off the top of my head, but we used the normal groupings of councils, and I remember that for some councils the impact was equivalent to maybe 1 or 2 per cent of their rate base, whereas for other councils it was around 10 per cent of the rate base. The problem then becomes how you account for such variability in the rate cap itself, and because of that, as I said, either we are going to have 79 different rate caps, which would mean that we would be developing something that would very quickly turn into a black box — we just felt it was just too difficult to account for all those different factors, whether they be funding or anything else, in individual caps.

**The CHAIR** — With respect, I think you have been played for a patsy, and I think you have been dragged in — —

**Ms SHING** — Sorry, point of order, Chair.

**The CHAIR** — No, no, no — —

**Ms SHING** — Sorry, may I make a point of order, please?

**The CHAIR** — No, you — —

**Ms SHING** — No, I may make a point of order, pursuant to the standing orders that apply in this committee.

**The CHAIR** — You may. That is right.

**Ms SHING** — I would seek that you avoid actually editorialising on this and expressing your own personal views —

**The CHAIR** — I am asking a question.

**Ms SHING** — where you have actually expressed that you think the witness has been taken for a patsy. You are referring to the Essential Services Commission.

**The CHAIR** — That is right, I am.

**Ms SHING** — Right. Okay. That reflects very badly, in my opinion, on the Chair.

**The CHAIR** — That is great.

**Mr LEANE** — On the whole committee.

**Ms SHING** — Indeed.

**The CHAIR** — The key point here is that I think you have failed to take account in your report of the impact of these state government cuts. I think that has weakened the independence of your report, and I am registering here my considerable concern.

**Ms SHING** — As the shadow Minister for Local Government.

**The CHAIR** — No, I think many councils would concur with me on that.

**Ms SHING** — You are in a good position to be independent on this point, Chair.

**The CHAIR** — Your opportunity to talk.

**Ms SHING** — Thank you, Chair, at last! Thank you for your submission to this particular inquiry and for coming along today to provide oral evidence to assist us with the terms of reference. I would like to take you again to part 3 of your submission, in relation to determining variations and the way in which variations might usefully be calculated to assist the implementation of the policy and to achieve, to the best possible extent, compliance with or achievement of the principles you have come up with in the document that has been circulated to the committee today.

In talking with smaller councils, which would include regional councils, including in Gippsland, the area I represent, I would like to get a sense from you of the way in which councils have couched their concerns around the need to access the variation process, to have that conducted in a timely fashion and in a way that enables them to get an outcome that takes account of their individual circumstances and of current and future needs on the one hand whilst not presenting a huge wall of work for them to have and perhaps at the expense of the business as usual that takes up their resources currently.

**Dr BEN-DAVID** — We spend a lot of time talking to a lot of councils, large and small, but particularly the small councils. I think we have to be a little bit careful before jumping to conclusions around small councils. I have not done detailed analysis, but my impression in talking to them is that they are the most innovative, probably the most efficient and quite probably the most accountable local councils in the state. They are familiar

with working in very tight circumstances. While they are I suppose struggling with the idea of a rate cap, that is not necessarily equivalent to what they are struggling with overall.

When I presented at a conference hosted by the VLGA — the Victorian Local Governance Association — a few months ago, as we were discussing this and as they were expressing their concerns about the rate cap, I said, ‘All right, well, what if we made your cap 20 per cent?’, and there was like this silence in the room because it just highlighted the fact that the rate capping framework itself, even the variation process itself, is not the core of their problem.

**Ms SHING** — To extrapolate upon that point, what is the core of their problem?

**Dr BEN-DAVID** — The core of their problem is their long-term financial sustainability or viability, and that is not something, as I said in my opening remarks, that is caused by the rate capping framework or something that can be dealt with by the rate capping framework. While the variation process that we have designed to deal with their circumstances, as well as anybody else’s circumstances, does not discriminate in favour or against any particular council, it does try to minimise the burden on all councils, not just the small councils. As I said, my impression — and this is purely an impression — is that other than maybe resourcing the work that needs to be done they will probably have the least trouble in demonstrating the requirements of the framework, because they are already there. They are already operating quite efficiently if not very efficiently.

**Ms SHING** — In putting those views to them, which I suspect may have become apparent in the course of the consultation process, what has been the response from those councils, in particular those rural and regional councils, around the innovative work they are already doing on the one hand versus the broader challenges of financial viability when the squeeze is on from funding sources at both a state and a federal level?

**Dr BEN-DAVID** — I guess we just have a mutual agreement when we have that discussion that these are bigger problems that, as I say, cannot be solved within the framework itself. Where there is a touchpoint between their issues and the framework is the resourcing or the effort that needs to go into producing a variation application. The question is: how is that dealt with? I think there are really only two options. One would be, as we mentioned in the draft report, around the government either providing or coordinating additional support for those small local councils, but that is a policy decision, not one that we can implement.

The only other way would be to deal with it through the rate cap itself, where those councils could be given a slightly higher rate cap. Let us say it costs \$50 000 to put in an application. For those small councils that equates to about a 1 per cent above-the-cap increase, so it is another option to give them that 1 per cent. We felt that we could not make that recommendation, because we felt that was a policy question rather than one of regulatory design, because it comes down to whether those ratepayers should face a 1 per cent higher rate cap than everybody else. We felt we were not in the right position to make that recommendation, so we have highlighted that that is a consequence or an option, but we have not sought to resolve that.

**Mr DALLA-RIVA** — Thanks for your presentation. Can I go to draft recommendation 4 and get some clarity? I always found this interesting when I was in PAEC, the public accounts committee. When we look at your rate cap formula as proposed — bear with me because I am seeking clarification in the first instance — the rate cap is going to be 0.6 times the rate of increase in CPI, where CPI is DTF’s forecast published in December each year, plus 0.4 times the rate of increase in the wage price index, which is DTF’s forecast published in December each year. As I said, as a reviewer of the budgets over many years in this place, DTF to the best of their ability never get it right.

**The CHAIR** — They are hopeless.

**Mr DALLA-RIVA** — They seem to be their own unelected entity.

**The CHAIR** — It is fantasy land.

**Mr DALLA-RIVA** — I put these as examples. In December they may say that the percentage of CPI is 2 per cent in the forward estimates, so everyone works on that basis. Then after the event the rate capping is assessed at 2 per cent and whatever the wage price index may be — let us say that does not change — but come later on it is actually identified that it was 3.2 per cent, so you have basically crushed councils by a percentage. I am aware that it can work the other way — it could be 3.2 and go back to 2 — but I am trying to work out how

in your recommendations you do not have issues where the CPI ends up being well above what DTF have projected and the WPI ends up being well above what DTF have projected. Therefore what compensatory elements have you proposed, or are there any recommendations about compensatory adjustments after the fact?

**Ms SHING** — Noting that DTF use very different variables to the ABS as well. That is an important point to make.

**Mr DALLA-RIVA** — I am just going on the recommendations — and the other thing is I do not know if you have seen the submission by the property council. They had a suggestion in respect of trying to maybe look at it retrospectively and say, ‘Okay, the CPI was X in a previous year, then that is what the adjustment should be for the forward estimates’. That way there is a real figure. Do you wish to respond to my statement, and how you are going to deal with those concerns?

**Dr BEN-DAVID** — Okay, there is quite a lot in that, so I will just work through that. Dare I speak ill of our brethren in DTF — you are right; they never get it right. The good news is they never get it right in the same direction; in other words they under and over forecast pretty much equally.

**Ms SHING** — Lately they have been over.

**Dr BEN-DAVID** — You are right; there will be swings and roundabouts on that. We did look at options around under and over forecasting and whether — in our world we call that a true-up. At the end of the year or in the following year you might try to come back and correct for any misforecast in the previous year. It became extremely complicated, and one of the principles we always set out in designing this framework to adopt was simplicity. We did talk to councils about this, and in fact the feedback was they could live with that risk. They were not uncomfortable with bearing the risk of unders and overs, provided they were within reason, of course.

In terms of the DTF forecast — I have to be very careful here — it was not as clear as it should have been in the draft report. They are actually not what is called headline CPI; they are underlying measures of CPI. They will end up being much more stable than the headline CPI because they take out the more volatile elements. They can under and over — you are absolutely right, but the volatility is much less because they abstract out those volatile elements. It was not a big problem for the sector.

We also spoke to the sector quite extensively about backward versus forward-looking measures the CPI and WPI, and in fact other measures. From councils themselves — and this is at the CEO and CFO level — there was overwhelming support for forward-looking measures rather than backward-looking measures. The problem with a backward-looking measure was we were setting it in December of the year prior to the cap applying — what is that, seven months before the cap applies? — we would probably be using the September or July actuals from the ABS, which means that the figures we were using would be seven to nine months out of date by the time they took effect. They were much more comfortable with a projected or a forecast measure of these indices.

It then came down to, ‘Well, which one do we use?’. There are a few out there. We looked around. We felt the DTF ones, particularly because they looked at underlying inflation, were as reliable or as unreliable as pretty much anybody else’s, and that is why we settled on those.

**Mr DALLA-RIVA** — The community’s expectation, then — they would assume that CPI would be a fairly straightforward process, so if you get your rates notice, it would make sense. But there is a level of complexity that now seems to have come in in the assessment you are trying to put forward that may be somewhat confusing to the broader population. When they get their rates, you have got this 0.4 times WPI, a 40 per cent weighting, a 60 per cent weighting and then the CPI is not necessarily — I am just trying to work it out for the simplicity of what it was meant to be as opposed to what is suggested in recommendation 4. Would that be a fair assessment?

**Dr BEN-DAVID** — I cannot comment whether it is a fair assessment, but without doubt the policy and the outworkings of the framework will need to be communicated clearly. I do not expect we will be tasked with that communication task, but if we are, we will certainly work with government and with councils on how to make it very clear each year how the cap is set, how it applies and what councils need to do if they think they cannot work within that cap. But in general terms we are not a communications outfit. What we were trying to do was

design a framework that we felt was fair to all the parties and, as I said in my opening remarks, balanced all the different tensions that we had to balance. This is the best way we felt we could achieve that.

**Mr LEANE** — Not long ago the chair of this committee said that you know well his position on rate capping. If that is the case, could you tell us what is the opposition's position on rate capping so all the rest of us might know? You do not have to answer that.

**Dr BEN-DAVID** — Thank you.

**Mr RAMSAY** — You did not really want a response, did you?

**Ms SHING** — Yes. We would all really, really like to know.

**Mr LEANE** — If that is the case, it would be fantastic.

**Ms SHING** — The chair said he loves it, but now he will not comment on it.

**Mr LEANE** — I do not think anyone knows, but anyway. In the draft recommendation 2 in the third dot point you say:

service rates and charges should not be included in the rate cap —

and you give an example in the body of your submission that they might be garbage rates et cetera —

but be monitored and benchmarked.

Could you expand on what you mean about monitored and benchmarked?

**Dr BEN-DAVID** — Yes, okay. We had to work out in the terms of reference to what would the cap apply. As you would be aware, councils have various different funding sources, and we looked at the different ones. When we got to the service rates — and this is, I think, almost exclusively if not fully exclusively garbage or waste disposal charges that they levy on their ratepayers — what they told us was that most of these rates are set in line with the cost of delivering the service. So it is not used as a general rate base. It is just this is what it costs to deliver these services; therefore we translate it into a rate, and we apply it to all our ratepayers. A lot of them also told us that they procure this competitively or externally through the market. We did not have the time or the capacity to test those claims that were made to us, but we did take them at face value. We felt that if what they told us was indeed right — that these were cost-reflective and market-tested charges — they did not need to come under the cap, because they were probably as close to the efficient cost of delivering those services as possible. We took it at face value, but that is all we could take it at, given, as I said, time frames and other limitations.

What we recommended in the draft report was: let us exclude them from the operation of the general rate cap, but we need to go back and test those claims around whether these really are efficient costs. So that is what the monitoring and benchmarking go to — making sure that these are indeed the sorts of fair and reasonable costs of delivering these services, that they are not padded with other costs that have been loaded on, and therefore being used as general rates. We could not solve that question in the time we had, so we said, 'Let's exclude them from the rate cap. Let's come back and look at that in more detail when time allows'.

**Ms BATH** — I would like to draw your attention to your principles guiding development of the rate capping and variation framework. Principle 1 states:

Local communities differ in their needs, priorities and resources.

I would like to give you an example of how they do very much differ, and I will walk you through two examples from the 2014 rates income. The city of Stonnington has an area of approximately 26 square kilometres. For a residential house or property valued at \$800 000 the City of Stonnington collected in 2014, \$962 for that property. If we go down to the shire of South Gippsland, which has a value of approximately 3300 square kilometres, the rates collected for a property worth \$800 000 were \$4400. It is the same value property, but the rate charge is fourfold on that. I will just finish on that example where the council rate income for Stonnington is a bit over \$98 million and for South Gippsland shire it is \$38 million.

**The CHAIR** — How many people?

**Ms BATH** — I cannot give you the number of people. I can give you the number of assessments. The number of assessments for Stonnington was 58 000. By comparison, there were 19 000 in South Gippsland. You did highlight that country councils are creative or doing great things with tight budgets. There is an example of how tight the budgets are. My other comment is that country councils — and you will know this — have far more limited resources to access further charges. They do not have parking meters and the like — or they are reduced. We have a lot more, loads and loads more, roads and bridges, and we have cut the country roads and bridges program under the current government. I guess my big issue is that there is a big differential in terms of finances. People in country areas — and I am just using South Gippsland as an example — still need the same level of services, whether they are living in Stonnington or South Gippsland.

We spoke also — and I will get to my question in a minute — to people in Torquay, in western Victoria and in Sale, and asked the CEOs and mayors about applying for variations. A number of them said that the procedure is going to be arduous, financially, again, another burden and time consuming. Some of them just did not know if the net result was worth it. I know Ms Shing bought this up to some degree as well. My point is that you are talking about a single cap, but many of the councils would prefer to be rated differentially. What have you to say in response to those comments?

**Dr BEN-DAVID** — That is another question with a huge amount of — —

**Ms BATH** — It was a bit of information there.

**Ms SHING** — Just in 15 words or less, if you would not mind.

**Ms BATH** — I was highlighting the difference.

**Dr BEN-DAVID** — The issue of I suppose we could call it the distribution of the burden of providing services across the state was not something that was in any way within our terms of reference. The two comparisons of Stonnington and South Gippsland and looking at the different burden placed on those councils to deliver services was not within the realm of what we could do. Maybe I am speaking a little out of school, but to the best of my understanding an attempt to equalise across councils is something that the grants commission is charged with doing. It is a different task to ours. How effective that is I do not know, and I am not even going to try to comment on that. But that is an equalisation process, or an attempted one, whereas there was no suggestion that the rates capping framework was ever going to be that.

Things like the need for the same services and minimum services or minimum standards is not something that was in the realm of our work. Whether it is something that is addressed through the review of the Local Government Act will be up for others to comment on, but it is not something we could look at.

What we did feel though is that the variation process that we have outlined, as required in the terms of reference, does provide each and every council with the right to come forward with a claim if it feels it has a legitimate claim. We made it very clear that there should be no automatic process. Some councils asked — and not just councils — some submitters said, ‘Well there should be some automatic thresholds. If something happens, we automatically get a rate rise’. Again, we looked at that, and we started compiling a list. Now no matter how long a list you compile, you are never going to get everything. The problem is that even if you do compile a list, in the implementation it comes down to arguing over definitions. What constitutes a fire? What constitutes a flood? What constitutes anything? We felt, why get into those arcane debates? Rather, let us just have the framework that is as flexible as possible so it can account for all different circumstances and allow each one of those applications to be considered on its merits. Conversely, at least in the draft report, we did not recommend that there should be any automatic disqualifications for an application. So again the whole idea was we wanted to make it very much on the merits so each council can come forward.

In terms of the arduousness of the variation process, I suppose I will just reiterate my earlier comments that we have piggybacked the framework on the existing processes — internal and external — that councils already tell us that they apply. I actually know South Gippsland, that they have a very detailed financial model; in fact, I think it goes out about 10 or 12 years and that includes their budgeting and their asset management. Councils have been very strong in making it clear to us that they consult very heavily with their communities. Now if they do all that, if they can show that they have support, or at least they have addressed the concerns of their



communities in making an application — that they are budgeting, that their asset management systems and their strategic resource plans all take into account these requirements — it is just then a matter of pulling out that relevant information and submitting it to us. So we have done our best to minimise what you refer to as the sort of arduousness of the variation process. Self-evidently, it will still impose some obligation on them — we cannot not do that — but we have done our best to make it as small and as non-arduous as possible.

**Ms DUNN** — I thank you both for your submission today. There are a couple of things I want to cover off on. Just taking up the issue not only of those small councils — who I believe earlier you said are already operating efficiently — there are a number of councils who have already undertaken efficiency drives in terms of trying to keep their rate rise as low as possible and respond to community needs. I note in the rate cap formula that there is an efficiency factor to be applied within that formula. So I just wonder, in terms of the small councils who are already operating efficiently and those other councils who are already on efficiency drives, what does the future look like to them? How do they fulfil that efficiency factor when they are already well and truly on the journey?

**Dr BEN-DAVID** — I will have to check with the Hansard transcript, but I think what I said was my impression was that they are operating efficiently and innovatively and accountably in terms of their communities. So it is an assertion, and it is one that we have not, in the limited time we have had, actually done an efficiency review of the different councils, but in my discussions with them that was the impression I walked away with.

The efficiency factor actually goes back to the Chair's question around the design of the cap, and Mr Dalla-Riva's question as well around CPI and the inclusion of the WPI. The efficiency factor plays a few roles here. The first of those roles is: if the policy, as stated in the terms of reference, was to take the CPI as our starting point for the government's policy intentions, we felt that the problem with just imposing a CPI cap from day one was that it slams the brakes on. These are councils who have been increasing rates — I am not talking about the small councils in particular now; I am just talking in general — 6, 7 per cent year in, year out for quite a few years. We felt that if we suddenly said, 'Right, we're down at 2', or even less, 'per cent at CPI', that that would have the effect of slamming the brakes on. Councils, like any organisation, will have some financial inertia. They will have contracts in place, all sorts of different contracts. So we felt that we had to allow for that. And that is really the effect of the inclusion of the wage price index. It is to allow for the fact that some of their costs cannot just be reined in straightaway.

The efficiency factor — I am getting to the question — offsets that a little bit. Whereas the wage price index allows them something above CPI, the effect of the efficiency factor is to bring that back to CPI over time. The efficiency factor in the first year actually starts at zero, then in the second year it is 0.05 per cent and then it goes to 0.1 per cent. The effect of that is to bring the overall rate rise back down towards the CPI. Now we do not know what the final efficiency assumption should be around local government, large or small. That is why we have recommended, at least in the draft report, that we undertake a very detailed productivity study of the sector — we do not think anything like that has been done before, at least not in Victoria — and we try to work out what is the appropriate long-term assumption around the capacity of councils to be efficient or more efficient than they might be at the moment. In that analysis we would open the lid on: is there a different set of assumptions or findings that you make for different types of councils, whether it is small or large, interface or regional cities? I have no prior view on what we will find, but we need to do the work because we do not have that knowledge.

The idea of the efficiency factor, I think, is also important. We made this clear — I said it quite openly when meeting with councils — that it is there to send a strong signal that they are meant to be looking for efficiencies in their operations and returning that to ratepayers. That is what the efficiency factor does — it returns those savings to ratepayers. When I said what I am about to say to them, they never disputed this. I would say to them, 'Surely you have internal efficiency or productivity factors that you apply just as your normal day-to-day management that would be well in excess of 0.05 per cent'. They would be 1 or 2 per cent. I wish I could operate under a 0.05 per cent efficiency factor. The effect of the efficiency factor is really just to return that to customers. To be frank, it is as minimal as we could make it while still providing a strong signal — 0.05 per cent is 5 cents in \$100. That is what it adds up to. For every \$100 they spend it is looking for 5 cents of savings, which we thought was pretty modest. But where does it end up in the long term? We do not know — and again, small, large or any other council — and that is what this productivity analysis will help us uncover. That will be a completely open process.

**Ms DUNN** — That productivity study that you mentioned is work that is going to happen?

**Dr BEN-DAVID** — Yes, subject to the government asking us to go ahead and implement the framework, we would see that as part of the work program — probably within the first two years.

**Ms DUNN** — So in terms of what you have said to the government, that is part of your recommendation: that that work is undertaken.

You talked about monitoring outcomes for unintended consequences and also talked about deterioration of services and possibly infrastructure — because I did not quite hear all of that commentary. I am just wondering if you have any views on what that looks like in relation to that monitoring, because I am assuming in order to really assess the deterioration of services you need to have an extensive knowledge of what is happening in the current provision of services and infrastructure in order to measure whether there is any deterioration. I am just wondering if you have got any thoughts on what that looks like.

**Dr BEN-DAVID** — What we have recommended as part of the framework is that there be two forms of monitoring. One, which does not go to your question, is monitoring against the rate cap — so, did they meet the rate cap or any approved variation above the cap? That is a pretty straightforward task that we would do each year. The second one is what we call an outcomes report, where every year or maybe every couple of years what we would do is we would gather all of the available data from the sector, or from and on the sector, and we would match it with the rating data that we have been responsible for. We would try to see: what is going on out there? What patterns can we discern? What can we see? What we were strongly alerted to by council and others as we embarked on this review was what was called the New South Wales problem. New South Wales, I think it was 37 years ago, established a rate capping framework. It was a very crude framework, and what happened was councils subsequently chose not to raise their rates above the cap — go through the variation process — but they cut their clean infrastructure. The proverbial hit the fan, but it took some decades for it to do that, and we were very conscious of that. So the monitoring framework is really there to use available information to try to find out what is going on in the sector in terms of investment, infrastructure, maintenance of infrastructure, renewal of infrastructure, delivery of services and new services or abandoning of other services that might no longer be needed, so that we get a much clearer picture of what is happening out there and so we do not have to wait decades to find out whether there is a problem or not, by which time it is usually too late to do anything about it.

At least initially we intend using existing data sources. Again the aim was to not impose or create new obligations on councils. We said, ‘Let’s use existing data sources’, whether it be the Auditor-General’s data, whether it be the grants commission data, councils’ own data or the departments developing a service reporting framework, which we would also draw in. There is the community satisfaction survey. So there is a lot of information, but it sits in very disparate places at the moment. Our aim was to bring it together so we could get an overall picture. The question then becomes quite interesting: what does that mean? Because if we detect through that exercise that councils have not been increasing their rates but their infrastructure has been deteriorating — i.e., the New South Wales problem — what does that mean? It is a really interesting question — one that goes beyond my remit — but I think we have got a governance problem on our hands then: that rather than do the work to get a rates increase above the variation, they have chosen to — —

**The CHAIR** — The costs might be too high as well.

**Dr BEN-DAVID** — Again, that is something that we have addressed elsewhere. We need to know — when I say ‘we’, the community needs to know — where that is happening, and that is why we think the monitoring framework is very important. It is something they still do not have in New South Wales.

**Ms DUNN** — Is that an annual process, that outcomes report?

**Dr BEN-DAVID** — I think in the draft report we said ‘annual’. That might be a little bit too frequently. Things do not necessarily change that quickly. As long as it is not too infrequent — whether it is every year or every second year — I think that is the main issue.

**Ms DUNN** — Should that be adopted by government? Do you believe the Essential Services Commission is properly resourced to undertake that work?

**Dr BEN-DAVID** — I think it should be adopted, to answer the first part of the question. I had this image of a three-legged stool: you have got the rate cap, you have got the variation and you have got the monitoring. You do need all three to work — they balance each other out. In terms of resourcing, we are working with Local Government Victoria and the Department of Treasury and Finance on developing our budget bid to support this work.

**Ms DUNN** — I imagine that is a fair bit more work for the commission, so you would need some additional resourcing.

**Dr BEN-DAVID** — It is a fair bit of work. Because it is using existing data, once we have established the framework — once we have established how we collect the data and how we store it — the hard work is actually working out how you report it in a way that is easy for people to understand it. We have not done that work yet, but we will start investing in that in due course.

**Ms DUNN** — Thank you. I am sorry, can I just ask one question on variation? It is a quick question, so hopefully it is a quick answer. Really I just went to get an idea: is there any thought or criteria around is it about discrete projects, is it about capital works, could it be for general services or operational matters, can it address things like cost shifting? The flexibility within that, have you given any thought to it?

**Dr BEN-DAVID** — One of the shortcomings of the draft report in the variation process was that we were recommending basically an all-or-none approach in terms of either we accepted the entire application or we rejected the entire application, in which case the rate cap would apply. In our discussions with lots of people over the course of the last few months we felt that was probably a little bit harsh, and so now we have given thought to whether you could have ‘Accept it all, except that project’ or ‘Reject it all, except that project’.

**Ms DUNN** — So you can pick and choose.

**Dr BEN-DAVID** — Yes, a bit more flexibility. If everything is pretty good, but there is one project that looks a little bit undercooked, we could accept it all, except that project; and then of course the council could return the following year with better detail of that project.

**Mr RAMSAY** — I want to refer to evidence we collected from a number of rural councils which were under the previous government receiving the \$160 million country roads and bridges program — a million dollars per rural council.

**Ms SHING** — That was before the feds cut \$200 million, but anyway.

**Mr RAMSAY** — You have had your turn, if I could have mine, thanks, Ms Shing. I just want to parrot the mayor of Colac Otway shire, who sits in or represents the seat of Polwarth. He indicates under the current model you are proposing in your draft report a loss of income of half a million dollars in the first year, then consecutively \$35 million over 10 years without additional support. They put a submission in talking about a cap that recognises the capacity of revenue earning in rural councils as against metro, and you have made no notation of that in your report. So while you have indicated, yes, you will provide exemptions on garbage, and not only garbage but fire services levy, landfill levy and other service matters, which might include parking fees and other things that metro councils do have a capacity to raise revenue from. I do not see how the impact of your proposal in relation to rate capping is a fair and equitable balance in relation to rural councils that are losing significant important funding by the current government policy and also the lack of opportunity to raise revenue. I do not believe your recommendations have provided that sort of recognition to those rural councils, as against the metro councils, in relation to a capacity to provide services against capacity to raise revenue under the cap.

**Dr BEN-DAVID** — There is a lot in there. I do not want to be a commentator on the grants funding issue, but we did have a look at the reduction in the financial assistance grants.

**Mr RAMSAY** — You have already mentioned that. And I will also say the federal government provided supplementary grants to fill that void to those councils.

**Dr BEN-DAVID** — That is right. That is the point I was going to make. The Roads to Recovery funding actually exceeds what was cut, from what I understand; however, the point you make is an important one, because that does not necessarily benefit all councils equally. Some councils do well out of that; some councils

do not do well out of that. I cannot comment on how they have distributed that, but again we feel the variation framework allows those councils to come forward to us and say, 'Hey, we've got a problem here'.

In that sheet we handed out is principle 5. What I did not mention is that we have consulted on these principles, and there was no serious objection to them at the very start of our work. Principle 5 is: 'Rate increases should be considered only after all other viable options have been explored'. In the case of a small council, which you mention, they will not have a viable option to explore in terms of alternative funding sources — roadside car parking and that sort of thing. Really it is a matter of demonstrating to us that they have got no other option and that they do need to raise rates in order to fund that infrastructure. Again, we thought it was just too difficult to address these things in the rate cap itself. We felt it was far more efficient, given the basically 79 different sets of circumstances out there, to deal with it through the variation process.

**The CHAIR** — They are statewide cuts though.

**Dr BEN-DAVID** — But statewide cuts fall unevenly.

**The CHAIR** — I know you do not want to talk about that, and that is unfortunate.

**Mr RAMSAY** — It is a timing issue for a lot of councils. If the bureaucracy process for variation requests is so long that they cannot time their pre-budgets, councils are not going to bother applying for the variation; but that is another argument in relation to how it is streamlined.

**The CHAIR** — Simon, thank you. We thank you for your submission, and we may need to have the secretariat talk further in the next period.

**Witnesses withdrew.**