How IPART Incentivises Poor Financial Management and Lower Productivity

As a pricing regulator, IPART exists to protect ratepayers from monopoly pricing. Unfortunately, it is failing in this objective because of the way it interprets OLG regulations on Special Rate Variation (SRV) applications from local Councils.

IPART's methodology is flawed because it places too much weight on the "financial need" of Councils. It should look more closely at what has created the "financial need" in the first place.

Central Coast Council (CCC) is a good recent example. CCC freely admits its "financial need" was caused by its own financial mismanagement.

So, in approving a 15% rate hike for CCC, IPART was effectively telling Councils that financial mismanagement creates "financial need" which in turn unlocks IPART's criteria for a rate hike. IPART's methodology therefore incentivises financial mismanagement.

IPART uses the Operating Performance Ratio (OPR) to measure financial need. The OPR, however, is really a measure of how well a Council manages its finances. All a Council has to do is increase its expenditure to unsustainable levels and the OPR turns negative – thereby unlocking IPART's criteria for a rate hike.

IPART is also incentivising lower productivity.

Productivity is a quantifiable measure of output per employee. Yet, even though it is one of the five IPART criteria, Councils are not required to produce quantifiable measures of productivity (output per employee) in their applications for SRVs.

All Councils have to do is to provide isolated examples of cost reduction initiatives (which may well have been dwarfed by other cost increases not mentioned in their submissions), without providing any overall measure of output per employee.

Again, CCC is a good example. Even after their recent staff cuts, half of which were vacant or unfilled positions, they still employ more staff - approx. 2000 according to their latest Operational Plan approved on 29 June 2021 - than before the merger (1875 according to the Administrator's 30 day report). And CCC is providing fewer services given all the recent service cuts.

So, CCC is providing fewer services with more staff than before the merger which means their productivity has fallen. How can providing less service with more staff justify a rate hike?

In approving a 15% rate hike for three years, IPART argued that CCC would have a breathing space to work on productivity and efficiency initiatives whilst being free to apply for a further SRV if these measures aren't effective.

But how on earth do you incentivise productivity improvements by telling Councils if they fail to deliver such improvements they will qualify for a further rate hike in three years based on "financial need?"

IPART is incentivising low productivity. No wonder CCC has totally ignored the three year limit on the SRV and produced a long term financial plan, approved on 29 June, that assumes the 15% SRV will be made permanent when the three year period expires.

CCC has effectively approved a long term deficit budget that only balances on the assumption that IPART approves further rate hikes. CCC will run out of cash sometime in 2024/25. It is intentionally creating financial need to game IPART's OPR assessment.

And it's not just employee numbers. IPART is also incentivising a nose in trough culture at senior management level.

Senior management salaries and other perks are going through the roof because Councils know such expenditure makes rate hike applications more likely because of the negative impact on their OPRs. Executives can game the system to subsidise their life styles.

The CCC Administrator's report shows that between 2017 and 2020, CCC's employee numbers increased by 242 or **12.9%** (1875 to 2117). Yet, over the same period, employee related costs rose by $55M or 33.1% (166M to $221M) = $55M or **33.1%**

The fact that employee costs rose three times as much as employee numbers suggests increased salaries and perks at Executive and Senior Manager level. More and more higher graded and higher salaried staff. And none of this feeding through into any measurable improvement in services for the community. Yet IPART is incentivising this nose in the trough culture.

Possible Reforms

1 Interpret the “financial need” criterion as non applicable where a Council is deemed to have ***intentionally*** created financial need. For example, CCC has set a long term deficit budget with the aim of turning its Operational Performance Ratio (OPR) negative from 2024/25 thereby unlocking the “financial need” criteria for a rate rise.

2 Require Councils to produce quantifiable measures of productivity (output per employee) and annual targets for productivity improvements. SRVs should not be granted where Council’s have failed to increase productivity (on the basis they don’t need additional rate income if they can improve the OPR through productivity slack).