



19 July 2019

Independent Pricing and Regulatory
Tribunal NSW

Contact: Andrew Glauser
Our Ref: DOC2019/070782

**Lodged online via the IPART
submission portal**

http://www.ipart.nsw.gov.au/Home/Consumer-Information/Lodge_a_submission

To Whom it May Concern

SUBMISSION TO CONSULTATION BY IPART ON REVIEW OF COSTS OF CONDUCTING LOCAL GOVERNMENT ELECTIONS

Cessnock City Council (Council) welcomes the opportunity to lodge a submission regarding the above proposed reforms contained in a draft report dated 25 June 2019 (the Report).

Council commends the Independent Pricing and Regulatory Tribunal NSW (IPART) on attempting to scale down the budget request that was originally proposed by the NSW Electorate Commission (NSWEC), from a 60 percent increase down to a 30 percent increase in costs for local government. Having noted this, Council strongly objects to IPART's recommendations on the basis that the increase in costs is simply not justified and nor are the benefits noted in the Report.

Although the Report indicates there are efficiency gains which will benefit councils the end result for most councils, including Council, is a substantial increase in the election costs estimated likely to be incurred by NSW councils for the 2020 local government elections. The increase in costs appears to be a combination of increases in staffing costs which are difficult to justify, a diversion of scarce local government funds to support school funding, and cost shifting through the allocation of costs which in some cases appear to have a tenuous link at best to the cost of actually running local government elections.

The elements of the costs and the new recommended allocation method will be addressed by component later in this submission however there is possibly a more fundamental issue that needs to be addressed first. The intent to promote competition and fully distribute costs might actually add to the overall costs of providing election services across state and local government entities (when taking a systems view and combining the costs incurred across both NSWEC and billed by private service providers). Such an outcome clearly is not desirable and would justify in itself a rethink of the proposed model.

It appears the philosophy of fully distributing costs has been assumed as the best model. Significant discussion is presented of the need for competitive neutrality and the need to promote competition (with a view probably of a number of, possibly many, councils electing

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to use private service providers rather than the NSWEC). The belief is that this will create competition and in the process should over time reduce costs to councils.

It appears analysis has focused on determining costs in a static scenario (considering 2020 alone) rather than considering the implications into the future. A simple example will be provided below of what might happen over time. Based on the example provided below, we submit that financial modelling should be completed of the possible implications of the proposal over time based on more councils electing to use private service providers.

The material on the IPART website associated with competitive neutrality supports a more flexible approach and recognises that the allocation methodology needs to consider context. The document "*Policy Statement on the Application of Competitive Neutrality*" (**Policy Statement**) authored by NSW Treasury is referenced and has a link on the website. Pages 15 and 16 of the Policy Statement acknowledge that "full cost attribution" covers a range of costing methodologies including marginal or variable and avoidable costs.

The Policy Statement recognises that private sector competitors will also apply similar methodologies in assessing whether to invest in business opportunities and determine pricing. The Policy Statement recommends that government agencies should have the same flexibility as the private sector and that actually using fully distributed costs could result in an agencies neglecting opportunities to efficiently supply goods and services. The Policy Statement does mention the approach should be restricted to possibly special circumstances. These circumstances do not appear to be documented however based on the apparent cost dynamics involved (highlighted in the example below) election services could well meet these circumstances.

Fundamentally if costs are fully distributed, there will be a significant increase in the cost to councils (for Cessnock in particular this would equate to a 61 percent increase).

Private entities will be able to more easily compete due to the higher price point. As noted in the Policy Statement, it would make sense for private entities to consider the opportunity by evaluating marginal benefit and cost as any gain will add to their profits (or enable them to spread their overheads across a larger revenue base) thereby lowering average costs.

The fundamental problem however is that a private entity could propose a price just sufficiently below the current cost to encourage councils to utilise this services but above the marginal cost to the NSWEC of providing that service. For each instance this occurs, the total cost to the State and Federal government of election services will increase and costs will need to be redistributed.

A simple example might assist to illustrate this point. Council will be charged approximately \$465,000 under the proposed approach. A private operator could tender, say \$400,000 (at least 15 percent lower and therefore attractive). The NSWEC however can only lower costs by, let say 50 percent (a combination of direct costs avoided and maybe some limited reduction in indirect costs?) which equates to approximately \$230,000. Therefore the total cost of providing the service has actually increased by approximately \$170,000. This could occur across a number of councils. The common costs that were previously allocated to Council will now be allocated across other NSWEC customers in effect increasing their costs and making NSWEC even less competitive as based on the methodology common costs are almost fully distributed. The cycle then continues. When some form of equilibrium is reached the State government and remaining councils (as noted below maybe rural?) will bear a much high burden of the common costs and it is quite possible the total cost of election services to both State and local government entities (provided by NSWEC and private operators) is higher than it was previously.

A key factor in this is that there is a significant component of fixed or largely fixed costs (based on the IPART analysis provided). As a result, there are clear economies of scale. By fragmenting the service provision, these fixed costs need to be replicated across each service

provider. There will need to be a high level of confidence that increased competition will more than offset these scar benefits. This is definitely not clear from the Report. In addition, we assume NSWEC will continue to provide services to State entities and there the common costs will remain in some form. It is noted in the Report that significant investment is required in systems to support increasing complexity - this adds to fixed cost and probably limits the number of entities that might compete in providing these services. An oligopoly might not achieve the level of price competition sought anyway. This structural limitation to competition might exacerbate the issue further.

As well as the other economics possibly being questionable, the playing field is clearly not fair. Government entities need to share information that other entities consider confidential such as cost and pricing data. In addition, government entities cannot choose their customers and might need to moderate pricing differentials to support equity. Private operators therefore have a number of advantages as they will have access to cost and pricing data for NSWEC and can price to undercut, and are better placed to compete knowing their competitor. They also could target specific councils which they think they can make greater profits on leaving other councils which are more challenging to provide the service for (possibly rural councils?).

Private operators could price differentiate. They might offer attractive pricing to attract councils and structure arrangements to make it harder to switch back to NSWEC. All these elements might mean there are some possible winners and losers and some of the losers might be councils that can least afford to have higher costs. However as noted above, from a sector perspective there are likely to be more losers than winners and an increased cost burden to the sector overall. In addition, State entities could also be losers as they increasingly have to incur a larger portion of the "common costs"

In summary, the cost allocation methodology raises many questions that clearly need to be addressed before being finalised. Time will of course indicate whether a fully distributed costing approach is the best option. Any assessment in the future should include the collective cost of elections to State and local government entities from both NSWEC and private operators. If NSWEC costs per elector increase over time it would probably be appropriate to consider the loss of scale as a possible factor.

If the above analysis does not raise fundamental questions regarding the allocation methodology there are other more specific concerns with the individual components proposed to be charged. These are covered in the rest of this submission below.

Specifically Council makes the following observations:

- Based on the IPART recommendation, the bill to CCC for the conduct of elections would increase 61 percent, from \$288k in 2016 to \$465k in 2020.
- Although IPART highlights efficiencies as one of the outcomes, the increment in actual costs (like-for-like) appears to be higher than inflation and with the allocation of many other costs to councils, the cost to each council is substantially more than the original proposal from NSWEC (which is estimated as a 29 percent increase for CCC).
- Although IPART has challenged NSWEC costs in a number of categories there is minimal difference in overall costs considered across 2016 and 2020.
 - Despite election staffing costs being pared back from \$23,397k to \$18,749k there is still a substantial increase of 30.3 percent or \$4,363k (from \$14,386k in 2016). This appears to be difficult to explain in a low inflation environment with both wages and CPI being typically less than 2 percent per annum and population growth approximating 1 percent across NSW. As noted in the Report, there has been no difficulty in past elections in fully staffing to support the process in prior election cycles so an increase in wages does not appear warranted and places an extra burden on councils.

- The increase in venue procurement of 24.9 percent or \$800k across the State appears equally difficult to justify. Schools are a key contributor to venues and in the past have received fees in accordance with how schools charge not for profits that use their facilities. The Report appears to recommend that a market based approach should be followed. Councils are clearly identified as part of the not-for-profit sector and therefore the historic basis of charging would appear more equitable. In effect, this results in local councils now contributing to the funding of the State education budget through a profit or market driven pricing model. This constitutes more than cost recovery and is resulting in schools receiving a profit component from local councils.
- The most substantial contributor to the additional cost is the identification of a number of general or derived costs (based on various assumptions) which result in almost \$10m (or \$9,978k) in additional costs being borne by councils. The review appears to have identified any possible factor to maximise the costs that could possibly be transferred to councils. The items identified are as follows:
 - Corporate overheads (electoral management fee), estimated as \$3,808k for 2020, was previously borne by the NSW Government and will now be borne by councils.
 - A series of costs not previously identified for on charging such as executive salaries and asset depreciation, can be considered a form of cost shifting. The NSW state government will have budgeted for these costs and incurred these costs in the past. This is in effect creating “cost savings” to spend in another manner by transferring these costs to councils (without any financial compensation). The argument that on a ‘per council’ basis the cost is not significant does not address that approximately \$8m in costs have been added to NSW councils for no particular benefit and that cost shifting needs to be considered in aggregate (i.e. with other changes which have a financial impact).
 - The cost being billed to councils is now including the funding costs for the net book value of investment in assets, working capital and the tax allowance. These are costs which as noted below are probably not a budgeted cost for the NSWEC or recognised in the tracking actual costs. These cost items require a more detailed review (covered below) however CCC believe they should not be charged to councils.

These costs are not of a proportionate or incremental nature. A number of these costs might not vary significantly (for example executive salaries or systems related costs) or if they do, they would not vary in proportion to the support of the local government elections.

As noted above, the additional costs assigned to councils relating to funding costs (return on assets, Weighted Average Cost of Capital (WACC)) and the tax allowance specifically warrant further assessment. The Report suggests that all of these costs (including the recognition of a tax allowance despite the NSWEC not incurring a 30% tax) is required for the purposes of ensuring competitive neutrality. This approach however might have some inherent issues and consequently might not be equitable or actually assist achieve the objectives sought.

- The first is that there can be a multitude of considerations which are impossible to determine in trying to create a level playing field and some of these considerations favour private entities. It is therefore not possible to formally normalise the comparison. Some examples include private competitors having multiple businesses which cross-subsidise their costs; they might be leveraged resulting in a substantial part of the net revenue before funding costs being funded with debt which is deducted prior to being taxed; the competitor might have a different operating model which reduces assets held that in turn would result in them not having equivalent costs or as is often the case with many private entities a competitor might have established tax effective structures to reduce tax. In addition, government functions might have imposts or obligations which add to operating costs and these costs are not incurred by private entities.

In effect there are many considerations which would need to be considered to try and normalise and it is probably not possible to identify all of these considerations and make adjustments for them. On this basis it is probably best to not factor in costs particularly when they are not actually incurred. In theory, considering certain costs might appear justifiable however in practice and considering the broader picture the approach might be questionable.

- The NSWEC appears to process the electoral activities of the vast majority of NSW councils. Based on a review of the table provided only 7 councils were identified which do not use the NSWEC. This then results in the perverse situation that the remaining councils (approximately 95 percent) are incurring millions of dollars in cost collectively on the basis that this supports fairer competition. This is millions of dollars that ultimately ratepayers will incur. This includes being charged for costs that the NSWEC does not actually incur.
- The NSWEC also undertakes other election activity (such as the NSW State government election). It is recognised the majority of the NSWEC costs are associated with non-local government activity. These activities will occur at different times and utilise these resources usually between local government elections. It is likely that the assets are sized to support sequential use of resources bringing into question whether holding costs should apply.
- The budgetary practices of the NSW State government have not been reviewed as part of the submission however it is considered unlikely that each State department or other government related entities budget the WACC associated with their assets or working capital. The NSWEC is probably similar in this regard. The Report indicated that 28 percent of NSWEC costs could be attributed to local government elections. By charging local government for funding costs and the tax allowance, councils in effect end up covering significantly more than the 28 percent of the NSWEC costs and in effect will be subsidising other “customers or users” of NSWEC services.

In aggregate terms, the costs allocated to councils have increased from approximately \$38m in 2016 to just under \$54m or an increase of nearly \$16m or over 41 percent. Approximately half of this cost reflects increases on a like-for-like basis, certainly not appearing to reflect any benefit from efficiencies and half the increase can be attributed to changes in cost allocation methodology. This has had a material impact on Council which like many other councils has to make difficult resource allocation decisions with its limited funds.

As noted above, Councillors and the Executive Management of Cessnock City Council believe there are significant issues with both the aggregate cost and the methodology used for charging councils for the upcoming election. A review of the approach considering the elements noted herein is seen as the most equitable option.

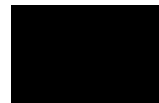
Cessnock City Council at the meeting of 17 July 2019 considered this matter by way of a Mayoral Minute and the resolution made is enclosed for your reference.

Yours faithfully

Authors:



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Manager Finance and Administration



Esmā Eftimova
Governance Officer

Encl: Council Resolution Mayoral Minute MM12/2019 - 17 July 2019

MAYORAL MINUTES

MAYORAL MINUTES NO. MM12/2019

SUBJECT: IPART REPORT - REVIEW OF LOCAL GOVERNMENT ELECTION COSTS - REQUEST FOR SUBMISSIONS

MOTION *Moved:* Councillor Pynsent

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RESOLVED

1. That Council endorse the draft submission to the IPART report recommendations, noting in particular:
 - the overall budgetary impacts for Council should it engage the NSW Electoral Commission for the 2020 elections, with the anticipated cost to undertake the 2020 election being approximately \$465,000 which represents an increase of over 61% on the costs for the 2016 election.
 - the Independent Pricing and Regulatory Tribunal on attempting to scale down the budget request that was originally proposed by the NSW Electoral Commission, from 60 per cent increase down to 30 percent increase in costs for local government.
 - strong opposition to the increased apportionment of the operational costs of the NSW Electoral Commission to local government sector, which represents a cost shifting exercise.
 - uncertainty around the ability and costs associated with engaging a third party to undertake the 2020 elections, particularly with the logistical and operational concerns experienced with past elections and interactions with the NSW Electoral Commission.
 - the impacts on Councils Operational Plan 2019-20 with an additional \$75,000 required to be allocated to reserve for the 2020 election and \$150,000 being required to be allocated in the 2020-21 Operational Plan.
2. That Council write to the Hon. Shelley Hancock MP, Minister for Local Government outlining Councils position and concerns with the cost shifting implications of funding the NSW Electoral Commission operations and the significant adverse budgetary impacts of the Independent Pricing and Regulatory Tribunal report recommendations for Council, and that Council forward a copy of the submission to the Shadow Minister for Local Government, Greg Warren MP and request meetings with both the Minister and Shadow Minister to discuss Council's concerns.
3. That a copy of Councils position and submission be provided to Local Government NSW.

FOR	AGAINST
Councillor Olsen	
Councillor Doherty	
Councillor Fagg	
Councillor Stapleford	
Councillor Fitzgibbon	
Councillor Gray	
Councillor Dagg	
Councillor Sander	
Councillor Lyons	
Councillor Pynsent	
Total (10)	Total (0)

CARRIED UNANIMOUSLY