RESEARCH & EVALUATION

Price Setting for Local Government Service Delivery: An Exploration of Key Issues

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Local governments in Australia are constantly seeking to raise additional revenue to fund higher service demands. One key revenue source is service fees and charges, including fines. Premised on the notion of user pays, service fees and charges represent a significant proportion of total revenue for many local governments, especially in New South Wales, Queensland and Tasmania. This exploratory essay addresses a number of key issues related to this revenue source in order to stimulate discussion and debate on matters which are presently under-examined in the literature. The article examines the philosophy underpinning price setting, the identification of the principles of price setting, the adoption of applicable price setting models, the need to adhere to National Competition Policy and also the applicability of differential pricing of service delivery within local government. Calls for more open approaches and enhanced disclosure relating to service provision and pricing are made.

There is a dearth of literature in the public domain on price setting for public services within the Australian public sector as a whole. In particular, very little has been written on price setting for service delivery in local government. In recent years, local governments have been experiencing a net transfer of responsibility for service delivery from State governments, in particular, and also from the Commonwealth government under a phenomenon known as ‘cost-shifting’ (Commonwealth of Australia, 2003, chapter 3). Notwithstanding, there are political and social constraints to further expanding municipal rates as the principal revenue source in local government. Accordingly, local governments have necessarily raised additional revenue from service fees and other charges, including fines, to fund higher service demands. This key revenue source amounts to $6.2 billion across Australian local government and constitutes almost one-third (that is, 31 per cent) of the local government revenue base. On a state by state basis, service fees and charges as a proportion of total revenue range between 18 per cent (South Australia), 20 per cent (Victoria), 21 per cent (Western Australia), 34 per cent (New South Wales) to 41 per cent (Queensland and Tasmania) (Australian Bureau of Statistics, 2005). Such revenue stream proportions, across Australia, are not expected to contract, at least in the foreseeable future. Most accounting academics would intuitively tend to turn to management accounting textbooks in exploring pricing issues. Paradoxically, management accounting textbooks focus little attention on price setting. When price setting is considered it is typically confined to privately-owned organisations, especially corporations in the private sector. Take, for example, a typically undergraduate textbook entitled Managerial Accounting: Manufacturing and Service Applications, by Schneider and Sollenberger, which devotes a mere two pages to price setting. Schneider and Sollenberger (2002:10-21; to 10-22) indicate that there are two types of prices: market-driven prices and cost-based prices. The former genre of prices is set primarily by market influences, such as brand appeal and reputation, and may include, for example, the prices of garments of renowned designers in the international fashion industry. Cost-based prices, while subject to market influences,
are typically set for more generic, mass-produced products or highly demanded services where the key focus is to set prices that exceed cost, as ascertained on the basis of particular cost models, with a targeted margin applied for organisational profitability purposes. Within local government in Australia, however, prices are typically set for service provision and achievement of an overall ‘balanced budget’. Such prices are usually set with particular considerations involved. These considerations include the need to charge a price which assists in meeting particular social or environmental policy objectives, such as relating to litter control, youth unemployment, disabled people, or single parents, or to price designated services at ‘statutory’ charges which, in Australia, are prescribed by State governments.

This article explores a number of key issues associated with the growing service fee revenue for local governments in Australia which appear to have attracted little specific attention in journals, magazines and other outlets. Such issues include the philosophy underpinning (that is, mindsets behind) price setting for service delivery, the identification of the principles of price setting, the adoption of applicable price setting models, and the need for local governments to comply, where appropriate, with National Competition Policy (NCP). Meanwhile, the notion of ‘differential pricing’, under which prices are differentiated according to the speed or quality of the services delivered, or both, remains largely unexplored within local government, with implications for ‘customer’ (that is, ‘citizen’) satisfaction in an era where immediacy in all forms of life is becoming increasingly apparent and is often commanded. While such issues may also be of relevance overseas, it should be recognised that the functions and operations of local governments across jurisdictions are often not compatible, such as between Australia and the US, while counties operating in the UK, for instance, typically have much larger population bases than in Australia and tend to rely heavily upon rates with little or virtually no public land to manage.

Before addressing the issues identified in this exploratory essay, it is useful to outline the basis for the general rates and service fees dichotomy within Australian local government.

**Rates and Fees Dichotomy**

Australian local governments rely heavily on revenue from rates and services fees. Indeed, these sources of revenue comprise at least 75 per cent of the revenue base of most local governments in Australia. In Victoria, for example, revenue derived from specific purpose grants and general (untied) grants comprise around only 10 per cent and 11 per cent respectively of total revenue base (Local Government Victoria 2004).

As a general basis for local government operations, the public services provided, including facilities which are generally used by a large cross-section of the community are typically funded by the general property rate. It is often impracticable or unacceptable to charge fees for these services, such as the use of local roads, parks and reserves and also community participation in festivals, in which case these services are funded by the general property rate. It is often impracticable or unacceptable to charge fees for these services, such as the use of local roads, parks and reserves and also community participation in festivals, in which case these services are funded by the general property rate or untied grants. On the other hand, where the services are used by a smaller segment of the community, it is more common for these public services to be provided for a specified fee, such as a service delivery fee or charge, on what is commonly known as a user pays approach. Such services include animal registration, the availability of public golf courses or similar sporting and recreational facilities, and urban planning and development processing. The recent shift to a service delivery culture within local governments has witnessed the adoption of new services on a user pays basis or the advent of charges for pre-existing services that were previously funded by the general rate.

User fees for public services may be set on a number of different bases. The most common forms of which are identified as
follows:

(1) ‘cost recovery plus’;
(2) ‘cost recovery’;
(3) ‘partly subsidised’, and
(4) ‘mandated level’.

Each of these will be briefly addressed as follows.

Under the cost recovery plus basis, the service fees applied to those making use of the associated services are intended to contribute towards the on-going development of the services, including the renewal of any underlying facilities utilised, as well as to meet the daily costs of operation. These fees may also be described as commercial fees and may be similar in amount or even identical to those charged by private service providers, if any, of the genre. Services provided on a cost recovery basis, where the fees applied to those making use of them are intended to meet the daily net costs of operation, are intended to contribute towards the maintenance and development of services. Partly subsidised services are those that involve the imposition of a partial charge which is deemed to be fair, based generally on perceptions of the service users’ ability to pay. Fees set at a mandated level include statutory charges and particular service fees that are otherwise agreed as part of grant funding arrangements.

Within local governments, prices for service delivery are typically applied using all four bases depending, of course, on the nature of the services and the philosophy underpinning their provision. In practice, only a small proportion of services are charged at prices which are set under a properly applied cost recovery plus approach.

Notwithstanding the diversity of fee bases available for use, commonly no mention is made of pricing policies within the published annual reports of local governments. On other occasions, vague terms or phrases are stated with respect to service provision in these key public documents, such as referring to the delivery of ‘sustainable services’ or the provision of ‘cost-effective services’ to the community. One may pose, for instance, the following questions: ‘Are these services sustainable at any specific price that may be charged?’ or, more simply, ‘How effective is the cost?’

A more significant concern lies in the inability of ratepayers to identify readily and evaluate the bases for price setting for service delivery. This leads to the importance of articulating the mindsets which govern price setting within specific local government contexts in the interests of enhancing transparency. As a starting point in the process, councils may consider the following question: ‘Where do generic services, as afforded by general property rates and untied grants, end and where do specific services, funded by fees and charges, begin?’

**The Philosophy of Price Setting**

Local government, as ‘social enterprise’, is more complex and contested than private enterprise as local governments across the country aim to achieve an array of objectives, many focussed around enhancing social capital and are, accordingly, expressed in non-financial terms (Guthrie 1998; Ryan 2001). As a result, the outcomes of local governments cannot be effectively measured in financial terms alone. Recent moves towards adoption of full accrual accounting or commercial accounting in Australian local government may indeed result in an over-emphasis on ‘measurable’ financial outcomes while de-emphasising the importance of outcomes which are not measured in financial terms in the context of what is known as ‘general purpose financial reporting’ (Carnegie and West 2003; Carnegie 2005; also see Parker 1996, Rentscheler and Potter 1996; Parker and Gould, 1999; and Guthrie 1998). Notwithstanding, both managers and councillors within local governments have been reported to have ‘an understanding of accountability of performance and are considered to be accountable for performance’ (Kluvers 2003:57).

Australian local governments are also diverse (see for example, Aulich 1999). Local governments may be located within central business zones of major capital cities or within the metropolitan regions...
of these cities, or otherwise be based in provincial cities or country towns, and extend into rural and vast outback regions. In addition, the services they provide vary from one state to another and be provided, across the country, on different bases.

All local governments both define and reflect values that are shaped, across time, by the individual councils, comprising publicly-elected representatives, which govern them while senior council officers may also be influential in shaping organisational culture. In many cases, these variations in world views both define and reflect the nature of individual local communities that exist. For a range of reasons, including demographic factors, certain councils may have a stronger social or human services orientation than others which may seem to be more prone to exploit economic development opportunities or to demonstrate stronger economic rationalist tendencies. While all local governments set and implement social policy, the former set of councils are potentially more likely to adopt broad social initiatives and policies which are, for example, more supportive of disadvantaged groups of citizens than councils which may view such disadvantage with less tolerance and promote a more entrepreneurial style.

Despite such apparent differences in philosophy, which may be particularly discernible among municipalities even within particular regions, especially where Councils are at least perceived to be influenced by representatives drawn from major political parties, often little or no attempt is made within specific local governments to articulate and communicate to ratepayers the underlying philosophy in providing public services and in setting prices for them. What mindsets underpin the prices charged for service delivery within the municipality in which you live? Where does one look to ascertain any information of this kind? More often than not, no readily available information will be found in the public domain to assist in elucidating a satisfactory response to the former question, thus leading enquirers to an unsatisfying result in exploring the second question.

A cursory examination of the annual reports of a number of local governments will reveal that there is typically no written explanation of the inherent cultural values which underpin the service provision and associated pricing regime that has been adopted for public services of all genres. Instead, broad and vague objective statements or goals, such as the following, can be found in published annual reports: ‘To effectively deliver a range of sustainable services that meet community needs’; or ‘To deliver efficient and reliable services to the community at affordable prices’. One may pose the following question: ‘How is it possible to properly assess the accountability of local governments when council-specific mindsets that shape the nature, availability and prices of services delivered within individual municipalities are unspecified or even unknown?’

The Principles of Price Setting

Local governments tend to be opaque in identifying the principles which underpin the setting of prices for services. In the experience of the authors, council officers, especially those with accounting and finance backgrounds, tend to view ‘principles’ of price setting as being directly linked to a council’s preferred cost accounting basis. Oral assertions that a local government sets its services fees on a cost recovery basis, as a ‘principle’, is unrealistic for most, if not all councils, especially as they provide certain services, including where full cost recovery practices are asserted, that are either heavily subsidised or freely made available. The assertions also confuse a technical basis for determining prices with broader price setting principles which should be specifically identified and articulated. Interestingly, such oral assertions can be heard from time to time within municipal offices in the absence of any publicly-available written statements to support such ‘informal’ views on the matter.

For completeness, service fee regimes within local government may be applied
with reference to a number of principles. The following six principles are proposed for consideration and adoption, if not already adopted in whole or in part, within specific local governments:

- **Efficiency** – the fees are simple and are not cumbersome to administer
- **Transparency** – the nature and use of the service is understood by users
- **Effectiveness** – the fees provide value-for-money for users
- **Clarity** – users are clear about when and how fees apply
- **Equity** – the fees are fairly applied across a range of users.
- **Ethics** - users with special service needs (for example, due to temporary or permanent disabilities) are not charged exorbitant fees directly in accord with the cost of higher servicing requirements.

Setting, reviewing and defending fees on the basis of these principles is more likely to assist in discharging accountability within local government than claiming adherence to mere technical bases for price setting.

It is important to render due consideration to distributional, vertical and horizontal equity issues (Local Government Victoria 2003:14-18) in the adoption of a fees and charges schedule that is both fair and broadly perceived to be fair. Above all, a mechanism is needed to assure compassionate review of individual circumstances on a case-by-case basis. A common weakness in the application of equity through a council pricing schedule lies in conflict between specified social objectives and the accessibility of particular services to certain groups. For example, the pricing of youth out of services which are intended to provide social engagement is likely to conflict with a social policy that identifies disaffection of youth as a cause of community vandalism and substance abuse.

**Applying Price Setting Models**

Earlier, four different pricing bases were outlined. In order to arrive at an effective model for informing price setting decision making in local government, it is important to properly incorporate the costs of providing services to the extent that these may be ascertained or otherwise estimated. Costs should include not only all applicable direct operating costs but also an indirect cost allocation (or apportionment of council overheads, including accommodation related overheads), as fairly and cost-effectively determined. Using direct costs only, such as the specific costs of contractors alone, in ascertaining the costs of service delivery is an inappropriate means of determining costs on a whole-of-council basis. It implies that centralised council administration is ‘cost-less’ which is not in accord with the underlying circumstances. In the highly unlikely circumstances where councils were to outsource all service provision, they would still be required to undertake a core set of governance functions, at a discernible cost, as the price of democratic control. Not surprisingly, where local governments claim to be adopting the cost recovery plus approach in providing specific services, further analysis tends to reveal that the full range of costs connected with service delivery is not always recouped.

It is also important to set prices for local government service delivery based on an understanding of their component parts as contained in the following pricing formula:

\[
\text{Price} = \text{Costs} + \text{Margin} - \text{Subsidy}
\]

In the case of partly subsidised services and certain services where statutory charges apply, knowledge of the estimated amount of subsidies involved in providing these services should be recognised as a means of enhancing accountability within social enterprises rather than, as can sometimes and even unfairly be the case, be portrayed as a reflection of poor performance or even bad pricing decisions. Indeed, the identification of a subsidy for public services, expressed in financial terms, can properly be perceived as a measure of the ‘social benefit’ of local government service delivery as public service and as a means of augmenting transparency within local governments.
Recognising that local governments are not ‘for-profit’ entities, margins may be desired and achieved on providing certain services under specific cost recovery plus regimes. Such a scenario may not arise regularly across the broad base of services typically provided on a user fees basis and may occur, for example, where local governments are competing directly with private sector providers for similar or identical services. Presently, most services provided by Australian local government for which specific fees or charges apply are likely to be provided on a ‘break-even’ or subsidised basis.

Any inadequacies in cost determinations, such as inclusion of direct costs of services only, will result in mis-specification of the inherent subsidy or margin to be identified. In Denmark, for example, local governments were sometimes found to have set prices below costs because depreciation is ignored in measuring costs (OECD 2005). Alternatively, attempts to apply unduly complicated or overly sophisticated cost allocation approaches to service delivery within local government are more than likely bound to fail on the basis of the associated costs outweighing the asserted benefits. Indeed, effective and dependable social institutions should, as a matter of course, place more attention on delivering necessary community services than on potentially over-burdening those services with unreasonable accountability processes and excessive administration costs and, perhaps inadvertently, putting particular services beyond the reach of those who may need them the most or even out of existence. Making accounting accountable in the public sector is a commendable community expectation (Carnegie and West 2005).

Placing monetary valuations on non-financial public resources, particularly community resources including the collections of museums, art galleries, libraries and historical societies as well as trees along roadways, botanic parks and land under roads, and subsequently depreciating certain ‘assets’ of this genre over their estimated useful lives is not a solid basis for discharging the accountability of accounting (Carnegie and West 2003, 2005).

Having knowledge of the estimated amounts of subsidies, particularly in the case of services provided at a mandated level, may also assist in negotiating with other parties, particularly State governments, and in conducting periodic and informed reviews of specific service fees involved. Importantly, should reviews of this kind not ordinarily be conducted on a periodic basis, they may indeed become frequent due to the common availability of such pricing information. Such reforms may be identified as a benefit of enhanced transparency in local government price setting.

Viewing local government as ‘social enterprise’, thereby delivering a range of diverse services and related social benefits within communities, adds a further dimension to discussions on price setting within certain accounting textbooks which, as illustrated earlier, are confined to cost-based or market-driven prices. Alternatively, prices for certain services delivered by local governments tend to reflect an inherent capacity to pay, thereby enabling participation by identifiable groups of individuals who may be disadvantaged in particular ways, such as financially or physically or through remoteness of location. This category may be regarded as ‘social benefit’ prices.

Price Setting and National Competition Policy

Local governments, in providing commercial goods and services, are required to comply with National Competition Policy (NCP) which has its background in a set of Federal – State agreements that collectively define NCP in Australia. Reaffirmed in a recently - issued Commonwealth report (Productivity Commission 2005), NCP is about ensuring government businesses compete fairly in the market when it is in the public interest. It involves transparent cost identification and pricing in a way which removes net cost advantages arising from public ownership. Competitive neutrality, of course, does not apply to non-business, non-profit activities of government.
For local government, the main benefits of complying with NCP are in the broad areas of community relations, business management, and governance processes. Broadly, local governments are generally required to develop an improved understanding of their costs and prices for specific services, such as those associated with aquatic and recreation centres, child care, waste removal and sale yards, and an appreciation of how these compare with those applicable in the private sector. Developing a full awareness of the relationships between costs and prices, as represented in the pricing formula shown above and related commentary, across the range of commercial services provided by local government, is important in both achieving the objectives of NCP and in minimising potential complaints and in effectively dealing with complaints that may arise. It should also be recognised, that costs of services and the prices based on those costs may vary between states and territories and also between city and country, even in the same state.

Differential Pricing

While there has been a traditional and enduring focus on the exercise of cost control within organisations, there can be clear benefits in focussing more attention on the revenue side of ‘net return’. ‘Revenue management’ is a term that is used ‘to describe the process of achieving the maximum return’ (Marchant 2004:28). One way of enhancing returns under a revenue management scenario is to differentiate a product or service in a variety of different ways in order to derive a higher return on the segmented product or service with a view to enhancing the total return overall from that particular genre of product or service. A product or service may be differentiated on the basis of quality, such as premium gasoline or high grade motor oil, for enhanced motor vehicle performance overall, or on the basis of time, such as an express or fast lane option for service delivery, in order to accelerate throughput and heighten customer convenience.

Local governments have been slow to realise the potential which seems to exist for differentiating service delivery, where the existence of different user expectations can be met in practical terms, especially through the availability of express or fast delivery options for particular services. One reason for such reticence may relate to possible concerns about charging for certain services at levels that may be identified as above the applicable statutory prices that may apply. Another reason for reluctance, at least within some local governments, relates to a concern that the statutory service level may become perceived as sub-standard service and effectively be portrayed as a mere ‘safety net’ option for those who cannot afford speedier service delivery.

Notwithstanding, the continued availability of ‘regular’ public services at statutory prices, where they are applicable, would appear effectively to alleviate any pressing concerns about applying charges in excess of the statutory prices. In other words, citizens would be afforded the option, exercisable at their discretion, to pay for regular services at statutory charges within particular jurisdictions. Price differentiation based on the type of product or service provided is well accepted and understood in modern society which values, indeed increasingly demands, immediacy in both the private and public sectors.

Price setting within local government should also embrace a periodic and informative cross-sector comparison of service fees and charges in order to assist councils in making balanced and informed decisions in pricing services of all genres. Such comparisons are likely to be particularly relevant where local governments are similar in nature and size. It is particularly relevant, for instance, to make direct comparisons of the prices charged by a metropolitan local government with those applied by other metropolitan local governments of a similar size as opposed, for example, to wholly rural-based local governments. An example of a formal approach to benchmarking of this genre is known as LG Price – a Victorian local
government pricing survey – which is a collaborative initiative of Worksmiths, a consulting firm which specialises in delivering financial services to governments and not-for-profit organisations, and the School of Enterprise, University of Melbourne.

Conclusion

Across Australia, service fees and charges have been shown to account for almost one-third of the local government revenue base. In some states, as identified, such revenue is in excess of one-third of the total local government revenue base. However, pricing regimes applicable to such service delivery within Australian local government have traditionally evolved on an ad hoc basis and are under-explicated. Apart from elucidating the institutional setting, this article has drawn a critical distinction between rates and service fees and charges, considered various conceptual issues in price determination, proposed six principles that should be invoked in pricing deliberations and decision making, assessed four models of price setting, proposed the use of a pricing formula for augmenting transparency within local governments and introduced the notion of social-benefit prices.

In addressing such issues, local governments are encouraged to develop more open and structured approaches in effectively managing this revenue stream in harmony with their broad social objectives. Citizens have a genuine interest in ensuring that their local governments, as social institutions, are making pricing decisions for service delivery in accordance with organisational objectives, on a well-informed and systematic basis. Moreover, they are entitled to be apprised of the price setting philosophies, principles and practices that apply to service delivery within their own local government. Such foci should be recognised as a key means of effectively managing public service delivery in accordance with underlying objectives and in properly discharging accountability obligations within local government. Developing improved understandings of the components of prices, as proposed under the above pricing formula, and their importance in achieving policy objectives as well as facilitating improved disclosure relating to service provision and pricing are not only to be encouraged but should, indeed, be expected given the significance of services fees and charges within Australian local government.

Endnotes

1 On releasing the Commonwealth report, the Inquiry Chairman made the following statement: 'The unanimous report of the inquiry into cost-shifting onto local government, released today, finds that local government has been short-changed, particularly by the actions of state governments, with more functions expected of local government but no or insufficient funds provided to them’ (Media Release by Inquiry Chairman David Hawker MP, 24 November 2003) (http://www.lga.sa.gov.au/site/page.cfm?id=388; web site visited on 3 October 2005).

2 The Government Finance Statistics classify this revenue source as ‘sales of goods and services’ while revenue from rates is shown as ‘taxation revenue’ (Australian Bureau of Statistics, 2005).

3 According to the Productivity Commission (2005, p. xiv) report ‘NCP is based on an explicit recognition that competitive markets will generally serve the interests of consumers and the wider community, by providing strong incentives for suppliers to operate efficiently and be price competitive and innovative.’

4 On announcing the release of the Productivity Commission report, the Federal Treasurer made the following statement: ‘The report recommends that Australia continue with competition-related reform to sustain and extend out impressive economic performance’ (Media Release by Treasurer Peter Costello MP, 14 April 2005) (http://www.treasurer.gov.au/tsr/content/pressreleases/2005/032.asp; web site visited on 3 October 2005).

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