



Submission to the Independent Local Government Review Panel

6 March 2013

"In a small republic, the public good is more strongly felt, better known and closer to the citizen". Montesquieu, 1748.

Summary

Mosman Council strongly supports the independence of financially sustainable small local government areas and strongly rejects the concept of forced amalgamations. Like many other small councils, Mosman Council is a cost-effective and innovative council with exceptional service levels.

Mosman Council considers that, in its November 2013 Paper, the Independent Local Government Review Panel (the Panel) failed to address the Terms of Reference for the Panel. Responding specifically to these Terms of Reference, this submission shows that there is no general case for compulsory amalgamation of councils. Both theory and evidence show (a) that small councils are as cost effective as large ones and (b) that small local government areas provide their households with greater and more personal levels of service than do large areas.

The Mosman community has frequently and overwhelmingly endorsed continuing independence, most recently by over 80% in the September elections 2012. Compulsory amalgamation would be undemocratic and have serious and unfortunate consequences for the provision of local services and for protection of environmental amenity, with no offsetting benefits.

In so far as some councils are not financially viable, the underlying causes are low household incomes and low population density. These councils may need state government support. Amalgamating neighbouring councils with similar socio-economic profiles does not solve this financial problem.

1 Introduction

The Terms of Reference for the Panel are to consider governance options and boundary change for local government taking into consideration:

1. Ability to support the current and future needs of local communities
2. Ability to deliver services and infrastructure efficiently, effectively and in a timely manner
3. The financial sustainability of each local government area
4. Ability for local decision making and representation
5. Barriers and incentives to voluntary boundary changes

Considerations (1) and (3) are essentially both about financial capacity. Financial capacity (3) is generally necessary and sufficient to support the needs of local communities (1).

Consideration (2) is essentially about technical efficiency and costs. Consideration (4) we take to be primarily about understanding and meeting the needs of local populations.

This submission addresses in turn the key issues of the Panel's terms of reference, namely costs, provision of services and financial capacity. Finally, the submission addresses some other issues raised by the Panel (2012) in its Interim Report, *Better, Stronger Local Government: The Case for Sustainable Change*. There is a short concluding section.

However, at the outset, it is essential to recognise a key attribute of local councils because this is the key issue and one that is widely ignored, including by the Panel. The key attribute is that local councils are a monopoly supplier of most local public services (other than those services provided by the state government). Unregulated monopolies in the public sector as in the private, lacking competition, tend to be slack and inefficient. In such structures, costs are not always well controlled and services are not always well provided. As a local monopoly, local government is answerable only to a regulator such as the Division of Local Government or the NSW Independent Pricing and Regulation Tribunal IPART or via political elections every four years.

The key policy issue is how to strengthen these constraints on inefficient monopoly behaviour without excessive regulation. Turning small monopolies into larger monopolies will do *nothing* to resolve the underlying monopoly problem.

2 Efficiency and Costs

There is a widespread belief that larger local councils are more cost effective than smaller ones because they can achieve various economies of scale, for example in senior management or in operations (see for example ACELG, 2011). However, this is an over-simplified view which is not supported by the evidence. There are three strong countervailing factors.

First the potential economies of scale from larger organisations can be achieved by cooperation between councils either through formal on-going regional organisations of councils or through ad hoc relationships. For example,

- Mosman Council works co-operatively with Manly, Pittwater and Warringah Councils through the voluntary regional organisation SHOROC in collaborating to reduce costs through regional purchasing (for example for road maintenance), shared services, joint operations and projects, with identified savings since 2010 of \$337,000 and growing.
- Mosman led the establishment of Kimbriki Environmental Enterprises Pty Ltd over the past decade with an important objective of managing waste locally in a sustainable manner at the resource recovery centre at Terrey Hills. The independent board has development approval from the NSW Government to construct a 60,000 tonne non-putrescible, dry recyclable wastes (MRF), and 100,000 tonne putrescible source separated food and garden organic and mixed residual wastes (RRF) facility. The Alternate Waste Technologies (AWT) will be a \$70m private public partnership with international tenders to be called in 2013, and the facility operational in 2015.
- Over some 30 years Mosman has achieved substantial IT and other savings for library services via the group of Shore Link councils.

- Mosman Council has been instrumental in establishing a regional internal audit function involving six Councils on a service sharing basis ensuring independent objective assurance and consulting activity designed to add value and improvement to the organisation's operations. The model encourages combined collaboration of resources and ideas amongst members while recognising the importance of independence.

Second, and at least as important, larger organisations are behaviourally less constrained, less transparent and less efficient than small ones. In larger bureaucracies costs are less clear to both managers and councillors and internal contracts are generally less precisely defined. The larger the local government unit, the larger and more remote is the bureaucracy.

The evidence is that incompetence and corruption occur more often in large councils. This is evident in the record of the councils that the NSW Department of Local Government has placed into Administration over the past two decades. Nearly all the councils placed in administration have been large ones. There is good reason for this. Incompetence and corruption are hidden more easily in large councils than in small ones.

Thirdly, as the Mosman record shows, small councils are innovative.

- Mosman Council has been a pathfinder in the development of pro-active management plans. MOSPLAN was one of the first major management plans developed in NSW and is an internationally recognized management instrument.
- In 2011/202, 95% of Council's capital infrastructure and maintenance works were exposed to the marketplace by public tender – by far the highest in NSW.
- Mosman has a comprehensive asset management plans for road, buildings, drainage, open space and marine allowing prioritization to address in an orderly fashion under-investment in assets over an extended period.
- The Division of Local Government has adopted the Mosman Financial Model as one of its key case studies in financial planning and management workshops

Critically, in a system of local public service monopolies, there is no market metric of efficiency (profits or market share). The officials that run each council may indeed be conscientious but they have little competitive incentive to provide an efficient level of service. Efficiency is driven in large part by the competitive elective process for councillors. This works most effectively in small local areas.

These considerations are borne out strongly by empirical work on council costs. This work needs to be sophisticated to sort out other drivers of expenditure like income levels or population density (unit costs rise with lower population densities). Undertaking such work in the early 1980s, Abelson (1982) found no evidence for lower unit costs or economies of scale in larger local councils in Sydney.

More recently and authoritatively, Dollery et al. (2012) provide detailed and extensive evidence in Australia and internationally that forced amalgamations have not produced financial sustainability or any cost savings. As Professor Dollery observed in the Sydney Morning Herald (12 February), anyone who still believes that compulsory council amalgamation leads to financial sustainability in local government, lower costs or scale economies, has not acquainted themselves with the vast empirical literature on amalgamation.

3 Services and Benefits of Small Councils

As the Panel (2012, p.4) remarked, "Councils must be able to decide how best to respond to the particular needs of their local communities."

It is well established that different communities have different preferences and different needs. Where this is so, the public finance *Theorem of Decentralisation* (Musso, 1988; Abelson 2012) concludes that service differentials are better achieved by differential services provided by small local areas than by uniform services across the whole area.

A major finding of the 2012 Nobel Prize winner in Economics, Elinor Ostrom (1990) is that small communities generate much greater trust and social capital. It is simply not credible that communities of 300,000 people can generate as much inter-personal trust and mutual social capital as communities of 30,000.

Historically, as local historian Gavin Souter (1994) has described, Mosman seceded from North Sydney in 1893 because Mosman Ward was being treated 'like as if it were a wilderness' and the ratepayers of Mosman often found their wishes frustrated by the Aldermanic majority representing the more populous Wards of St Leonards.

Abelson (1982), in a paper published in the US journal *Publius*, showed how households in small local government areas in Sydney receive much higher levels of service (as measured then by letters, telephone calls and personal visits) from their elected councillors than do households in larger areas.

In Mosman we have over 450 volunteers working with Council. Evidence collected by Mosman Council shows that the number of volunteers per head of population in Mosman and in Manly (another small council) is between two and ten times *higher* than it is in four other councils with three times the population size. They also volunteer twice as many hours per volunteer. It is inconceivable that Mosman would be able to retain anywhere near our number of volunteers or their time input if the municipality were abolished and run from an impersonal large bureaucracy 20 km away.

Both in running and in facilitating cradle-to-grave programs, Mosman Council delivers a range of affordable and highly recognised community services in partnership with a dedicated army of volunteers. These services include Seniors and Youth Services, Carers Support Group, Community Visitors Scheme, menu-of-choice Meals on Wheels, community transport and early childhood programs to name but a few award winning services.

Other evidence of Mosman's service levels include:

- The Mosman Art Prize is the oldest, continuous local authority annual exhibition in the nation, and was the forerunner to the Council's award winning Art Gallery. The Gallery has a major arts donor program and runs affordable yet significant arts and cultural events, providing leadership, enhancing the area's long history in Australian arts, attracting resources and reaching out to national and international audiences.
- Mosman is the only Council to fully implement Sydney Harbour Catchment Management Plan by installing 31 stormwater quality improvement devices (SQIDs) that filter 94% of the Mosman catchment stormwater before it enters the Harbour.
- Mosman Council was the first council in NSW to introduce a 50kph speed limit for residential areas.

- Mosman was the first Council to adopt the 1945 Library Act (free public libraries); the first Council in Australia to open library on Sundays in 1988 and foundation member of the Shorelink regional library network. Mosman is consistently placed in top five libraries in NSW for loans per capita.

4 Financial Sustainability

Turning to the issue of financial viability, there are two main factors associated with a lack of financial viability.

First, and most critically, some local government areas have a high proportion of low income households. These councils inevitably have limited fiscal capacity. However, as the Productivity Commission (2010) pointed out and concluded in a major review of local government financial capacity, financial incapacity is fundamentally a function of low household incomes in the area. It is *not* a consequence of a limited taxation base via taxation of land.

Second, some local government areas outside Sydney are very large and the responsibilities for maintaining infrastructure across the country areas are beyond the capacity of the low density population across these areas.

Amalgamating of some regional councils may address this second problem to some extent. However the maintenance of infrastructure across the remote areas of the state must be primarily a state responsibility.

Within the Sydney metropolitan area, some low income councils may need state government support. However, amalgamating neighbouring councils with similar socio-economic profiles and similar financial constraints will do nothing to increase financial capacity or to resolve financial problems. The appropriate response is to provide more state (or Commonwealth) assistance to low income councils.

On the other hand, there is no case in terms of financial sustainability to merge Mosman with any local areas such as North Sydney or Manly. All these councils are independently financially sustainable. With reference to Mosman,

- The Council has spent \$30mon capital works over the last four years and remains in a strong financial position.
- TCorp has advised that “Council’s finances have been well managed” with its underlying operating result (measured using EBITDA - earnings before interest, taxes, depreciation and amortization) increasing. Mosman’s own source operating revenue ratio has been consistently above benchmark each year and the Council has been proactive in seeking cost savings and efficiencies.
- Council’s 10-year financial plan indicates improved operating results and core financial indicators over the next 10 years.

5 Other Issues

In its Interim Report, *Better, Stronger Local Government: The Case for Sustainable Change*, the Panel (2012) states that: “Local government in New South Wales must change. The future is challenging but also full of potential. Local councils must embrace the challenges and realise the potential... We all know the world will be a very different place in 2036, and

therefore a realistic program for the future must be a program for substantial and lasting change.”

This language has no clear substance or meaning. It is hard to interpret this kind of language as other than platitudes and generic rhetoric. The Panel's Interim November 2012 Report does *not* deal directly with the formal Terms of Reference for the Panel.

In his address to the SHOROC Councils in February 2013, the Chair of the Panel (Professor Sansom) identified the major goals of the Review as a “stronger system for local government”, including an effective relationship between local and state government and a need for local councils to have a strategic capacity. The Interim Report also stresses the need for local councils to have a strategic capacity.

Again these are elusive and non-measurable concepts. There is a major risk that such vague concepts will be used to justify changes without any real understanding of the nature of the problems or the objects to be achieved.

Also in the November 2012 Report, the Panel states that “it is very difficult to see how large imbalances in population size can be justified”. But the Panel does not explain the problems associated with having some small, highly effective, councils. In the United States, there are over 80,000 local councils doing various functions, of greatly varying sizes and many with only a few thousand citizens.

Importantly it should also be observed that large local areas are almost always dominated by political parties to the exclusion of independent individuals. Parties have the resources to organise and campaign over large areas. Individuals do not. The amalgamation of councils into larger areas will lead to the party politicisation of local councils and be detrimental to grass roots democracy.

6 Conclusions

In any organisational or policy review it is fundamental to establish the problems to be addressed. These problems are not clearly articulated in the Panel's November 2012 Report. Nor does this Report address directly its Terms of Reference.

Of course, even in the best run organisations it is possible to find cost efficiencies and to improve services. And doubtless some councils are less cost-efficient than they could be and some councils could improve their services.

However there is no evidence that these problems are smaller in large councils. To the contrary, the evidence suggests that the problems of poor services, cost blow outs and poor administration are often greater in large councils. Certainly, as shown in this submission any such problems are relatively minor in Mosman and, we believe, they are minor in most other small metropolitan councils.

Any changes to the structure of local government in NSW should retain, and not destroy, the strengths of the current system. It is counterproductive to change what is working well.

As this submission has shown, the major problems in local government arise from its role as a monopoly supplier of local public services. Unlike business services, customers cannot obtain an alternative service. Such monopolies tend to be inefficient. As a local monopoly,

local government is answerable only to a regulator such as the Department of Local Government or the NSW Independent Pricing and Regulation Tribunal or via political elections every four years.

The optimal method for dealing with the problems of local government is improvement to the regulatory framework. The key policy issue is how to strengthen these constraints on monopoly behaviour without excessive regulation.

Making small monopolies larger will do nothing to resolve the underlying monopoly problem. Amalgamation will lead to loss of local identity and will force major party politics into local government and lead to another group of full-time politicians.

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