

**Submission  
No 135**

## **INQUIRY INTO LOCAL GOVERNMENT IN NEW SOUTH WALES**

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**Date received:** 7/07/2015

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7 July 2015

The Director  
General Purpose Standing Committee No. 6  
Parliament House  
Macquarie St  
Sydney NSW 2000

Dear Sirs

**RE: SUBMISSION TO INQUIRY**

Thank you for the opportunity to provide information on the potential for developing a stronger future for local government.

I have worked in local government for 28 years, coming through the financial side of operations and into management. I have worked in five different councils, from moderately large to very small during my career in local government. While there have been many changes in my time, there is still a great potential to provide governance and services to local communities in ways that provide for better outcomes for the broader community.

During my time I have been through a number of rounds of restructuring local government. This has led to my needing to get a good understanding of exactly what is likely to gain good outcomes for the communities that we are looking to support.

Continually the argument seem to come back to a simply approach of changing the size of councils as the solution to the issues being faced. This does not address the changes that have occurred in the communities and economy that have occurred over many years since this model of local government was set up.

It is not intended to comment on all of the terms of reference, but limit commentary to areas where it is considered I may be able to provide some input to the committee with a potentially different view point or where I consider the issue to be of critical importance. Equally the timeframes and resources do not allow for a full commentary on the wealth of information that exists to show what could be achieved in local government looking from a broad and unhindered perspective.

**1 (b) the financial sustainability of the local government sector in New South Wales, including the measures used to benchmark local government as against the measures used to benchmark State and Federal Government in Australia**

*Financial Sustainability – Addressing horizontal equalisation*

It is not considered that there has been a willingness to look closely at the fundamental financing system of local government and assess whether this needs to be changed as part of the review of the future of local government. This is required as the degree and extent of the financial failures means that there are significant structural issues surrounding the funding of local infrastructure and service provision and has nothing to do with rate pegging.

Financial analysis of the accounts of local government indicate that there is great variability in the level of maintenance (and estimates of required spending) and depreciation. These two factors are most likely leading to significant misstatement of the true position of local government. It is important to ensure that any assessment is undertaken based on reasonable financial data. Adjusting these factors to reflect maintenance costs equivalent to 3% of asset value and depreciation based on statistical correlations across NSW Councils, gives a different picture of local government. Instead of 33% of councils showing a negative operating result in the 2013/14 comparatives, 46% do. This is considered to give a better true position of the industry. The financial gap is considerable in many cases, with this methodology doubling the gap for those councils with a negative Operating Position.

The current approach is to seek councils to reduce expenditure or raise revenue on a council by council basis. Considering that the required rate increases go up 760%, or would require more than half of expenditure (including depreciation) to be somehow cut, this will be a daunting challenge. And it cannot be resolved by edicts on increasing efficiency, as to a great extent this loss includes only the level of maintenance required optimally, not the current actual spending of the Council.

What is needed in a more holistic industry approach towards resolving the funding issue. The approach suggested is based on the principle that there are basic services that everyone in the state should have. People should have to make an equivalent financial effort towards having those services provided. Those costs that relate to disadvantage factors beyond local control should be funded from a central pool of funds. This is the horizontal equalisation aspect of the Financial Assistance Grant process.

There is already a system in place for determining the disadvantage factors. My research indicates that it most likely does not realistically cater for the disadvantage cost of roads, but the methodology could be fine tuned to deal with this factor through research. The immediate problem is that the pool of funds required to achieve horizontal equalisation as calculated by the NSW Grants Commission is about twice what is currently provided by the Commonwealth Government.

The gap of around \$700million needs to be raised and redistributed to meet the gap identified by the NSW Grants commission. Such a pool equates to around \$2 per week per assessment on average. Already levies are imposed across the state such as the Waste Levy and emergency service levies. The issues of basic infrastructure is just as pressing as waste minimisation or emergency response and needs to be addressed.

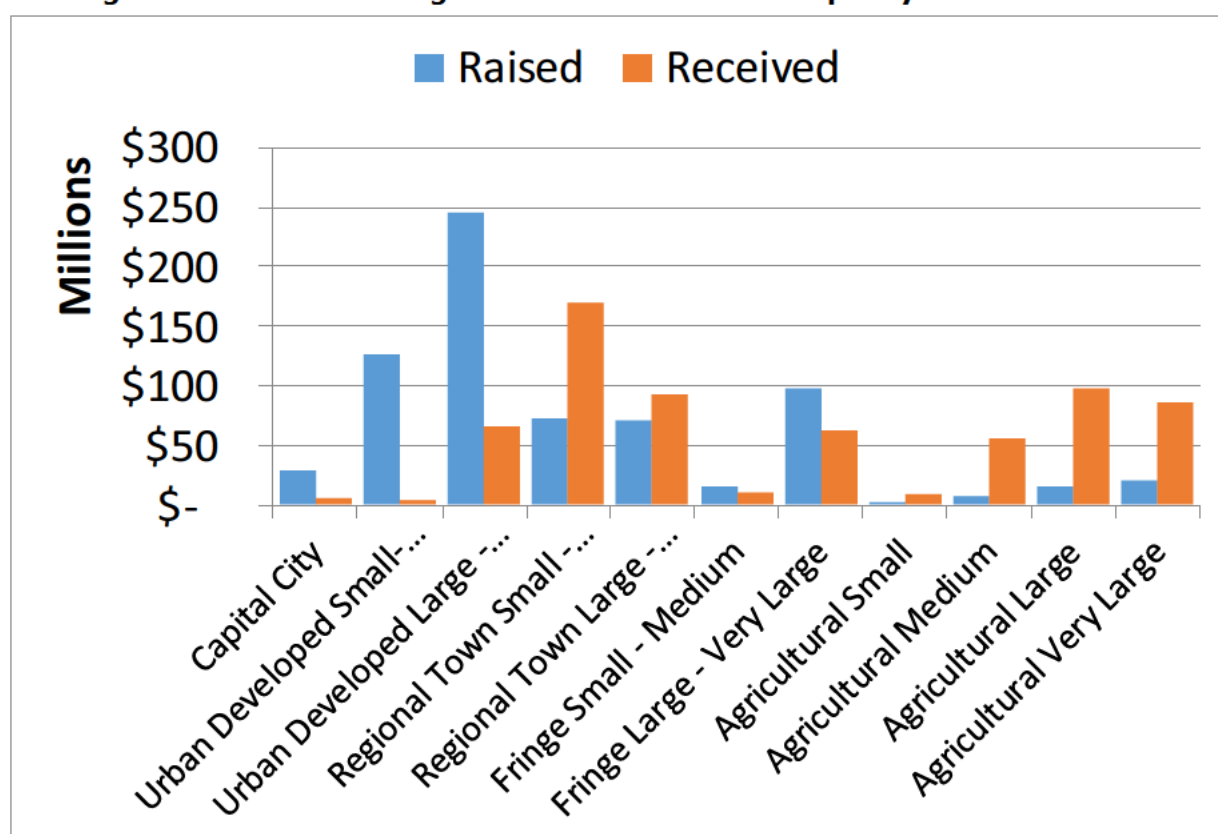
The failure to face and address this challenge is considered a significant factor in why there is such systemic financial failure in the rural areas. State and Local Government can resolve this issue, which would strengthen the rural economy and in turn help drive the growth of the state economy overall. A study by the Institute

of Development Studies <sup>(1)</sup> found that removal of infrastructure inadequacies improved economic growth rates:

*"It is useful to get an indication of the size of these effects. These results suggest that if a district's overall score [on] infrastructure was to improve from the mean to the top quartile, it would gain around 0.3 per cent per capita GDP growth each year. A further 0.35per cent in growth might be gained by lifting a district from the bottom quartile of electricity black outs to the median performance."*

Having created the pool, the Financial Assistance calculations will then provide a mechanism for allocation of funds based on needs. This would give the community added assurance that the funds are being directed where they are needed as there is no political involvement in the direction of the funds. Calculation of the figures indicates that funds would move towards the areas of greatest need. Stabilising those areas and moving them to a position where there is more capability to resolve the remaining financial gaps over time.

#### **Funding basic services through Financial Assistance Gap levy**



For many years I have heard the industry claim that the issue of the lack of funding is very damaging to communities. I do believe that this is the case. What I do not believe is that as an industry and as State Government we should allow the damage to keep occurring.

### *Efficient Service Provision*

Going hand in glove with the issue of funding is the use of the funding. The level of industry wide investment in research and development into provision of services is very low. There needs to be a program that investigates the best practices across the industry and ensures that this becomes the norm among councils. If the funding pool is made available, this will not create a sustainable local government model unless it is coupled with efficient service provision. Equally for communities to support the provision of support to council areas the communities will need to have assurances that the funds are being used wisely. What is seen as critical in achieving efficient service delivery is discussed in later sections of this submission.

### *Benchmarks*

While it is often mentioned that "one size does not fit all" in the process of the Fit for the Future process, it would appear that in relation to measuring performance, one size does in fact fit all. Despite the wide variety of councils and situations they exist in there is the same benchmarks for all. This does not truly reflect a system that can cater for a wide diversity of situations.

Consider that the Office of Local Government classifies councils into a number of groupings to reflect that there are clear differences in the situation of those types of Councils. More recently the Office of Local Government has started grouping the councils into five major classifications. It would appear that on this logic, it would be consistent to consider the need for benchmarks for these grouping at a minimum.

In some instances there is no need for separate benchmarks, such as the operating performance ratio, where there is a fundamental need for a sustainable position, but others, such as own source revenue, could better reflect the differing situations faced across the State. This has now been done partially by allowing the inclusion of the Financial Assistance Grant for some groups of councils, but a better approach would have been to assess the various categories of councils and determine an appropriate benchmark. Instead of an ad-hoc approach there is a need to determine a systematic approach that is based on investigation into what benchmark is required.

To have meaningful benchmarks the first step does have to be determining what is a reasonable outcome for that type of Council. This will require a clear definition of what is desirable. Is it desirable for remote rural communities to have to cover the high per resident costs of basic services or should there be a degree of long term subsidy as discussed above? Is so, what should their own source revenue level need to be?

### *Are the benchmarks compatible with Federal and State benchmarks?*

It is considered that consistency in the benchmarks would allow greater transparency to the community. It is difficult to create a belief in the community that the criteria for assessing local government are valid and important indicators if the NSW Government does not also apply them in assessing their performance.

The criteria for the NSW Government are taken from the Fiscal Responsibility Act 2012.

The first fiscal target is that annual growth in general government expenditure is less than the long term average general government revenue growth of the state. If the Operating Performance Ratio was modified to indicate that the long term growth in expenses should be less than the long term growth in revenue of the Council, this would provide a realistic measure of performance that would be better than the current measure, which effectively indicates a worse financial position than the reality in most cases. It would also provide consistency across two levels of government.

The benchmarks also do not accord with those seemingly used by the NSW Government to assess its own plans for future performance. The Report on State Finances 2013-14 indicates (on page 4-2) that the Key Performance Indicators for the finances of the NSW Government are:

- Revenue
- Expenses
- Budget Result (Net Operating Balance)
- Comprehensive Amount
- Capital Expenditure
- Cash Surplus/ (Deficit)
- Net Lending/ (Borrowings)

Of these only the Net Operating Balance indicator has a similar comparison in the local government benchmarks. The approach of the NSW Government is to include capital revenue in the Net Operating Balance. This varies from the benchmark for local government, where capital revenue is excluded. Over time it is clear that the historical measure of sustainability should include all income received, as used by the NSW Government, and as a result future estimates of sustainability should include reasonable estimates of capital income, which seems to be used by the NSW Government in its budget statements.

Capital expenditure is the closest indicator to those of local government for assessing asset management. The NSW indicator only measures relative level of expenditure. No effort is made to assess the level of expenditure against the ideal long term need. The NSW Government should adopt the same benchmarks sought from local government, to benchmark against the level of capital renewal that should be occurring and against the level of maintenance that should be spent.

At a Commonwealth level, the Intergenerational Report that is required within each five years is seen as having great merit. Instead of a finance metric approach to determining future sustainability, a more holistic view of the changes in what the community needs and how those needs will be met, including the financial position of the State and local governments would be seen as beneficial. The intergeneration report was strongly supported by the National Commission of Audit in their 2014 report, including a specific comment on the value of adopting such an approach for state and territory governments.

Some thought would need to be put into how this could be achieved. Most likely there would be a need for a centralised development of the future projections supported by localised information provision on the current policies of the council.

This would provide the community with valuable information as to whether the decisions being made today are in fact beneficial and sustainable over the longer term. The focus of the reporting is on the outcomes that will occur, which makes the report more useful and understandable to the community.

### **1(d) The scale of local councils in New South Wales**

Scale and scope of local government has been investigated around the globe. The concept that bigger means better needs close examination against the empirical data that exists both in local government and corporate settings. What is clearly evident is that councils provide a large range of services. The idea that a particular sized council will be the right scale to provide all that range of services is difficult to justify. Research in Canada found this, with different service provided having different scale economies. Some had no economies of scale and for others diseconomies of scale occurred at different points.

"The threshold population sizes for particular services are different, and this is a key factor in determining whether shared service arrangements can lead to improvements." <sup>(2)</sup>

The complexity of defining an appropriate scale for councils becomes more pronounced when other factors, such as geography are taken into account.

There is a need for a good process to investigate and determine the factors that influence the various services that are provided and then identify the best ways in which to provide services in each instance. Effectively a service review process needs to be undertaken that is based on an evidential approach. This should not be on a council by council basis, but instead starting from the point of view of an industry providing services across the state and then determining where the optimal scales do occur.

There is a need to delve into the factors that influence the costs and ability to harness resources and analyse the optimal method for service provision based on this for each of the activities currently or proposed to be undertaken by local government. It needs to reflect that there are scales below which professional skills become costly to harness. It needs to reflect that distance may increase costs. It needs to reflect that additional levels of management may not add value in excess of scale economies.

Achieving all the economies and dis-economies would require a matrix model of service provision to be developed. Some aspects of service provision would be best provided on a large scale, yet others by individual councils. The size and scale of these business units needs to be based around facts and will vary enormously. Work I have done on regional basis shows some areas have clear benefits in gaining access to specialised staffing and career paths, yet other areas show increased management costs and no material offsetting benefits.

Creating a larger organisation will in some cases not get the optimal scale economies and in other service areas incur scale diseconomies. This is not the ideal outcome as it increases the cost of services to the communities. Creating a matrix of service provision units, suited to the most efficient and effective scale will harness advantages that exist.

## **1(g) Costs and benefits of amalgamations for local residents and businesses**

Data is not available to conclusively show that amalgamations improve the outcomes for communities. Most studies have focused on the costs and benefits in financial terms and generally cannot find net improved benefits.

Canadian research indicates that the economies of scale are already in place, especially for small municipalities, noting that diseconomies of scale are what occur when municipalities of more than 2,000 inhabitants are amalgamated. <sup>(3)</sup>

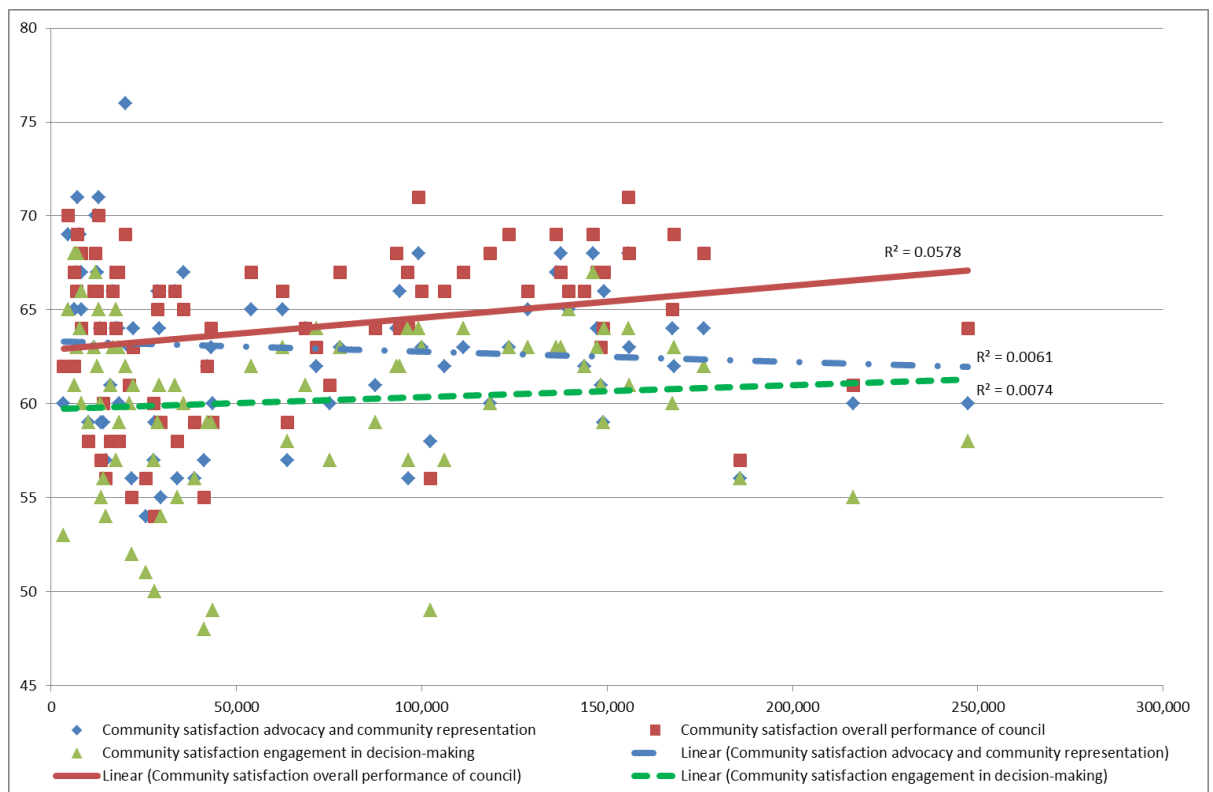
Robert L. Bish undertook numerous studies into the Canadian amalgamation outcomes. Bish concludes that *"there is overwhelming evidence that the least expensive local governments are found in polycentric systems of small and medium-sized municipalities that also cooperate in providing those services that offer true economies of scale. Large municipalities do not seem to be as capable of cooperating in this way, of decentralizing their services, or of using alternative delivery mechanisms for services that lack economies of scale."*

*He also found that the benefits, as perceived by the community often are not achieved. "Cost savings do not appear to have been achieved in the case of Chatham-Kent Ontario, an amalgamation of 11 municipalities (four of which had a population of less than 1,000) with a total population of 74,000. A recent survey of residents indicates, however, that they perceive the quality of services to have fallen."* <sup>(4)</sup>

The Victorian Government has been collecting data on community satisfaction with local government since 2005. The council populations range from 3,000 to 230,000, so they provide a good equivalent sample range. This provides a great opportunity to assess whether the larger councils are seen by the community as providing a better outcome. <sup>(5)</sup>

If larger councils are going to have benefits to communities it would be expected that the larger councils in Victoria would be gaining higher satisfaction rankings from their communities. The 2005, 2010 and 2014 data were analyses to see if there was a relationship between the size of the council and the community's satisfaction. The flowing scatter plot shows that there is not seen to be a connection between council size (as a function of population) and the ability to advocate or engage in the 2014 data. The data does show a marked reduction in satisfaction among councils with less than 50,000 population between 2010 and 2014. This is part of an overall trend towards lower satisfaction, and in the prior year periods there was only a very slight upward trend evident in the satisfaction against population.

### **Community satisfaction against population in Victoria**



The other advantage of the Victorian data is that it allows the different aspects of the organisation to be considered separately. The roles of determining the services the community wishes to have provided (engagement in decision making), advocating for those services and supplying the services are three very separate activities. The current debates around the future of local government have not been pulling apart these areas and looking at them separately.

What scale is required to decide what a community wants? In reality this is the cost of supporting the election and decision making of a group of councillors. If we develop a strategic advisory unit that they can access services through, a shared administrative support system, the cost is probably relatively low and scale advantages are likely limited. So scale of local government council's as governing bodies determining the services to be provide in a community is not a reason to change boundaries.

What has been stated as the issue is the ability to get regional strategic planning occurring. Local government is not and should not be made into quasi regional government unless this is a specific outcome that is shown to be more beneficial.

### **1(I) The role of co-operative models for local government including the 'Fit for the Futures' own Joint Organisations, strategic Alliances, Regional Organisations of Councils and other shared service models, such as the Common Service Model**

## **1(n) Protecting and delivering democratic structures for local government that ensure it remains close to the people it serves**

Decoupling issues about the efficiency of service provision from the efficacy of representation would allow for democratic structures that can remain close to the people. Determining the needs of the community and the services that should be provided is not intrinsically related to how the service is to be provided.

It is considered that care needs to be taken that any system developed does not transfer the power over determining the services and service levels from the elected representatives to some larger regional body.

Research indicates that there is a conflict between creating larger local government structures to gain scale efficiencies and smaller governments being trusted more by communities. This was well put in a study into the quality of local governance in Belgium. <sup>(6)</sup>

*" We explore this multi-dimensionality further by including the role of the municipalities' size in our analysis. Size can be related to quality of governance in two ways. Several empirical studies suggest that increasing the size of organisations has a positive influence on efficiency (Van Dooren et al., 2007). Increased size could lead to economies of scale and efficiency gains. In turn this will result in higher organisational slack, which facilitates innovation (Damanpour, 1991). Larger municipalities could therefore be linked to better performance. On the other hand, theoretical and empirical studies on citizens' trust present a different picture. Survey data from Denmark, the Netherlands, Norway and the UK find that trust in local government is higher in small municipalities (Denters, 2002). A multilevel analysis of trust in local government in 55 US cities concluded that population size is inversely related to trust in local government (Rahn and Rudolph, 2005). Thus, assessments of the quality of governance by citizens could come to different conclusions than assessments based on performance data."*

This conflict between the value that the community sees in having a say at a level where they have influence and a shared view and efficient scale of service provision can only be resolved as outlined by Bish. There is a need to uncouple the issues of how to determine the communities' needs from how those need are met. There is a need to separately determine what are the local communities now, and into the future, and provide them with a local voice. Then look at how best their needs can be met.

The process that we are going through is in no way unique. A paper by the Montreal Economic Institute from October 2001 ([http://www.iedm.org/files/fusions\\_en.pdf](http://www.iedm.org/files/fusions_en.pdf)) is well worth reading as it succinctly shows that that region of Canada was exactly where we are sitting now, fourteen years later. There is enough research and information out there to show there are better ways to provide local government than the path often taken in the past. In NSW we need to ensure that we do not make the same mistakes of the past, but instead face the challenge of learning from what has been found through research and investigation and creating a truly valuable tier of local government.

The use of the Independent Panel of the term "strategic capacity", led to me undertaking some research to try and find the meaning of the term. In broader academic terms, the term 'strategic capacity' comes from the work by Marshall Ganz, which appears to be built

on earlier work relating to capacity building undertaken by Jacqueline Stavros. Based on a brief reading of the concepts, the essential elements of local government would be:

- organisations where the aims and purpose are about the communities values not issues,
- organisations that can work with communities to transform their resources into power,
- That have alignments with other communities to build broader coalitions and larger alliances,
- to have leadership that can bring the resources together and turn them into power,
- that identify and train leaders within the community, and
- that find ways to couple local action with national purpose.

The philosophy of the work undertaken by Ganz comes from identifying the ways that small groups with limited resources have been able to achieve positive outcomes against larger bodies with much greater resources at their disposal. These studies indicated that many smaller communities have much higher resilience and ability to achieve good results with limited resources. Linking the work of Ganz with the findings of Bish and others in the field, such as Charles Tiebout from back in the 1950's, the picture of the most successful version of local government can be seen to be a range of small dynamic and co-operatively-competitive organisations representing their communities who can come together and provide services on a shared basis where the evidence shows there are benefits.

The science exists to develop local government to meet the need of the future well and given political will so does the ability to provide basic services to communities across the state at a reasonably equivalent cost. It shows that if local government is set up well it will create a more prosperous outcome, which benefits the NSW Government as well as the communities across the State. It does need a new funding mechanism and it does need strategic capacity discussed by Ganz and the sharing of service provision as outlined by Bish. The answers exist.

Yours faithfully

David Rawlings

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