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INQUIRY INTO LOCAL GOVERNMENT IN NEW SOUTH WALES

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CONSULTATION PAPER – METHODOLOGY FOR ASSESSMENT OF COUNCIL FIT FOR THE FUTURE PROPOSALS - APRIL 2015

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1. Introduction

The sudden release of Independent Pricing and Regulatory Tribunal's (IPART) (2015) *Methodology for Assessment of Council Fit for the Future Proposals; Local Government Consultation Paper April 2015* on 27 April 2015 came as a shock the NSW local government sector. With a mere two months left to the 30 June 2015 deadline for *Fit for the Future* council submissions, at a stroke IPART introduced substantial changes to the assessment criteria with which local authorities are to be adjudged. Moreover, the NSW Government summarily dismissed its earlier promise to establish an Expert Panel to appraise council submissions and instead simply instructed IPART to fulfil this role.

The NSW Office of Local Government (OLG's) *Fit for the Future* program had previously set out criteria and concomitant benchmarks which local authorities were required address in the submissions to the OLG. With the release of *Methodology for Assessment of Council Fit for the Future Proposal: Local Government Consultation Paper April 2015*, some of the *Fit for the Future* program was rendered obsolete. In particular, the criteria contained in *Fit for the Future* were modified in *Methodology for Assessment of Council Fit for the Future Proposals*.

Methodology for Assessment of Council Fit for the Future Proposals thus places NSW local government in difficult circumstances. Prior to the release of the IPART (2015) *Methodology for Assessment of Council Fit for the Future Proposals*, local authorities across NSW had spent considerable effort consulting with local communities and preparing merger, 'council improvement' and Rural Council proposals on the basis of the *Fit for the Future* process and its assessment criteria. Many of these exertions are now rendered obsolete. Moreover, too

little time now remains for councils to once again go through a thorough community engagement process and carefully prepare submissions using the new *Methodology for Assessment of Council Fit for the Future Proposals.* In addition, the new assessment criteria and benchmarks proposed in IPART's (2015) *Methodology for Assessment of Council Fit for the Future Proposals* contain serious flaws.

IPART (2015, p.43) was instructed in its Terms of Reference (TOR) to assess each council's 'future fitness' with 'consistency, fairness and impartiality'. However, the TOR also requires IPART (2015, p.43) to 'be consistent with the Government's local government reform agenda, as outlined in the *Fit for the Future* documentation'. This last requirement placed significant limitations on IPART because the *Fit for the Future* (FFTF) program itself had numerous deficiencies, which were identified in a previous submission to the Office of Local Government by the United Services Union as well as Drew and Dollery (2015d).

Table 1 shows the major differences between the *Fit for the Future* performance indicators and the indicators recommended in *Methodology for Assessment of Council Fit for the Future Proposals.* As we can see from Table 1, substantial differences are evident between *Fit for the Future* and IPART (2015). A major difference resides in the differentiation between 'non-rural', 'rural' and 'merged' councils in IPART (2015) and the 'one size fits all' approach in *Fit for the Future.* In addition, the benchmarks which must be met diverge widely between IPART (2015) and *Fit for the Future.*

Table 1: *Fit for the Future* and IPART (2015) Performance Criteria

Criteria and measure	Benchmark	IPART Non-Rural	IPART Rural	IPART Merged
Scale and Capacity	ILGRP recommendations.	ILGRP recommendations or merger broadly consistent with ILGRP or Sound argument for no structural change.	Demonstrates it has considered merger option and has strategies to enhance capacity.	Not applicable.
Sustainability				
Operating Performance Ratio	Greater or equal to break-even over 3 years.	Must meet within 5 years.	Plan to meet within 10 years.	Must meet within 5 years (non-rural). Plan to meet within 10 years (rural).
Own Source Revenue Ratio	Greater than 60% over 3 years.	Must meet within 5 years.	Plan to improve within 5 years & consideration of FAGs.	Must meet within 5 years (non-rural). Plan to improve within 5 years & consideration of FAGs (rural).
Building and Asset Renewal Ratio	Greater than 100% over 3 years.	Meet or improve within 5 years.	Met or improve within 5 years.	Meet or improve within 5 years.
Effective infrastructure and service management				
Infrastructure Backlog Ratio	Less than 2% over 3 years.	Meet or improve/inform within 5 years.	Meet or improve/inform within 5 years.	Meet or improve/inform within 5 years.
Asset Maintenance Ratio	Greater than 100% averaged over 3 years.	Meet or improve/inform within 5 years.	Meet or improve/inform within 5 years.	Meet or improve/inform within 5 years.
Debt Service Ratio	Greater than 0% but less than or equal to 20% over 3 years.	Meet within 5 years.	Meet within 5 years.	Meet within 5 years.
Efficiency				
Real Operating Expenditure	A decrease in Real Operating Expenditure per capita over time.	Must demonstrate operational savings (net of IPR supported service improvements) over 5 years.	Must demonstrate operational savings (net of IPR supported service improvements) over 5 years.	Must demonstrate operational savings (net of IPR supported service improvements) over 5 years but may not be practical in short term.

Source: IPART (2015).

This presents severe problems for councils which have already undertaken *Fit for the Future* analyses of their performance on existing *Fit for the Future* criteria and benchmarks. Apart from the flagrant procedural irregularities derived from 'changing the rules of the game' towards the end of the *Fit for the Future* process, it also gives local authorities have a mere two months to assess their performance under the new IPART (2015) methodology, assuming that the final version of *Methodology for Assessment of Council Fit for the Future Proposals* does not differ markedly from the draft version. Indeed, it need hardly be stressed that this is a chaotic way of conducting public policymaking.

Against this background, this Submission by the United Services Union provides a critical assessment of *Methodology for Assessment of Council Fit for the Future Proposals.* We demonstrate that *Methodology for Assessment of Council Fit for the Future Proposals* not only fails to remedy the numerous problems inherent in *Fit for the Future*, but also contains further flaws itself.

The Submission is divided into nine main parts, each of which will examine different aspects of IPART's (2015) *Methodology for Assessment of Council Fit for the Future Proposals: Local Government Consultation Paper April 2015*.

- Section 2 considers 'meaning-making' in the IPART Report.
- Section 3 provides a synoptic account of generic performance monitoring program design to provide a theoretical framework for evaluation public sector performance assessment systems.

- Section 4 outlines problems with the *Fit for the Future* criteria which adversely affect the proposed IPART methodology.
- Section 5 examines the methodology for Scale and Capacity.
- Section 6 considers Rural Council characteristics.
- Section 7 evaluates the methodology for Sustainability.
- Section 8 appraises the methodology for Infrastructure and Service Management.
- Section 9 scrutinises the methodology for Efficiency.
- The Submission ends in section 10 with a consideration of other relevant matters.

2 'Meaning Making' in the IPART Report

As we have seen, IPART (2015, p.3) has been set the challenging task of assessing councils with 'consistency, fairness and impartiality', but with the significant constraint that it must 'be consistent with the Government's reform agenda for FFTF'. On the whole, IPART (2015) has shown a greater degree of flexibility and understanding of the problems inherent in the extant Fit for the Future criteria and it has been far more consultative then the NSW OLG. However, uncertainty continues to exist, especially surrounding the meaning which has been imparted to previous work by the ILGRP.

For instance, IPART (2015) makes no mention of the NSW Government's policy of 'no forced amalgamations' which we heard so much about in the Independent Panel's report and Sansom's (2015) subsequent defence of the Panel. Instead we are given an incomplete statement that:

> '*Not Fit* – if the [council FFTF] proposal does not satisfy the scale and capacity criterion, or does not satisfy overall the other criteria based on our analysis; this rating which would be accompanied by our explanation and, potentially, a recommendation' (IPART 2015, p.20).

What is missing from this statement is detail on the kind of recommendations which might be made by IPART. Thus uncertainty regarding the nature of the recommendations for councils deemed 'not fit' remains a concern.

We are also concerned that some of the work previously conducted by the Independent Panel is being ascribed meaning which the Chair of the Panel has previously refuted. For instance, in an article in the scholarly journal *Public Money & Management*, Sansom (2015) stressed that the Panel had not recommended mergers at all but simply listed amalgamation as a 'preferred options'. It now appears that IPART (2015) is also conferring a meaning to the 'preferred options' that the Panel never intended. For instance, it refers to the 'preferred options' as: (a) 'recommended *preferred option'* (p.24); (b) 'recommended options' (p.12), (c) 'merger recommendations' (p.15).

A further point of concern is the manner in which IPART (2015) suggests that the Panel's (2013) 'recommended *preferred options'* were based on rigorous empirical research. For example, we are informed that 'the ILGRP carried out research and consultation on the subject of scale and capacity and determined that there was not a "one-size fits all approach"'.

This is a curious statement because the OLG benchmarks are set at the same level for every council, indicating that the end users of the ILGRP (2013) report accept that 'one size fits all' (see section 4 of this Submission). However, we note that IPART (2015) has tackled this problem by introducing three distinct sets of performance benchmark (non-rural, rural, and merged). Moreover, the statement above refers to a footnote which the reader might expect would contain details of the rigorous empirical evidence provided by the Panel. Instead the footnote simply informs us that:

> 'The ILGRP informed its recommendations on scale and capacity (including the merger recommendations) by looking at the unique characteristics of each area – geography, economic and transport flows, communities, interest and local identity. It also considered a list of criteria for a given council area, including sustainability and strategic capacity, efficiency and effectiveness and accommodating population growth, and whether boundary changes would better achieve the criteria. OLG, *Fit for the Future Guidance material – Completing Template 2: Council Improvement Proposal (Existing Structure),* October 2014, p 8, and ILGRP, *Revitalising Local Government – Final Report of the NSW Independent Local Government Review Panel*, October 2013, p 76.' (IPART, 2015, p.15)

However, there is no reference to rigorous empirical research, such as regression analysis or data envelopment analysis (DEA), because these essential empirical exercises were never undertaken and – as we have shown elsewhere – they do not support the arguments of the ILGRP (2013) in any case. Indeed, the Panel relied almost entirely on conjecture and the ideology that somehow 'bigger is better'.

An even more concerning development is found in the IPART (2015, p.13) report:

> 'The ILGRP also noted that a number of recent studies in NSW, and elsewhere, clearly demonstrate the potential for amalgamations, where properly managed, to generate both efficiencies and increased strategic capacity, i.e., economies of scale and scope.[15,16],

Two footnotes are provided: footnote 15 and footnote 16. However, while one expect would these footnotes to include details of the 'number of recent studies in NSW and elsewhere', they simply refer to the Panel's report and a basic macroeconomics textbook which is employed to define economies of scale and scope! There is thus no supporting empirical evidence provided for the claim that a 'number of recent studies' provide empirical evidence for municipal mergers. Accordingly, we urge IPART to reassess the 'evidence' provided by the Panel (2013) in view of a number of scholarly papers which present empirical evidence that council amalgamations will damage NSW local government. In particular, IPART is strongly recommended to consult the following recent peer-reviewed empirical articles in the scholarly literature before making recommendations on the fate of 'not fit' councils:

- Abelson, P. and Joyeux, R. (2015) New Development: Smoke and Mirrors – Fallacies in the New South Wales Government's Views on Local Government Financial Capacity. *Public Money & Management*, July 2015, p 315-320.
- Drew J, Kortt MA, Dollery B (2014c). Economies of scale and local government expenditure: Evidence from Australia. *Administration & Society*, 46(6): 632-653.[1]

[1] Published on-line 2012.

- Drew, J. and Dollery, B. (2015a). Inconsistent Depreciation Practice and Public Policymaking: Local Government Reform in New South Wales. *Australian Accounting Review*, 25(1), 28-37.
- Drew, J., and Dollery, B. 2014b. Estimating the Impact of the Proposed Greater Sydney Metropolitan Amalgamations on Municipal Financial Sustainability. *Public Money & Management*, 34(4), 281-288.
- Drew, J. and B. Dollery. 2014d. Keeping It In-House – Households as an Alternative Proxy for Local Government Output. *Australian Journal of Public Administration*, 73(2): 235-246.
- Drew, J., Kortt, M. and Dollery, B. 2015b. No Aladdin's Cave in New South Wales? Local Government Amalgamation, Scale Economies and Data Envelopment Specification. *Administration & Society*, Online First.

3. Performance Monitoring Program Design

The constraints placed on IPART in its Terms of Reference ensure that reasonable and reliable decisions *cannot* be made on the 'future fitness' of any council in NSW, irrespective of the methodology finally employed since it is obliged to use the flawed *Fit for the Future* process developed by the NSW OLG. The method of remedying this problem to ensure that decisions are made with 'consistency fairness and impartiality' (IPART, 2015, p.43) is for the NSW Government to remove the constraints placed on IPART in its Terms of Reference to enable IPART to scrap the entire *Fit for the Future* process and instead implement a sound performance monitoring (PM) program.

This begs a question regarding how a government agency should go about constructing an optimal performance monitoring or performance evaluation program. The working party on Performance Monitoring in the Public Services – reported in the *Journal of the Royal Statistical Society* – made the following generic recommendations on the matter (emphases added):

1. 'All performance monitoring (PM) procedures need a detailed protocol.
2. A PM procedure must have clearly specified objectives and achieve them with *methodological rigour*. Individuals and/or *institutions monitored should have substantial input to the development* of a PM procedure.
3. A PM procedure should be so designated that *counter-productive behaviour is discouraged*.
4. Cost effectiveness should be given wider consideration in both the design and the evaluation of PM procedures…
5. *Independent scrutiny of a PM procedure is needed as a safeguard* of public accountability, methodological rigour, and of the individuals and/or institutions being monitored...
6. Performance indicators (PI) need clear definition. Even so, they are typically subject to several sources of variation, essential or systematic – due to case mix, for example – as well as random. *This must be recognised in design, target setting (if any) and analysis.*
7. The reporting of PM data should *always include measures of uncertainty.*
8. Investigations of a range of aspects of PM should be done…

9. *Research should also be undertaken on robust methods for evaluating new Government policies,* including the role of randomized trials…
10. *Ethical considerations* may be involved in all aspects of PM procedures, and *must be properly addressed*
11. *A wide-ranging educational effort is required* about the role and interpretation of PM data' (Bird et al 2005 p.2).

A brief review of the *Fit for the Future* program serves to demonstrate that the NSW Government has singularly failed to meet most of these minimum requirements for a rigorous PM program. The following problems are especially concerning:

- Failure to implement procedures with a sufficient degree of methodological rigour.
- Failure to allow councils to have substantial input into development of the program (see Wholey and Hatry, 1992).
- Failure to respond sufficiently to independent scrutiny.
- Failure to include measures of uncertainty.
- Failure to conduct appropriate research.
- Failure to take account of ethical considerations.

By contrast, in its local government evaluation program, the Victorian Government's Department of Planning and Community Development implemented a performance framework at about the same time as the NSW Government began developing its financial sustainability ratings with the assistance of TCorp (2013). The Victorian Department of Planning and Community Development started its process with the release of a *Directions Paper* in December 2012. The process was then managed according to a number of stages:

- *Stage 1*: Consultation with over seventy local councils, academic and other experts, peak associations and the Victorian Auditor-General's Office.
- *Stage 2*: An invitation to Victorian councils to embark on a pilot program subsequent to feedback on the *Draft Local Government Performance Reporting Framework & Indicators Working Paper* dated May 2013.
- *Stage 3*: Implementation of enabling legislation which included public submissions (see, for instance, Municipal Association of Victoria 2014).
- *Stage 4*: Data collection and refinement of the performance indicators subsequent to the pilot program (including intensive site visits of 11 councils).
- *Stage 5*: Final reporting, due in the annual reports of the 2014/15 financial year.[2]

This two and a half year implementation program, including pilot programs and extensive consultation, contrasts starkly with the NSW OLG rushed implementation which took insufficient note of academic, union and local government advice. Indeed, the NSW process did not even involve a pilot program to evaluate relevance or reliability! This is dismaying. The scholarly literature insists that all sound performance monitoring regimes include a pilot program. For instance, Bird et al. (2005) note that 'revisions in light of pilot studies should be anticipated in the overall timetable for PM implementation'. Moreover, the Victorian program uses 70 quantitative and 24 qualitative measures of council performance.[3] It is thus curious that the NSW OLG believes that it can measure municipal 'fitness for the future' through just seven quantitative measures designed on an entirely *a priori* basis!

[2] This should not be construed as an endorsement of the Victorian performance monitoring program. We simply seek to illustrate the different approaches taken by the governments in question.
[3] The Victorian sustainability framework itself employed 12 quantitative and 26 qualitative measures across the 3 dimensions of financial performance, capacity, governance and management. It should be noted that the OLGs FFTF doesn't include any measures related to governance which suggests that they do not believe it is an important element of sustainability!

It is even more surprising that the NSW OLG has rejected the advice of the experts that it had formerly commissioned, notably the NSW Treasury Corporation, despite the fact that the OLG and Independent Panel had both formerly endorsed the TCorp (2013) financial sustainability ratings without reservation as Table 2 demonstrates.

Table 2: Changes to the TCorp Financial Sustainability Ratios

Financial Ratio	TCorp Weighting	*Comparative Information Report 2012/13*	TCorp Threshold	*Fit For The Future*
Operating ratio	17.5%	Reported	>-4%	>0.0% over 3 years
Own Source	17.5%	Reported	>60%	>60% over 3 years
Cash Expense	10.0%	Reported	>3.0 months	Abandoned
Unrestricted Current	10.0%	Reported	>1.5	Abandoned
Debt Service	7.5%	Reported	>2.0	0 to 20% over 3 years[4]
Interest Cover	2.5%	Not reported	>4.0	Abandoned
Infrastructure backlog	10.0%	Reported	<0.02	<2% (unchanged) no time frame specified
Asset Maintenance	7.5%	Not reported	>1	>100% (unchanged) over 3 years
Building and Infrastructure Renewal	7.5%	Reported	>1	>100% (unchanged) over 3 years
Capital Expenditure	10.0%	Not reported	>1.1	Abandoned
Real Operating Expenditure per Capita	n/a	Reported in nominal terms only according to 8 functional categories	Not considered	No time or threshold in documentation

Source: TCorp (2013); Office of Local Government (2014a), Office of Local Government (2014b)

It is not unreasonable to expect the NSW OLG to explain why it rejected the advice of TCorp (2013) which it had formerly commissioned as experts. Although we have significant reservations regarding TCorp's (2013) approach, it nonetheless contained measures of liquidity and the ability to service debt – critical measures which are clearly integral to any program purporting to measure financial sustainability.

[4] It is important to note that the OLG has radically altered the definition of this ratio.

However, there are a number of other indicators which should also have been included in the *Fit for the Future* program which purports to measure NSW municipal 'fitness for the future':

- *Revenue effort* (NEERPL 2015): This is particularly important in light of the concerns raised by the ILGRP (2013) regarding inter-municipal inequity and the deleterious effects of externally imposed revenue constraint on fiscal position.
- *Depreciation rate*: This is required to discourage counter-productive behaviour (Bevan and Hood 2006; Bird et al., 2005), as well as producing measures of uncertainty and understanding external constraint (Bird et al., 2005).
- *Budget overrun* (Levine et al., 2013): This is just one of the critical measures which go to the heart of corporate governance which is the foundation of municipal sustainability and accountability. It is also important as a measure of the ability of municipalities to forecast future performance. *Fit for the Future* requires councils to forecast performance four years into the future. Councils will undoubtedly have made the requisite forecasts, but the question remains whether there should be any confidence in said forecasts (see section 5 of this Submission).
- *Community need* (Drew and Dollery, 2014b): The OLG *Fit for the Future a Blueprint for the Future of Local Government* begins with the following definitional statement: 'Strong councils providing the services & infrastructure communities *need*' (emphasis added). It is thus somewhat surprising that the *Fit for the Future* criteria contain no measure of community need. This is despite the fact that, as a result of the previous United Services Union submission, it seems that IPART (2015) is excluding IPR related service sufficiency measures form the requirement to demonstrate operational savings.

- *Distributive equity* (Carter Klein and Day (1992); Tichelar (1998); Flynn et al., 1988; Carter (1991)): It is universally agreed that local government should also strive to be equitable in distributing goods and services. However, equity comes at a price. For instance, a rural council seeking to seal roads for a greater proportion of its residents will incur one or more of the following: higher expenditure, debt, a higher required annual maintenance burden and a higher ongoing depreciation accrual estimate. Thus more equitable distribution of local government goods and services will have a negative effect on the majority of *Fit for the Future* measures. Yet there is no indicator to reflect this burden.
- *Measures of community satisfaction along various dimensions*: The scholarly literature holds that it is impossible to effectively compare municipalities without measures of service effectiveness and quality (see, for instance, Wholey and Hatry, 1992, Coulson, 2009). For example, councils could easily reduce the frequency of domestic garbage collection and thus improve 'efficiency' but this would hardly be 'providing services & infrastructure communities *need*' (OLG, 2014). Moreover, as it stands, councils are being compared against benchmarks and peers which provide vastly different services and quality of services. As Carter (1991) has observed, 'quality is actually part of the concept of efficiency, rather than its antithesis'.
- *Estimates and timing of cyclical infrastructure expenditure* (Levine et al., 2013): Infrastructure spending does not occur in discrete annual cycles but instead it is notoriously 'lumpy'. For instance, buildings are not re-painted on an annual basis but rather when required, possibly a period of 10 years or more. Moreover, quantitative data alone cannot covey the current state and future expenditure relating to infrastructure assets (Falconer, 1991).

- *Long term debt obligations as a proportion of tax revenues*: This measures the ability to service debt from predictable revenue sources and addresses the gaping hole in the current *Fit for the Future* criteria which do not assess ability to cover debt but rather the proportion of revenue used to repay *and* service debt. It should be noted that TCorp (2013) sought to include a measure of ability to service debt.
- *Measures of liquidity* (TCorp, 2013): This seeks to measure the ability of a council to meet obligations when they fall due. It is extremely unwise for a program which purports to measure financial sustainability to neglect to include a measure of solvency.
- *Slack relative to risk* (Levine et al., 2013): Resilience is an entirely different concept to efficiency (Carter, 1991). Efficiency seeks to minimise slack resources whereas sustainability implies the need to be able to employ slack resources to cope with financial or natural disaster shocks. Thus a measure of slack resources relative to anticipated risk is needed as a counter-balance to the focus on efficiency, if councils are to be in the position to respond to community and infrastructure need (Rose and Smith, 2011).

Having reviewed the principles of competent performance monitoring program design, we can now address the first of the many 'stakeholder questions' raised by IPART (2015):

IPART Question: Should council performance against FFTF proposals be monitored? If so, are there any improvements we can make on the approach outlined for councils to monitor and report progress on their performance relative to their proposals?

Response: *There is a strong case for implementing a perpetual performance monitoring program for councils. However, the program must be developed in consultation with all stakeholders, piloted and refined prior to implementation. Unfortunately this has not occurred in the case of the FFTF program and gaping holes exist in the extant measures of fitness. We suggest that there is little point in monitoring performance against existing criteria after it has served its current political purpose. Instead we appeal to the Baird Government and IPART to join with us and other stakeholders to build a PM program which all stakeholders can have faith in. Should a revised set of indicators be produced in collaboration with all stakeholders then we believe there would be great merit in monitoring the performance of councils against such criteria over time, provided it included the following elements (a) a thorough education campaign on the meaning of the indicators; (b) an explicit mechanism to control for external constraint; (c) a focus on local identify and rewarding excellence (d) comprehensive measures of the heterogeneous services provided by councils; and (e) comprehensive measures of uncertainty.*

4. Failures of *Fit for the Future* which adversely affect IPART's Proposed Methodology

In an earlier United Services Union submission to the NSW OLG, we set out a number of flaws in *Fit for the Future* which pose a risk to the fair and impartial assessment of council performance:

1. *Unfinished business relating to proposed removal of rate pegging.* The Panel (2013) made a recommendation that the NSW rate-pegging scheme be overhauled in response to inter-municipal inequity and significant fiscal constraints inherent in the

current regime. The NSW OLG seems to have accepted this argument and has promised an independent inquiry into the current rate-pegging arrangements. The obvious question is whether 'fitness for the *future'* should thus be assessed according to *current* revenue constraints which are likely to be lifted in the short term?

2. *Unfinished business relating to distribution of Financial Assistance Grants (FAGs) in accordance with Commonwealth legislation.* The Independent Local Government Review Panel (ILGRP) (2013, p.16) recommended that the NSW Government investigate opportunities 'to redistribute federal Financial Assistance Grants (FAGs) and some State grants in order to channel additional support to councils and communities with the greatest needs'. The fact of the matter is that the NSW Local Government Grants Commission has been failing to distribute funds according to need, despite the fact that the enabling Commonwealth legislation clearly directs it to do so (Drew and Dollery, 2014a). Given that the NSW Government has finally committed to directing FAGs on the basis of need, there will likely be a significant change to future allocations[5]. Once again, the obvious question is: how can 'fitness for the *future'* be ascertained without knowing the details of changes to this very significant source of municipal revenue?
3. *Inconsistency in financial reporting*: Since at least 2013 the NSW OLG has been aware that the data it relies on for *Fit for the Future* ratios was not sufficiently reliable to make informed decisions. [6] Specifically, the NSW Treasury Corporation (TCorp) (2013, p.66) noted that 'TCorp's review process has shown an inconsistency in the

[5] However, the NSW Local Government may well be hampered in its attempts to follow the legislation's intent of full horizontal fiscal equalisation by the proclamation made under subsection 6(4) relating to the minimum payment of FAGs (based on what they would have received had they remained separate entities) for amalgamating councils over a period of four years.

[6] In point of fact the Auditor-General advised the government of reporting irregularities back in 2012 in its report: *New South Wales Auditor-General's Report Performance Audit Monitoring local government Department of Premier and Cabinet, Division of Local Government.*

> approach of Councils to calculating the data included in these Schedules, particularly Schedules 7 and 8', adding that 'without a high level of confidence in the data presented, it is more difficult to make informed decisions'.

This suspicion was confirmed by Drew and Dollery (2015a) who demonstrated that inconsistent depreciation data had a very significant effect on achievement of municipal benchmarks for the operating ratio. Specifically, Drew and Dollery (2015a) used sensitivity analysis to determine that:

> 'When depreciation accruals were adjusted to the median depreciation to infrastructure ratio, this resulted in 38 (out of 152) councils' benchmark status changing…The results were largely consistent with expectations: 'weak' and 'very weak' councils tended to move up to benchmark levels whereas 'sound' councils moved down.'

A recent review of Performance Monitoring in the Public Services (United Kingdom) published in the *Journal of the Royal Statistical Society* notes that 'a small amount of defective data may be quite misleading' and a 'large amount of defective data may be extremely misleading'. Thus 'key preliminaries to any kind of interpretation are checks on data quality' (Bird et al., 2005).

A central problem is that *Fit for the Future* contains substantial amounts of defective data. Yet to the best of our knowledge the preliminary no checks and rudimentary sensitivity analysis has been performed. This is despite the fact that the NSW OLG has acknowledged the problem by assigning a new role to the Auditor-General to 'give communities the

assurance they deserve on how councils are managed financially'. The key question here is whether it is reasonable to undertake the 'most significant investment the State has ever made in the local government sector' (Toole, 2014) on the basis of grossly distorted data?

Since the earlier United Services Union submission a number of other failures have come to light which may make it impossible to assess 'council fitness' with 'consistency, fairness and impartiality':

Widespread 'gaming': Bevan and Hood (2006, p.533) have noted that 'complete specification of targets and how performance will be measured almost invites reactive gaming by managers of service providing units'. It seems that a large proportion of NSW councils have accepted the OLG's tacit offer to practice gaming, specifically in relation to the Infrastructure Backlog ratio which is assessed only on 2014 financial year data (compiled well after TCorp (2013) and the Panel (2013) revealed the critical importance of this ratio for the Baird Government's reform agenda). Moreover, gaming has also occurred on other Schedule 7 and depreciation accrual items and thus affects a total of four of the *Fit for the Future* ratios.

In order to illustrate this point, Table 3 contains statistical summary data for key unexpected financial statement items from the 2014 financial statements. The estimates of unexpected financial statement items were produced according to the general approach of Marquardt and Wiedman (2004) and Pilcher and Van der Zahn (2010), developed from the earlier work of Hribar and Collins (2002) and Mulford and Comiskey (2002). In essence, we compared the quantum of the three financial statement items in the 2012/13 and 2013/14 financial statements, making adjustments for changes to the asset base or asset maintenance and renewal.

Table 3: Descriptive Statistics for Unexpected Financial Statement Items, 2013/14 Financial Year

Financial Statement Element	Smallest	Largest	Quartile 1	Median	Quartile 3
Entire State					
Depreciation	-70.5%	113.1%	-6.3%	0.2%	4.9%
Cost to Bring to Satisfactory Standard	-124.5%	462.8%	-48.6%	-13.5%	8.4%
Required Annual Maintenance	-151.6%	950%	-48.8%	-11.4%	14.1%
Greater Sydney					
Depreciation	-70.5%	27.7%	-6.5%	2.0%	7.1%
Cost to Bring to Satisfactory Standard	-124.5%	345.6%	-36.7%	-9.0%	9.7%
Required Annual Maintenance	-127.1%	723.3%	-29.4%	1.4%	32.9%
Outside Greater Sydney					
Depreciation	-65.5%	113.1%	-6.0%	-0.1%	3.8%
Cost to Bring to Satisfactory Standard	-102.6%	462.8%	-49.9%	-13.7%	8.2%
Required Annual Maintenance	-151.6%	950%	-51.3%	-13.3%	6.8%

The key question here is whether it is reasonable to undertake the 'most significant investment the State has ever made in the local government sector' (Toole, 2014) on the basis of data grossly distorted by gaming?

A further problem with the *Fit for the Future* process is the absence of any control for external constraint. Put simply, external constraint refers to the exogenous challenges which a local authority faces in providing local goods and services (Andrews et al., 2005). In a recent paper, Drew and Dollery (2015c) exposed the inadequacies of existing municipal classification systems:

> 'The impact of exogenous external constraints on municipal behaviour may thus render it unwise to compare the performance of local authorities without explicitly taking into account environmental factors.'

It is not sensible to hold two or more councils facing completely different external challenges to the same *Fit for the Future* benchmarks. For instance, it is silly to suggest that Manly (with

105km of roads, an average wage of $87,682, indigeneity at 0.3% and average density of 3,097 individuals/km^2) faces the same problems as Penrith (with 970km of roads, an average wage of $49,046, indigeneity at 3% and density of 462 individuals/km^2). Yet this seems to be an implicit assumption in the forthcoming assessment of local authorities that will be taken by IPART (2015) in the absence of sophisticated analysis of environmental constraint and the relaxation of constraining Terms of Reference.

In addition, close examination of the NSW OLG toolkit has revealed serious errors in the data used to assess 'efficiency'. The OLG *Fit for the Future* toolkits/proposals use 2013 projected population data which the Australian Bureau of Statistics had clearly labelled ''Preliminary figure[s] or series subject to revision' (ABS, 2015). This is most unwise given that the preliminary population estimates used by the OLG have already been significantly revised in the latest release of the Regional Population Growth data (released on the 31st March, 2015)! Given the sensitivity of the ill-conceived 'efficiency' ratio to small changes in the data, this problem means that it is impossible to accurately undertake the task which the NSW OLG has set for IPART.

Errors of logic continue to plague certain *Fit for the Future* ratios. These errors have been pointed out to the Panel and NSW OLG in earlier United Service Union submissions, yet little has been done to ameliorate these problems. IPART (2015, p.31) recognised a significant problem with at least one ratio when it noted that:

> 'We should note that the benchmark for the Asset Maintenance Ratio is based on the underlying assumption that previous underspending has occurred, which has resulted in the infrastructure backlog for councils being greater than 2%... Should a council

continuously exceed the Asset Maintenance target by spending more on maintenance than is required (i.e., the ratio is > 100%), this may also indicate the council is not efficiently managing its assets'.

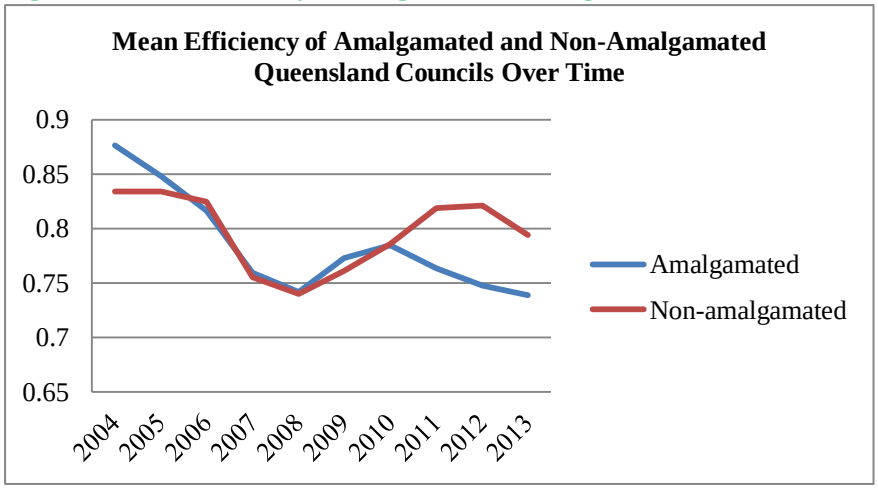
There are a number of difficulties raised by this acknowledged flaw:

- Firstly, there are a large number of councils which claim to have an infrastructure backlog ratio less than 2% - and indeed to be fit for the future councils must demonstrate that this is the case (thus, according to this statement it seems that a council demonstrating fitness on the infrastructure backlog ratio will simultaneously demonstrate inefficient asset management if they also meet the latter benchmark)!
- Secondly, if IPART were to use the *Fit for the Future* ratios for the purpose of continuous monitoring, then achievement of this ratio benchmark would actually indicate that councils are not 'efficiently managing' their assets.

However, perhaps the most important failure of the *Fit for the Future* regime which IPART have inherited is the fact that the architects of *Fit for the Future* – the OLG (2014) and ILGRP (2013) – still have not provided empirical evidence to suggest that amalgamation is in fact the panacea to the municipal sustainability 'crisis' that they claim it to be. It may well come as a surprise to most NSW residents that the NSW Government has embarked on the 'most significant investment the State has ever made in the local government sector' (Toole 2014) – predicated on enhancing the sustainability of the municipal sector as a result of amalgamations – without actually conducting a rudimentary examination of whether municipal mergers actually enhance council sustainability!

Fortunately, we have undertaken this essential empirical research task. NEER (2015) examined a stratified sample of the 2000/04 Carr Government mergers and found that there was no statistically significant difference in the sustainability of merged and unmerged councils. Moreover, Drew, Kortt and Dollery (2015) conducted an empirical examination of the outcomes from the Queensland 2007/8 amalgamations and found empirical evidence to suggest that the forced amalgamations were generally deleterious for the Queensland municipal sector. Moreover, NEER (2015) have provided compelling evidence that the efficiency of Queensland merged councils was much lower than their unmerged peers over the period. We have reproduced the graphical evidence from the NEER (2015) report to illustrate the point. However, readers are directed to the report itself for full details of the methodology employed. It should be stressed that our analysis of municipal efficiency does in fact measure efficiency (i.e. the conversion of multiple inputs into multiple outputs).

Figure 1: Mean Efficiency of Merged and Unmerged Queensland Councils over Time



IPART (2015, p.32) acknowledges that mergers of NSW councils will *reduce* efficiency when it states that 'some discretion will apply to Merger Proposal councils in the short term

as this measure may be affected by the transition to new arrangements that may require additional spending to achieve future efficiencies'.

The obvious question raised by this statement is how long should residents wait to see an improvement in efficiency subsequent to a merger? The rather convenient answer for the Baird Government is that local residents should wait for at least five years. This places expected improvement into the period *after* the next NSW election! However, recent scholarly evidence by Drew, Kortt and Dollery (2015b) suggests that residents may never see any improvement in efficiency arising from the proposed amalgamations.

The final problem relates to the importance placed on forecasts of performance. Both the existing structure and rural council *Fit for the Future* templates require councils to make specific forecasts of performance for each of the subsequent four years. In addition, IPART (2015, p.34) makes the following rather strange request of all councils:

> 'We consider councils should provide as much relevant information or data as is required to support the proposals. Therefore, we consider it would be helpful if a longer time series of data to include 2014-15 and 2015-16 is provided by all councils lodging proposals (no matter the type of the proposal). We consider that the additional two years of data would provide us with a better picture of the trend in council performance relative to the benchmarks. *The additional two years of data should be available from councils' annual reporting requirements and could be provided without imposing an unreasonable burden'* (emphasis added).

We agree that a longer time series may assist with assessment of some ratios (but not all, assuming that the apparently unsurmountable data distortions could be corrected. However, it appears that IPART has an inordinate faith in the budgeting ability of councils. Moreover, as we have seen the *Fit for the Future* templates imply a similarly high level of faith in forecasting and budgeting practice. This implies an empirically testable claim that budget data in NSW municipalities contains a relatively low degree of error.

Table 4 details the accuracy of budget projections made by councils in both the 2013 and 2014 financial statements. What is immediately clear is that the average council (median result) has an absolute budget error of around 8% of actual revenue. Furthermore, there is evidence of a wide variation from the average. For instance, 25% of councils had errors in excess of 16% in 2013 and one council missed the mark by 60%! It should be noted that many of the ratios employed by IPART are extremely sensitive to variation (particularly the 'efficiency' ratio). Moreover, it should be borne in mind that these errors are for forecasts which are made only one year in advance. It is thus reasonable to suggest that the accuracy of forecasts made two years in advance (to provide IPART with its longer time series) or four years in advance (for the *Fit for the Future* templates) will have errors so large as to make the forecasts effectively worthless. Moreover, Goodhart's law that 'any observed statistical regularity will tend to collapse once pressure is placed on it for control purposes' (Bevan and Hood, 2006, p.521) means that forecasts made in the current atmosphere of 'target terror' – to borrow a term from Coulsen (2009) – will be extremely unreliable. If IPART does want a longer time series of data, then the sensible thing would be to use data from earlier periods (i.e. to the 2011 and 2010 financial years) for most ratios.

Table 4: Accuracy of NSW Council Budget Projections (Deviance of Actual Result to Budgeted Item)

Budget Item[7]	Smallest	Largest	Quartile 1	Median	Quartile 3
Entire State 2013					
Operating Revenue Budget Error	-29.903	68.282	3.768	9.958	18.353
Operating Expenditure Budget Error	-24.513	60.798	-1.873	2.059	7.927
Operating Result Budget Error*	0.006	60.017	3.646	7.487	16.029
Entire State 2014					
Operating Revenue Budget Error	-32.337	40.563	-0.890	4.931	11.414
Operating Expenditure Budget Error	-31.788	41.738	-3.341	0.799	6.096
Operating Result Budget Error*	0.105	76.412	4.003	8.273	13.862

* This budget error is expressed as a percentage of actual revenue and is reported in absolute terms.

[7] All items are expressed as a percentage of the deviance of actual result from budgeted result except for Operating Result Budgeted error which is expressed in terms of actual revenue to reduce the occurrence of three figure deviances.

5. Rural Council Characteristics

One of the positive aspects of the IPART (2015) process is its emphasis on consultation.

IPART (2015) has proposed a question to stakeholders regarding which of the Rural Council characteristics are most important for classification purposes. However, the detail provided by the OLG is entirely insufficient for the purpose, as Table 5 demonstrates.

Table 5: Characteristics of Rural Councils

Characteristic	Implication
Small and static or declining population spread over a large area	What is a large area? Does a council cease to be rural simply because it's population has grown marginally (assuming of course that the population estimates are reliable)
Local economies that are based on agricultural or resource industries.	How exactly does one conceive 'based'. In terms of geographical area dominated by the select industries, or by the proportion of people employed directly or indirectly in the industry?
High operating costs associated with a diverse population and limited opportunities for return on investment?	Once again, the criteria lack quantitative measures. For instance Penrith is almost seven times less dense than Manly, yet few would categorise Penrith as rural (we assume 'diverse' is meant to refer to density rather than ethnic or religious diversity)! How is return on investment conceived – in terms of community satisfaction, projected savings or actual RoI? If the latter this raises the thorny question as to whether municipalities should be producing private goods (such as child care).
High importance of retaining local identity, social capital and capacity for service delivery	Firstly, many urban councils have made the argument that amalgamation will destroy local identity and social capital (see, for instance, Holroyd). Secondly, the OLG and Sansom (2015) have argued that amalgamation is necessary to *increase* capacity – so how can retaining capacity also be used as an argument by IPART and the OLG for not merging rural councils?
Low rate base and high grant reliance	As Abelson and Joyeux (2015) have argued this is an erroneous measure of financial sustainability because councils have had their rate revenue pegged for well over three decades! Moreover, the OLG has recently conceded that grant allocations have not been made according to the horizontal equalisation principals enshrined in federal legislation (see also Drew and Dollery 2014a). Therefore, how can this be regarded as a valid criteria for deciding whether a council is rural or not? Moreover, the logic flaws contained in the indicator apply equally to urban councils.
Difficulty in attracting and retaining skilled and experienced staff	Firstly, this presumes that rural councils do in fact have difficulty with staffing (despite there being no empirical data to support the claim). Secondly, if this is to be taken as an indicator that a council is rural it implicitly assumes that urban councils do not face difficulty with staffing – once again, a claim made in the absence of empirical evidence.

Characteristic	Implication
Challenges in financial sustainability and provision of adequate services and infrastructure.	This is a rather curious criteria for determining whether a council is rural or not given that the ILGRP (2013), OLG (2014) and Minister Toole have been loudly proclaiming that the entire NSW municipal sector is facing a financial sustainability and infrastructure crisis! If, as implied by this statement, the government believes that the challenges apply only to rural councils then there is clearly no longer a case for urban amalgamation!
Long distance to major (or sub) regional centre	Once again this criterion suffers from a lack of detail. How does IPART/OLG conceive 'long' – in terms of kilometres or travelling time? The criterion also exhibits a circuitous argument given that it is first necessary to identify non-rural councils before rural councils can be definitively recognised.
Limited opportunities for mergers	Yet another criterion which applies equally to rural and urban councils and lacks sufficient detail for judgements to be made. All councils in NSW have neighbours and therefore all councils in NSW have more or less equal opportunities for merger. Moreover, if the criterion is conceived in terms of willing partners, or merger partners which would enhance sustainability, then all urban *and* rural councils face limited opportunities.

This leads us to the point where we can answer the specific question raised by IPART (2015, p.11):

IPART Question: Which of the 'Rural Council Characteristics' are the most relevant, considering a council must satisfy a majority of the characteristics to be considered rural?

Response: *Unquantified characteristics that can often be applied equally to urban and rural councils are unsuitable for meaningful classification purposes. We suggest that IPART first quantifies the various characteristics, removes logical flaws from the criteria and discards the majority of the criteria which apply equally to urban and rural councils. After this has been done, informed decisions might be made regarding the relevance of any remaining characteristics. At this point, we recommend that IPART returns to the stakeholder consultation process in order to receive further feedback.*

6. Methodology for Scale and Capacity

The ILGRP's 'preferred options' – now referred by the IPART (2015) as 'merger recommendations' (p.15) – were based in large part on the Department of Infrastructure (2013) *NSW in the future: Preliminary 2013 population projections* (ILGRP 2013). This raises an important question as to whether it is wise to base decision making on *preliminary* forecasts made 18 years into the future, especially given the low rate of accuracy inherent in ABS population estimates for inter-censal base years.

Unfortunately little work has been done in assessing the accuracy of local government area (LGA) forecasts. An exception to this is Wilson and Rowe (2011) on Queensland LGA forecasts. They found a mean absolute percentage error for three separate 15 year forecasts of Queensland's entire set of LGA's in the order of 14.6% (Wilson and Rowe, 2011), suggesting that it is not wise to put much emphasis on long-term population forecasts.

It follows that the basis for the Panel's (2013) musings on the fate of NSW councils appears to be rather shaky. Hence our concern that the 'preferred options' now being cast as 'merger recommendations' by IPART (2015, p.15) will be based on unsound information. Moreover, it is entirely likely that the ILGRP 'preferred options' and subsequent OLG endorsements of the preferred options as 'merger recommendations' have been made on the incorrect functional unit for local service provision.

Drew and Dollery (2014d) have noted that household and business data is more reliable, less volatile and more relevant (than population data) to public policy making in Australian local government, given the preponderance of municipal functions focussed on 'services to

property' rather than 'services to people'. Moreover, use of a population measure of scale and capacity implies that business does not contribute to revenue or place demand on municipal goods and services! The neglect of business also means that spill-over effects are not being taken into account. In addition, population is negatively correlated to the length of council maintained roads (Pearson correlation coefficient equals -0.2659). The use of population data thus only ignores the single largest expenditure function of NSW local government (Price WaterhouseCoopers, 2006), but actively disadvantages councils with large road infrastructure. Finally, it is the number of households and employing businesses that a council has control over (via development applications and economic development expenditure), not organic population growth.

Even if we were to concede that population was the appropriate functional unit for Australian local government, there is still the 'inconvenient fact' that neither TCorp (2013), the ILGRP (2013a, 2013b) nor the OLG (2014) have provided any empirical evidence to suggest that there is an association between population size and the various measures of municipal sustainability which have been employed to date.

Drew and Dollery (2014b, p.287) conducted a series of regression analyses for Greater Sydney councils and found 'little evidence of any statistically significant association between the financial sustainability ratios and population size'. We now present a series of panel regression analyses which also suggest little or no association between population size and financial sustainability (according to the original TCorp (2013) financial sustainability ratios over the period 2009/11 (the three complete years of TCorp ratios published)):

Table 6: Greater Sydney Stratification of Linear Panel Regression, 2009/11 (n = 38)

	Operating Ratio	Own Source Revenue Ratio	Unrestricted Current Ratio (ln)
Population (ln)	-4.219	9.876	1.051
	(50.262)	(62.797)	(2.668)
Population Density	22.905	38.530	1.272
	(35.457)	(41.750)	(1.882)
Population Growth (ln)	-4.271	1.820	-0.143
	(3.091)	(3.535)	(0.164)
Exogenous Controls	Yes	Yes	Yes
Coefficient of Determination	0.18	0.07	0.12

	Interest Cover Ratio (ln)	Infrastructure Backlog Ratio (sqrt)	Debt Service Cover Ratio (ln)
Population (ln)	5.689	-1.732	3.489
	(9.270)	(1.182)	(7.632)
Population Density	-1.059	0.408	3.943
	(7.256)	(0.834)	(5.974)
Population Growth (ln)	-1.180*	-0.022	-0.587
	(0.524)	(0.073)	(0.432)
Exogenous Controls	Yes	Yes	Yes
Coefficient of Determination	0.15	0.07	0.11

	Capital Expenditure Ratio (ln)	Cash Expense Ratio (ln)	Asset Renewal Ratio (ln)	Asset Maintenance Ratio
Population (ln)	-2.442	6.335	-12.709	4.976
	(4.692)	(11.876)	(8.721)	(3.019)
Population Density	-4.903	-5.744	8.827	-7.017**
	(3.310)	(7.763)	(6.152)	(2.130)
Population Growth (ln)	-0.113	0.089	0.205	-0.287
	(0.289)	(0.656)	(0.536)	(0.186)
Exogenous Controls	Yes	Yes	Yes	Yes
Coefficient of Determination	0.38	0.12	0.18	0.20

Source: T Corp and the Australian Bureau of Statistics.
Standard errors in parentheses
* p<0.05, ** p<0.01

Table 7: Non-Sydney Stratification of Linear Panel Regression, 2009-2011 (n = 114)

	Operating Ratio	Own Source Revenue Ratio	Unrestricted Current Ratio (ln)
Population (ln)	214.249**	-17.076	2.450
	(58.391)	(37.244)	(2.040)
Population Density	16.343	4.028	-0.327
	(14.046)	(8.687)	(0.550)
Population Growth (ln)	2.093	1.200	-0.180
	(2.626)	(1.627)	(0.092)
Exogenous Controls	Yes	Yes	Yes
Coefficient of Determination	0.27	0.06	0.06

	Interest Cover Ratio (ln)	Infrastructure Backlog Ratio (sqrt)	Debt Service Cover Ratio (ln)
Population (ln)	8.025	0.047	5.312
	(6.397)	(0.692)	(6.122)
Population Density	1.813	-0.076	1.044
	(1.703)	(0.182)	(1.630)
Population Growth (ln)	0.028	0.008	-0.074
	(0.279)	(0.030)	(0.267)
Exogenous Controls	Yes	Yes	Yes
Coefficient of Determination	0.05	0.06	0.06

	Capital Expenditure Ratio (ln)	Cash Expense Ratio (ln)	Asset Renewal Ratio (ln)	Asset Maintenance Ratio
Population (ln)	5.480	3.033	13.914**	-3.635
	(4.025)	(4.304)	(4.646)	(3.486)
Population Density	-0.251	-0.321	0.249	-0.781
	(1.077)	(1.131)	(1.252)	(0.830)
Population Growth (ln)	0.329	-0.148	0.209	0.056
	(0.180)	(0.189)	(0.209)	(0.155)
Exogenous Controls	Yes	Yes	Yes	Yes
Coefficient of Determination	0.28	0.02	0.21	0.04

Source: T Corp and the Australian Bureau of Statistics.
Standard errors in parentheses
* p<0.05, ** p<0.01

As can be seen from Table 6 and Table 7, panel regression of the 2009/11 TCorp financial sustainability ratios only indicates associations for population size for non-Sydney councils (and then only for two of the ten ratios examined). These two associations may provide some limited support for the lower benchmarks proposed for 'rural councils' with small populations. However, there is no evidence of an association between population size and

financial sustainability for Greater Sydney councils when a time series analysis is conducted. Thus, this appears to be further evidence against the ideologically imposed scale criteria.

Drew and Dollery (2015d) have also empirically demonstrated that there is no association between population size and municipal expenditure. Hence, it has now been empirically proven that the assumptions of economies of scale pervading the ILGRP (2013) report are completely illusory. This recent evidence is consistent with the earlier work of Drew, Kortt and Dollery (2014c)[8] which was available to the ILGRP (2013) at the time that they prepared their report.

Moreover, Drew, Kortt and Dollery (2015b) have recently published data envelopment analyses which demonstrate that the ILGRP (2013) proposed amalgamations will result in over-scaled councils which predominately exhibit diseconomies of scale. This is yet further, evidence against the scale and capacity 'preferred options' advanced by the ILGRP (2013) without any empirical support now known as 'merger recommendations' (IPART, 2015, p.15).

A superior approach to securing the benefits of scale resides in delivering local services which exhibit scale economies at the regional level through constellations of councils in the form of Joint Organisations or similar bodies. By contrast, local services which do not enjoy scale economies should continue to be provided by individual local authorities in tune with local preferences. A wealth of research has been undertaken on both the types of services which exhibit scale economies and the optimal methods of organising regional service

[8] Published on-line 2012.

provision. This work has been summarised in Dollery, Grant and Kortt (2012) *Councils in Cooperation,* to which we refer IPART.

We are now in a position to answer further question posed by IPART (2015):

IPART Question: How should the key elements of strategic capacity influence our assessment of scale and capacity? Are there any improvements we can make to how we propose to assess the scale and capacity criterion, consistent with OLG guidance material?

Response: *Strategic capacity is an elusive term with no firm definition. Indeed, it derives more from the skills and talents of people running a given local council than the size of the council. It is thus illusory to seek to improve strategic capacity by modifying the structure of local government.*

These matters aside, there are many improvements that IPART can make with respect to the assessment of scale and capacity. In the first instance, IPART should use the most appropriate functional unit – the number of households and employing businesses. Secondly, IPART should disregard any scale recommendations based on preliminary population forecasts given the evidence that long range forecasts are extremely unreliable. Thirdly, IPART should base the scale criterion on empirical evidence rather than the 'preferred options' of the ILGRP (2013) which the Panel Chair himself has declared were never intended to be 'recommendations' (Sansom, 2015). If IPART thus takes cognisance of the scholarly evidence then it would be logically obliged to drop the criterion entirely. However, its terms of reference seem to force IPART to abide by scale and capacity criterion laid out by the OLG and ILGRP. This is rather unfortunate given that the scale and capacity criterion

is absolutely spurious and devoid of empirical foundation. We recommend that IPART takes heed of the Panel Chair's declaration that 'preferred options' should not be considered as 'recommendations' and instead analyse the existing scholarly evidence on the matter.

7. Methodology for Sustainability

According to IPART (2015), the sustainability criteria include the Operating Performance, Own Source Revenue and Building and Infrastructure Renewal ratios. Table 8 contains the definitions employed by IPART. Two of these ratios are heavily dependent on data which is still the subject of 'unfinished business', whilst the integrity of the data relating to the third ratio is under serious question. It is important to note these deficiencies given IPART's (2015, p.29) statement that it 'consider that ensuring councils are financially sustainable, and being able to show this will occur into the future, is fundamental to demonstrating a council is FFTF'.

Yet future revenue flows from both rates and FAGs cannot be predicted with any degree of confidence given that the outcomes from the proposed review of rating practice and changes to ensure FAGs are distributed to councils with the greatest need are still to be completed. As Abelson and Joyeux (2015) correctly note, it is not reasonable to hold councils accountable for revenue streams for which they have very little control. Local government residential taxation effort[9] lacks inter-municipal equity and has constrained an important stream of own source revenue as noted by the ILGRP (2013) and illustrated in Table 9. In fact, residential taxation effort ranged from 0.209% through to 2.497% with a mean of 0.998%. Thus the long-standing rate-capping regime has constrained the local taxation revenue of some

[9] Residential taxation effort is defined as the proportion of residential rates levied by a municipality expressed as a percentage of total annual incomes accruing to residents residing in the council boundary and is the preferred measure of municipal fiscal burden in the literature – see, for instance Ladd and Yinger 1989.

councils to just one tenth of their peers. This suggests that if rate-capping is removed (as seems to be the likely outcome of the NSW Government review), then the Operating Performance and Own Source ratios of some councils might be altered quite significantly.

We also caution against the idea that FAG revenue 'provide a stable income for rural councils' (IPART, 2015, p.29) but not urban municipalities. FAGs will not be a stable source of revenue for *any* NSW council owing to (a) the unfinished business relating to more equitable allocations and (b) the fact that the Commonwealth Government has frozen FAGs for a period of three years. This means that FAGs will be reduced in real terms for each of the subsequent three years. Moreover, there is no certainty that the Commonwealth Government will not attempt to extend the freeze or make further cuts to FAGs given the pressures on the Commonwealth's budget. Thus it is clear that it is very difficult for any council to demonstrate their fitness into the future without *both* the outstanding matters being addressed.

The final 'sustainability' ratios also present significant problems for IPART if it is to assess councils with 'consistency, fairness and impartiality' (IPART, 2015, p.43). This is largely because the data relied on for the ratio has been the subject of 'earnings management' and is thus not reliable (Pilcher and Van der Zahn, 2010; Drew and Dollery, 2015a). In addition, climatic factors and natural disasters may affect the ratio, thus requiring very careful analysis given little comparability across the sector. It is also clear that municipal efforts to address this ratio will have negative implications for the Operating Performance ratio which presents a rather difficult problem for councils seeking to demonstrate future fitness.

Table 8: *Fit for the Future* Criteria and Measures

Criteria and measure	Definition
Sustainability	
Operating Performance Ratio	Net continuing operating result*/ Total continuing operating revenue*
Own Source Revenue Ratio	Total continuing operating revenue (excluding all grants and contributions)/ Total continuing operating revenue (including capital grants and contributions)
Building and Asset Renewal Ratio	Asset renewals (building and infrastructure)/ Depreciation, amortisation and impairment (building and infrastructure)
Effective infrastructure and service management	
Infrastructure Backlog Ratio	Estimated cost to bring assets to a satisfactory condition/ Total (WDV) of infrastructure, buildings, other structures, depreciable land and improvement assets
Asset Maintenance Ratio	Actual asset maintenance/ Required asset maintenance
Debt Service Ratio	Cost of debt service (interest expense and principal repayments)/ Total continuing operating revenue*
Efficiency	
Real Operating Expenditure	Operating expenditure/ Population

* excluding capital grants and contributions; WDV = written down value
Source: IPART (2015, p.5)

Table 9: ANOVA Results for Taxation Effort All NSW Councils, 2012

	Prob> F	Agricultural (Ag)	Fringe (Fr)	Metropolitan (Met)	Regional (Reg)	Remote (Rem)	Differences
Taxation Effort (%)	0.000	0.807 (0.302)	1.201 (0.233)	0.844 (0.213)	1.422 (0.346)	0.551 (0.000)	Fr>Ag** Fr>Met** Reg>Ag** Reg>Met** Reg>Rem*

+ p<0.10, * p<0.05, ** p<0.01

We are now in a position to answer the question posed by IPART in relation to 'Sustainability' ratios:

IPART Question: Are there any improvements we can make to how we propose to assess the sustainability criteria, consistent with the OLG guidance? Are there issues that we need to consider when assessing councils' proposals using the measures and benchmarks for these criteria?

Response: *It is difficult to imagine how the future sustainability of councils can be accurately assessed without the unfinished business relating to rate pegging and FAG allocations being first resolved. Moreover, cluster analysis – or some other robust empirical method – needs to be applied so that councils can be assessed only against peers facing the same relevant external constraints. Ideally, the benchmark should be altered to reflect the various levels of external constraint. Otherwise councils will be assessed against the same benchmarks as their peers even though they might face entirely different conditions. For instance, councils which are located in areas of extreme climatic conditions may have higher rates of depreciation and impairment which make achievement of the Building and Asset Renewal ratio more difficult. Finally, it would be prudent to conduct sensitivity analysis on the Building and Asset Renewal ratio given the evidence of 'earnings management' on the denominator.*

8. Methodology for Infrastructure and Service Management

As demonstrated in Section 3 of this Submission, the ratios employed to assess Infrastructure and Service Management are subject to enormous levels of data distortion. It is thus hard to imagine that any methodology could be used to assess these criteria with 'consistency, impartiality and fairness' (IPART 2015, p.3) given that the councils which did not participate in 'reactive gaming' will be unjustly penalised if the unaudited data is taken at face value. Of greatest concern is the Infrastructure and Backlog ratio was compiled according to just a single year of data well after it had become known that the data would be used as an important ratio for the assessment of future fitness. Moreover, the data is unaudited (as is the data for the Asset Maintenance ratio) and thus it cannot be claimed that there is any basis for reasonable assurance.

It is hardly surprising that auditors have deliberately excluded Special Schedule 7 from their Audit Opinions in the past given that it relies on completely subjective assessments. For instance, the following definitions are employed to determine a 'satisfactory standard' and 'required maintenance':

> 'Satisfactory refers to estimated cost to bring asses to a satisfactory condition as deemed by Council. Required Maintenance is what should be spent to maintain assets in a satisfactory standard'

This specific example of the definitions was taken from Bombala's 2014 Financial Statements, but is repeated in all council financial statements. Clearly the definition falls far short of the Bird et al. (2005) requirement for a competent performance management program

and invites reactive gaming owing to the fact that it (a) does not commit the council to any particular future action, (b) is defensible given that it is based on professional judgement, (c) it does not require a 'real' transaction with second parties (Copeland, 1968, p.102). Moreover, the breadth of municipal infrastructure, along with the detailed engineering knowledge required to assess maintenance needs, suggests that it would be extremely difficult for an audit team to provide reasonable assurance on the Schedule 7 items. Without some assurance of the accuracy of the data, the two ratios which depend upon it are of no worth whatsoever.

In addition to this formidable problem, the Asset Maintenance ratio is subject to an obvious flaw. To achieve benchmark status a council must demonstrate that it is spending more on asset maintenance than what is required! We have already noted this problem in Section 5 of this Submission, along with the unconvincing attempt by IPART to try to justify the rather strange benchmark. If IPART (2015) is successful in extending the *Fit for the Future* assessments to include an additional two years of data (taking this ratio up to five years of data, then the unfortunate inherent problems in the benchmark will be further exacerbated. Perpetual reporting of the Asset Maintenance Ratio against the existing benchmark clearly would not make any sense.

The Debt Service ratio is also an interesting choice by which to measure municipal fitness. It should be noted that the OLG chose to entirely disregard the expert advice of the NSW Treasury Corporation (2013) on the definition of this ratio and have thus completely eroded the ratio's utility. It no longer measures the ability to service debt as indicated by the name given to the ratio, but rather measures the proportion of revenue that a council devotes to principal and interest repayments.

This has at least two deleterious effects:

- It discourages councils from reducing interest expenditure through high principal repayments (even though councils are simultaneously directed by the 'efficiency' ratio to reduce expenditure).
- Secondly, the ratio in its current form actively insists that councils (not currently in debt) take on debt! However, this lower bound benchmark for the ratio (0.0%) encourages some rather perverse behaviour for councils which currently have no debt. For instance, it appears that a council with no debt can become *Fit for the Future* according to this benchmark by taking out a loan large enough to be recognised in the financial statements and either (i) make interest only repayments and take no action to employ the capital for productive purposes or (ii) repay the loan the next week!

The reasoning employed by the OLG for requiring councils which have no need for debt to take on some debt is that councils should 'use debt wisely to share the life-long cost of assets and avoid excessive rate increases' (IPART, 2015, p.31). However, as we have demonstrated, councils can meet the benchmark without using debt in a 'wise' manner. Moreover, if the object is to use debt with the aim of intergenerational equity on long-lived assets then this presents a number of problems.

- Firstly, requiring councils to share intergenerational costs from this time forth imposes inequity on previous generations who paid the entire costs of assets which continue to have a useful life beyond this point in time.

- Secondly, the OLG objective assumes that the life of the asset will be closely correlated with the term of the debt without any reason to suppose this will be the case! If the OLG really believe that the intergenerational burden of infrastructure should be more equitably distributed in the future (and thus at the same time demand that previous generations be treated inequitably), then the obvious course of action is to use bonds issued specifically for capital infrastructure projects with either (i) terms closely correlated to the expected life of the asset or (ii) use consols as per the perpetual sharing scheme model (Brueckner, 1997).
- Finally, the objective assumes that debt will be used for capital projects rather than operational expenditure without any assurance that this will be the case.

We can now answer the question posed by IPART (2015, p11) in relation to assessment methodology of infrastructure and service management.

IPART Question: Are there any improvements we can make to how we propose to assess the infrastructure management criteria, consistent with the OLG guidance? Are there issues that we need to consider when assessing councils' proposals using the measures and benchmarks for these criteria?

Response: *The first two ratios are completely unreliable as they draw on heavily 'gamed' and unaudited data. They cannot be reliably assessed at present. IPART is thus strongly encouraged to drop the two ratios until such time that reasonable assurance of their accuracy can be had. Failure to drop the two ratios may simply promote further gaming of Schedule 7 items. With respect to the third ratio – Debt Service – the OLG and IPART are strongly encouraged to revert back to the definition previously employed by TCorp (2013).*

The ratio in its current form is illogical, promotes perverse behaviour and does not achieve its stated objective. The only thing that can be done to assess this criteria with 'consistency, fairness and impartiality' (IPART, 2015, p.3) is to (i) scrap the infrastructure backlog ratio until such time as the data can be shown to be reasonably accurate, (ii) change the Asset Maintenance Ratio so that achievement of the benchmark does not require councils to spend more than required[10] and (iii) revert back to the TCorp (2013) definition of Debt Service (but conduct empirical analysis to determine an appropriate benchmark).

9. Methodology for Efficiency

The first thing to note about the *Fit for the Future* 'efficiency' ratio which IPART has been asked to assess is that it does not measure efficiency! Technical efficiency measures the conversion of inputs into outputs generally through the use of non-parametric techniques such as data envelopment analysis (DEA). In the case of NSW councils the appropriate inputs would be measures of capital and labour used, whereas outputs might be specified according to number of households, employing businesses and roads.[11] We note that once again the OLG has ignored the expert advice of TCorp (2013) which did not include an 'efficiency ratio' in their suite of financial sustainability ratios.[12] We also note that IPART (2015, p.32) appear to conflate the 'efficiency' measure with 'value for money'. However, this a completely spurious conflation which further exacerbates the problems associated with this criterion given that ''achieving best value is not just about economy and efficiency but also about effectiveness and quality of local services' (Tichelar, 1998, p.34).

[10] This requires more than a reduction in the benchmark. The definition needs to be changed so that it incorporates previous maintenance backlogs.
[11] See Drew, Kortt and Dollery (2015) for a thorough investigation of municipal DEA specification.
[12] It should be noted that recent research by Drew, Kortt and Dollery (2015) has demonstrated that efficiency has very little association with measures of financial sustainability which probably explains why TCorp (2013) decided not to include 'efficiency' in their suite of financial sustainability ratios.

What the OLG has chosen to calculate is expenditure per capita. It is not efficiency because it implicitly assumes that all services can be proxied by the number of people in a municipality. As noted earlier in this Submission, this is problematic because (i) it uses the incorrect functional unit (Drew and Dollery, 2015), (ii) the functional unit used entirely ignores the expenditure related to businesses in the municipality, and (iii) it entirely ignores the single largest functional expenditure item for councils – roads (PwC 2006). Moreover, because roads are negatively correlated with population (correlation coefficient of -0.2659), use of population effectively disadvantages councils with low populations.

Victoria has also applied an incorrect measure of efficiency (Department of Planning and Community Development 2013):

> 'Underlying expenditure / Total number of assessments (where underlying expenditure does not include other large items and/or adjustments that are not in the ordinary course of business'

However, at least Victoria uses a functional unit which has a closer correlation to actual service provision (number of rates assessments)[13] and excludes items such as defined superannuation calls and one-off capital expenditure associated with specific capital grants. There are a number of other problems which plague the OLG 'efficiency' ratio (which does not measure efficiency). These problems include the population data employed in the calculations, the method used to deflate data and the method used to assess the direction of expenditure trend.

[13] This measure over-estimates the functional unit because it includes vacant land which is not closely associated with municipal service provision.

With respect to the population data, the OLG have introduced significant and avoidable error by using 2013 *projected* population estimates. Firstly, as we have seen earlier, population data in inter-censal periods already has significant error associated with it and this error typically increases with temporal distance from the last census (2011). Secondly, the projected population estimates were never meant to be anything other than a guide and were clearly labelled 'preliminary figure[s] or series subject to revision' (ABS, 2015). Thirdly, the figures have in fact been revised and many of the revisions are significant (for example, Cooma-Monaro was revised up 0.89% and Snowy River was revised down 1.17%). Given the high leverage of 'efficiency' data points even a very small error could result in a completely different assessment on this criterion (see below).

The OLG 'efficiency' ratio is also deficient as a result of the method used to deflate the nominal expenditure data:

- Firstly, it is not acceptable to use two entirely different indexes to deflate continuous data.
- Secondly, use of annualise growth in calculations (rounded to just one decimal place) imputes and compounds rounding error (given the sensitivity of the empirical method erroneously used to calculate the trend in expenditure per capita even relatively small errors could result in the wrong conclusions being drawn from the data).
- Thirdly, it was entirely unnecessary to deflate the 2010 financial year data and this decision simply introduced avoidable rounding error.
- Finally, expenditure per capita has been rounded to just two decimal places – this is problematic because (i) very small changes in expenditure per capita can completely

alter the result for this ratio and (ii) it ignores the basic rules for arithmetic calculations thus implying a higher degree of certainty than is warranted by the inputs.

The final – and fatal – problem associated with the OLG/IPART efficiency measure is the empirical method chosen to establish the direction of expenditure/capita trend. The OLG toolkit employs linear regression to establish whether expenditure per capita is rising or falling. Unfortunately, the use of linear regression to establish the direction of the trend is completely flawed owing to the fact that it breaks the key assumption of linear regression – that the data association has a linear functional form!

Figure 2 plots expenditure per capita against time for Hunters Hill council (data drawn from the OLG (2014) FFTF Toolkit). It is immediately obvious that the data points are best represented by a quadratic equation with local *maxima* – not the linear trend used by the OLG (trend line, line formula and coefficient of determination shown on graph). The distribution of Hunters Hill's expenditure per capita data is typical of many NSW councils and arises from the 'early payment in 2011/12 of Commonwealth Financial Assistance Grants (FAGs) that were not due to be paid until 2012/13' (Comrie 2013)[14]. As a result of the OLG employing a completely incorrect functional form the coefficient of determination for the regression indicates that the linear trend line explains less than 1% of the data!

However, there are further problems resulting from the unfortunate method employed by the OLG. Figure 3 shows the sensitivity of the 'efficiency' result as calculated in the OLG Toolkit wherein reduction in the final data point of just 1.3% radically changes the assessment of Hunters Hill fitness in this criterion! Given the error associated with ABS

[14] However, we note that capital grants and spending associated with natural disasters have resulted in more complex polynomial distributions for some councils.

population estimates, the error introduced through using preliminary figures (which have already been revised), the error introduced by rounding deflation factors, and the fact that the population for the last data point is not averaged over two years (as per previous data points) the sensitivity of the 'efficiency' ratio means that it is not fit-for–purpose in a policy making sense.

Figure 3 emphasises this problem by demonstrating that the high leverage of certain data points means that others are entirely redundant. For instance, changing the 2011/12 expenditure for Hunters Hill to an entirely implausible figure of $0 per person makes absolutely no difference to Hunters Hill's original 'efficiency' status!

Finally, Figure 4 illustrates how reducing the last data point by $0.01 ($'000 per capita) actually results in a zero gradient and hence no discernible trend whatsoever (according to the flawed OLG model)! Bird et al. (2005, p.15) have noted that 'even with longer time series, it can be very difficult to estimate trends very precisely'. However, the use of flawed methodology and a relatively short time series means that there is simply no chance of IPART (2015, p.3) assessing councils with 'consistency, fairness and impartiality'.

Figure 2: Hunters Hill 'Efficiency' Ratio

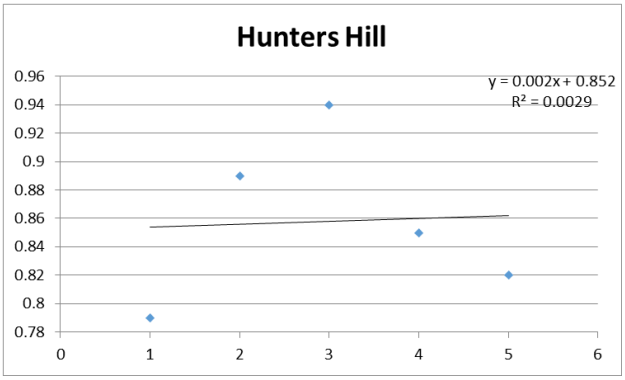
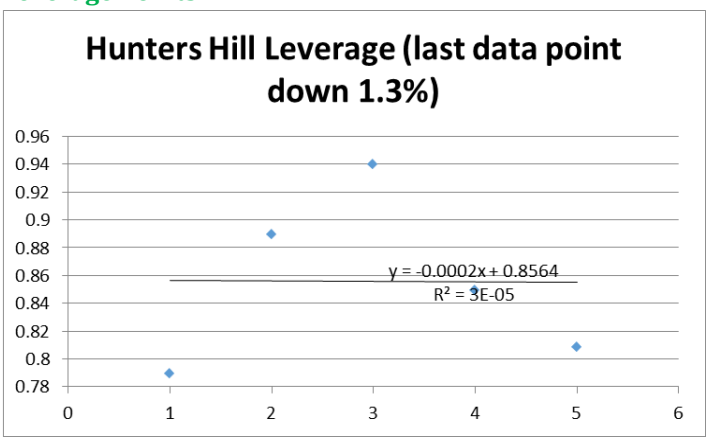


Figure 3: Hunters Hill 'Efficiency' Ratio with Changes Demonstrating the Sensitivity of High Leverage Points



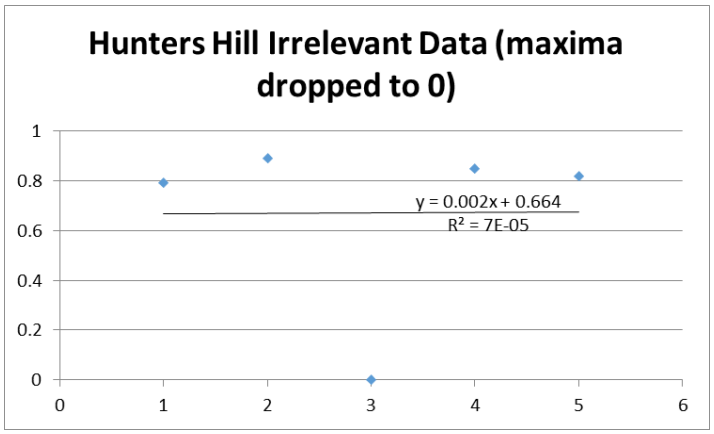
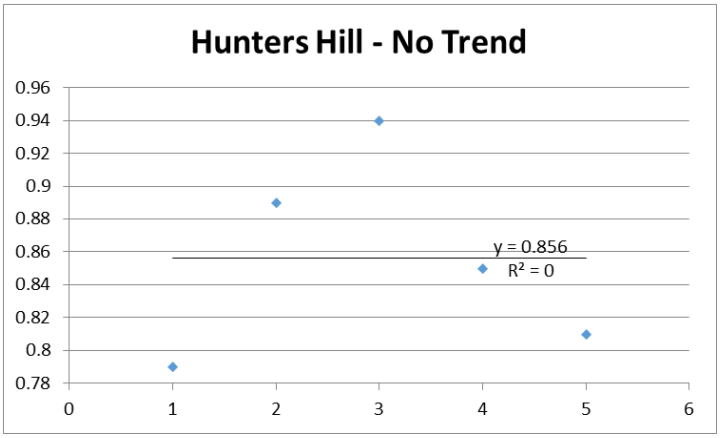


Figure 4: Hunters Hill 'Efficiency' Ratio Demonstrating the Perverse Results Possible



We are now in a position to answer IPART's (2015, p.11) stakeholder question:

IPART Question: Are there any improvements we can make to how we propose to assess the efficiency criteria, consistent with the OLG guidance? Are there issues that we need to consider when assessing councils' proposals using the measures and benchmarks for these criteria?

Response: *It appears that the previous United Services Union submission may have alerted IPART (2015) to the apparently insurmountable problems associated with the OLG's 'efficiency' ratio and that this may explain the new IPART (2015, p.32) benchmark that councils 'must demonstrate operational savings (net of IPR supported service improvements) over 5 years'. However, this new method for assessing 'efficiency' still poses problems for fair, consistent and impartial assessment. Firstly, it is clear that councils with relatively higher expenditure per capita have an advantage over leaner municipalities since there is more potential for expenditure cuts. The empirical design thus needs to be altered to take account of inequitable opportunity for expenditure reduction. Secondly, the use of population data as the denominator still presents problems related to accuracy, volatility, timeliness and functional relevance and we thus recommend a change be made on this point. The problems with deflation of data and rounding also need redress. Finally, it is critical that expenditure data exclude one-off items beyond the control of the council, such as expenditure associated with natural disaster responses.*

10. Ancillary Matters

IPART (2015) raise a number of ancillary questions in its *Methodology for Assessment of Council Fit for the Future Proposals* relating to the impact of water utilities on municipal performance and minimum standards for community consultation.

10.1 The Impact of Water Utility Performance

The OLG Toolkit requires general purpose councils to only input data related to the General Fund. This poses a number of problems for the assessment of general purpose councils according to the Terms of Reference which require 'consistency, fairness and impartiality'. Firstly, the audited financial statements only contain sufficiently disaggregated data for the calculation of the Infrastructure Backlog and Asset Maintenance ratios. The other five ratios draw on data which is not stated in the audited financial statements[15]. Thus, there cannot be any assurance for all seven ratios in the case of general purpose councils (readers might recall that Special Schedule 7 which informs the two ratios with sufficient disaggregated data is in fact outside of the Audit Opinion). This clearly casts doubt on the reliability of fitness assessments for these councils.

Secondly, there is no way for IPART (2015) to assess whether the data input by general purpose councils is indeed correct. Potential errors relate to (i) accidentally including water and sewer utility data where General Fund data was required, (ii) errors in disaggregating data, particularly in allocating overheads (which is highly likely), and (iii) deliberate attempts to misrepresent data.

Finally, there is an argument that water and sewer data should have been included in the fitness assessments given that the fitness of councils performing these functions must be affected by the sustainability of all functions performed. There may have been a case for developing unique ratios and benchmarks for councils operating sewer and water utilities.

[15] We do note that the ratio result for the Building and Asset Renewal ratio is disaggregated but the data inputs are not. The rural council toolkit should have been altered to allow councils to input the ratio rather than ratio inputs for this item.

However, it is hard to understand why these important municipal functions have been largely excluded from assessments.

10.2 Community Consultation in Fit for the Future Program

IPART (2015) also raises important questions in relation to the community consultation under the *Fit for the Future* process:

IPART Question: How should councils engage with their communities when preparing the FFTF proposals? Are there any factors we should consider to inform our assessments of council consultation? Please explain what these factors are, and why they are important.

Response: *The first point to note is that minimum standards for community consultation should have been developed by the OLG back in September 2014 before the release of the* Fit for the Future *Blueprint material. It really is a little late now to be thinking about minimum standards for community consultation just six weeks out from the* Fit for the Future *submission due date. Most local authorities have already undertaken this phase of* Fit for the Future *and are in the final stages of preparing submissions. However, IPART (2015) is right to raise the matter of inadequate consultation with the local community. Many municipalities have performed this function admirably. However it remains a fact that a significant proportion of the residents in NSW are entirely unaware of the* Fit for the Future *reforms, particularly in relation to the effect that reforms will have on personal budgets owing to the assumption of liabilities from merger partners and possible rate increases arising from harmonisation of rates and fees amongst merger partners. It goes without saying that major public policy reforms, such as* Fit for the Future, *which impose significant financial burdens*

on residents should be conducted transparently with full provision of relevant information. This is a basic principle of natural justice.

No evidence of local community opinion is reliable unless that opinion has been fully informed. The following lists the minimum information which should be provided directly to each resident affected by municipal merger proposals:

1. *All residents should be advised of the criteria by which councils are to be assessed. For fully informed consultation, residents should be provided with the empirical evidence (not opinion) used by the ILGRP and OLG to determine minimum scale (if such evidence indeed exists). Residents should also be informed of the flaws in ratios, the effect of unreliable data, the degree of distortion imposed on FFTF ratios by gamed data, the fact that many of the ratios are not based on audited data and the assumptions violated by the 'efficiency' ratio which therefore does not measure efficiency (or anything else for that matter).*
2. *All residents should be advised of the number of municipal jobs which must go in order for FFTF criteria to be met.*
3. *All residents should be advised of the effects on the local economy arising from amalgamations.*
4. *All residents should be advised of the reduction in political representation proposed by the FFTF amalgamations.*
5. *All residents should be advised of the explicit liabilities which they will assume on a per assessment basis from the proposed merger partners. Residents should also be advised of the implicit infrastructure liabilities which they will assume as a result of the merger proposal.*

6. *All residents should be advised of the increases to fees and rates which will arise from rates 'harmonisation' post-amalgamation.*

Councils should also conduct a survey of sufficient size and randomised so that tolerable standard errors result. Survey questions must be asked without bias, with necessary information to ensure knowledgeable answers and involve the use of a combination of open and closed questions. Finally, no amalgamation should proceed without a referendum. It is a generally accepted principle of democracy that where radical changes to the structure and political representation of government are proposed, these changes should only occur after citizens have had a vote on the matter. This is the principle enshrined in Part 3 Division 2 of the Local Government Act 1993. It is thus not unreasonable to suggest that the principle also be adhered to in this instance.

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