

**Submission
No 96**

INQUIRY INTO LOCAL GOVERNMENT IN NEW SOUTH WALES

Organisation: Woollahra Municipal Council

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The Hon. Paul Green MLC
Committee Chair
General Purpose Standing Committee No. 6
Parliament House
Macquarie Street
SYDNEY NSW 2000

Dear Chair

Inquiry into Local Government in New South Wales

Woollahra Municipal Council welcomes this Upper House Inquiry into Local Government in New South Wales and is pleased to make this submission in response to the Inquiry's Term of Reference.

Council's submission to the Inquiry is presented as *Annexure 1* and is consistent with the submission Council made to the Independent Pricing and Regulatory Tribunal (IPART) in May 2015 in response to their Fit for the Future Assessment Methodology Consultation Paper.

Council acknowledges the assistance of Professor Gary L. Sturgess, Chair in Public Service Delivery, Australia & New Zealand School of Government, and Professor of Public Service Innovation Griffith University, in the preparation of this submission and our previous submission to IPART.

Professor Sturgess also prepared Council's Fit for the Future Existing Structure Business Case which has been provided to IPART as an Annexure to Council's Fit for the Future submission. A copy of this Business Case is provided as *Annexure 2* to this submission to the Upper House Inquiry.

Should you have any enquiries in relation to this submission, please contact Council's Director Corporate Services, Stephen Dunshea on 9391 7014 or by email to stephen.dunshea@woollahra.nsw.gov.au

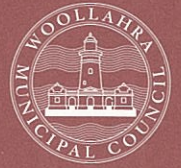
Yours sincerely



Gary James
General Manager

Encl *Annexure 1* Submission to the Upper House Inquiry into Local Government in NSW
Annexure 2 Fit for the Future Proposal, Existing Structure Business Case

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Submission to the Upper House Inquiry into

Local Government in NSW – 3 July 2015

Woollahra Municipal Council

Adapted from Woollahra Council's submission to IPART on its Proposed Assessment Methodology (May 2015) which was authored by:

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Professor of Public Service Innovation, Griffith University

on behalf of Woollahra Municipal Council

Annexure 1

Introduction

The Independent Local Government Review Panel recommended that the municipality of Woollahra should be merged with the City of Sydney, Botany Bay, Randwick and Waverley Councils in what it described as a 'Global City'. This would have a major impact on the residents of this municipality and their capacity to make a contribution to the way in which they are governed at a local level.

The government's terms of reference for IPART's review, and the methodology that IPART has adopted for the conduct of that review will largely determine the outcome. It is for this reason that Woollahra Municipal Council had chosen to respond to the Upper House Inquiry into Local Government in NSW.

This submission addresses similar concerns Council raised in its submission to IPART in May 2015 in relation to its Fit for the Future Assessment Methodology.

Presumption in Favour of Amalgamation

Contrary to reassurances given by the Chief Executive of IPART at a meeting in May 2015 with metropolitan mayors and general managers, there appears to be a presumption in favour of amalgamation.

We will consider first the ILGRP's *preferred option* for each council regarding scale and capacity and whether the council's proposed option is *broadly consistent* with this option.¹

While there is an opportunity for councils to present a sound argument (eg. using a business case) in its Council Improvement Proposal, the process appears to be biased in favour of the proposed mega-council.

Lack of a Business Case for Amalgamation

Councils that have been recommended for amalgamation will be declared 'unfit' unless they have presented a convincing alternative amalgamation option, or a business case that demonstrates that their proposed approach is 'as good as or better than' the recommended merger. This imposes a heavy burden of proof on councils which are opposed to membership in the proposed mega-council on the basis that there are no demonstrable benefits to their local community.

It is rendered even more onerous by the fact that the Local Government Review Panel did not provide a business case or any supporting evidence for its proposed Global City. There are, for example, no calculations identifying the alleged economies of scale associated with the proposed new mega-council, which makes it extraordinarily difficult for councils to respond. Municipalities such as Woollahra that see no benefits for their residents in membership of the mega-council are bound to a level of robustness and rigour that was never required of the preferred option.

Moreover, the Council Improvement Proposal was to be prepared and submitted by 30 June 2015, less than a month after the final methodology is produced by IPART. The state government would never impose such an onerous timetable on one of its

own state-owned enterprises or statutory authorities in relation to such a momentous decision. At the very outside, councils had two months to develop a business case that will determine their future existence, while IPART will have three and a half months to deliberate on the submissions. This means that the IPART review is biased heavily in favour of the Review Panel's recommended outcomes.

IPART has classified the issues relating to the amalgamation of metropolitan councils under four headings: scale and capacity to engage effectively across community, industry and government; sustainability; effective management of infrastructure and services; and efficiency. After considering the various capacity and scale criteria, we discuss IPART's methodology under those four headings below.

We conclude with a discussion of community attitudes, which IPART has relegated to a minor consideration.

Criteria Indicating Strategic Capacity

The IPART methodology states that: 'In making a FFTF proposal, councils must first assess their scale and capacity against the ILGRP's recommendations', and submit one of three types of proposals, depending on the structural outcome recommended by the Review Panel. It would appear that there can be no consideration of an alternative outcome until a council has responded to these criteria.

This part of the methodology relies on the key elements of 'strategic capacity' identified by the Review Panel in the assessment of scale and capacity:

- More robust revenue base and increased discretionary spending
- Scope to undertake new functions and major projects
- Ability to employ wider range of skilled staff
- Knowledge, creativity and innovation
- Advanced skills in strategic planning and policy development
- Effective regional collaboration
- Credibility for more effective advocacy
- Capable partner for State and Federal agencies
- Resources to cope with complex and unexpected change
- High quality political and managerial leadership.²

This is another extraordinarily onerous obligation on councils, since neither the Review Panel nor IPART have explained what these different criteria mean, and what evidence there is supporting the implicit assertion that the proposed Global City would be the appropriate structure to deliver them.

Status of the Financial Sustainability Benchmarks

IPART has also indicated that it will review councils' fitness according to the seven criteria laid down by the Review Panel and adopted by government. On the face of it, it would seem that a council that is complying with these financial sustainability criteria is meeting a number of the key elements of scale and capacity referenced above.

However, the weight that will be given to councils' compliance with these benchmarks (or capability of doing so in the near future) is entirely unclear.

A Fundamental Change to the Role of Local Government?

A number of the Review Panel's criteria appear to be premised on a fundamental change to the roles and responsibilities of local government – for example, the scope to undertake new functions and major projects, the ability to employ a wider range of skilled staff, and advanced skills in strategic planning and policy development.

At present, local authorities are primarily responsible for the delivery of municipal services, and it has not been necessary for them to make a deep investment in policy development and strategic planning beyond their local areas. Indeed, given the limited opportunity that councils have been given to have an impact on policymaking at state and federal level, investment in such a capability would have been rightly criticised as a wasteful overhead.

The state government has not outlined any plans to fundamentally change the role of local government, and it is unsurprising that local authorities have not developed the capabilities to deliver those responsibilities. We submit that where local communities are broadly satisfied with the services currently being delivered, and where councils are currently meeting the financial sustainability criteria or are capable of doing so in the near future, then it would be reasonable to conclude that they have the capability to deliver their existing functions. If there is to be a fundamental change, then councils will respond, but it would be irresponsible to do so until the proposed new role of local government has been made clear.

The concept of 'strategic capacity' has little meaning in the absence of a clearly-stated vision of the role of local government in the future.

Efficiency

Economies of Scale

The creation of mega-councils through forced amalgamation is a crude response to the challenge of stimulating greater efficiency and effectiveness in metropolitan government.³ In its final report, the Review Panel recognised that 'there is no simple relationship between council size and efficiency', but relied nevertheless on a study by the Australian Centre of Excellence for Local Government (ACELG) to claim that there is evidence of scale economies for some functions, and that some before and after studies show efficiency gains. There was potential for efficiency gains, it was said, if amalgamations were 'properly managed'.⁴

A significant number of Australian and international studies have concluded that the evidence on economies of scale in local government is mixed, at best. Most studies have used population as a proxy for output, when there is no reason to conclude that the two are positively correlated, and they generally fail to take account of quality and quantity, so that higher costs in smaller municipalities may simply reflect a demand by local citizens for more and better services. This is particularly so in a local authority with a socio-economic profile such as Woollahra's.

And it is not possible to rely on before-and-after studies without knowing whether it was the scale economies that drove the savings or some other aspect of the reform process. For example, the amalgamation of local government in Victoria in the early 1990s was accompanied by a widespread programme of competitive tendering, and it has been argued that many of the savings came from the latter part of the process, rather than the former.⁵

In short, there is no real evidence of scale economies in local government that would justify the creation of a mega-council such as the proposed 'Global City'. It is a leap of faith.

It would also be wrong to rely on the rather extraordinary claim that these benefits can be secured if the process of amalgamation is 'properly managed' – such a sweeping generalisation could be used to justify almost any proposal for reform.

There is some Australia research concerning the size of local authorities that are capable of capturing the scale economies in local services.⁶ This will not be the last word on the subject, but it would appear to be more sophisticated than the methodology apparently employed by the Review Panel. Based on this analysis, Woollahra falls within the optimal range.

However, under the IPART's methodology, Woollahra has been required to rebut a presumption in favour of an amalgamation for which there is no supporting evidence, and there was limited scope for the council to make a submission that challenges the concept of the so-called Global City from the perspective of efficiency.

Diseconomies of Scale

If there are economies of scale in local government services, then it follows that there will also be diseconomies of scale, and any proposal for mergers and amalgamations that does not attempt to identify where these thresholds lie is founded in an ideological belief that 'bigger is better' and not in economics.

The Review Panel provided no data on scale economies supporting its recommendation for the creation of the so-called 'Global City'. There is no concern that at some point, there might be diseconomies of scale, and no attempt has been made to identify the same.

Different Economies of Scale

In drawing upon the ACELG report, the Review Panel implicitly recognised that scale economies are different for different services, referring to studies which show that 'for some local functions, notably infrastructure and "back office services", increased scale can and does bring efficiencies and cost savings'.

Of course, there are economies of scale in local services. The problem is that we have little information about where these lie and the conditions under which diseconomies of scale emerge – they will differ depending on the topographical and demographic profile of the local authority and the services in question. The Review

Panel provided no insight into how the creation of mega-councils will assist in the exploration and identification of these different scale economies.

Encouraging a Search for Economies of Scale

If the NSW Government is serious about identifying the economies of scale and scope in the delivery of local services (and avoiding the diseconomies), then it should consider and support structures and incentives that will motivate local authorities to search for the efficient boundaries that apply to different services in different localities across the state – and a mechanism that encourages them to capture those efficiencies.⁷

In the past, special purpose county councils and regional organisations of councils were used to capture the scale economies of different local services, and (depending on how they are designed), the Joint Organisations proposed by the Review Panel might perform this role in the future. Mega-councils, whose boundaries are based on simplistic analysis, are likely to be a poor substitute.

Woollahra is currently a member of the South Sydney Regional Organisation of Councils (SSROC), which represents sixteen councils in the east, south and inner west of Sydney, covering a quarter of the population of the Greater Sydney metropolitan region. SSROC currently has around 30 contracts including basic commodities such as stationery, playground equipment and ready-mixed concrete and major services such as electricity supply and waste treatment.

As a joint purchasing organisation, SSROC permits councils to exploit different scale economies where they exist. Small groups of councils within the ROC also collaborate in the sharing of services across political boundaries:

- One SSROC council provides dog pound facilities for another;
- Several councils collaborate in the provision of 'Meals on Wheels';
- Three have worked together on waste management over several years;
- Eight councils have entered into long-term contract for the treatment of household waste. The contract will see a 60% reduction in waste to landfill across Greater Southern Sydney;
- SSROC's street lighting improvement programme has been so successful that it includes 18 non-member councils.

This is precisely what we would expect where the economies of scale are unknown and differ from council to council and from service to service.⁸

The methodology adopted by IPART treats regional structures as a secondary issue, to be addressed after councils have responded to the Review Panel's preferred solution of amalgamation. They should be regarded as a serious alternative, since many of the alternative solutions to the alleged economies of scale and scope will lie in collaboration at the regional level.

Amalgamation Will Weaken Contestability

A number of international studies suggest that public service monopolies are more sensitive to benchmark competition where there are multiple service units that can be readily compared with their peers and where service providers are physically located close together.⁹

Over the medium to long-term, this will result in reduced efficiency, and yet, there was no scope for this to be addressed within IPART's assessment methodology. As an economic regulator charged with the pursuit of greater efficiency, we submit that IPART should recognise the impact that mega-councils will have on contestability.

Mega-councils Will Suppress Voice and Choice

While there are limits to the capacity of residents to 'vote with their feet', the creation of mega-councils will further narrow the opportunity for residents to signal their preferences through choice.¹⁰ It will also weaken the impact of voice: councils that are closer to their communities are better able to identify subtle differences among user preferences. The creation of mega-councils through forced amalgamation will make it more difficult for local communities to signal their desire for a different quality and quantity of services.

This should be a matter of concern to IPART and the NSW Government, and yet there is no scope for it to be addressed within the assessment methodology.

Amalgamations Will Reduce Diversity and Innovation

The recently-published Harper Competition Review acknowledged the need for greater diversity in public service delivery, and while that report was primarily concerned with the supply side, we would submit that there is also need for diversity among commissioning organisations.¹¹

Diversity is important in the design of service delivery systems – it increases choice, it makes public services more adaptable, it ensures a deeper 'gene pool' from which to fashion new institutions for an uncertain future, and it allows for innovations in parallel rather than in serial. Mega-councils will significantly reduce the diversity of municipal government in the metropolitan area.

From its foundation, IPART has been concerned with the structure of governmental agencies and the way this impacts on the efficiency and effectiveness of service delivery.

Equity Considerations

An unstated motive for amalgamations might be to help poorer councils by cross-subsidising them with revenues from richer councils. However, the narrow revenue base of local government in Australia means that local councils have to focus on basics (e.g. roads and footpaths, rubbish collection and recreation facilities). They cannot afford a wide range of social services provided by local authorities in America

and Europe. As a result there is limited scope to use local government for redistributing income or wealth between households and localities.

Unless there are other compelling reasons, it will be inefficient to use amalgamations to address equity considerations. The same outcome could be achieved through redistributing existing government grants that already account for 28% of total NSW local government revenue. Within the Sydney City-Eastern Suburbs conurbation, none of the Councils within the region was found by NSW Treasury Corp to be financially disadvantaged except Botany Bay.

Financial Sustainability

The story is much the same with sustainability. While the Review Panel accepted that there is no simple relationship between size and sustainability, one of the assumptions in recommending that Woollahra should be incorporated into the so-called Global City was that the new entity would be financially more sustainable. However, NSW Treasury Corporation has found that many small to medium sized councils have stronger financial ratios than large to very large ones.¹²

Fit for the Future

Woollahra is already fit for the future on 5 of the 7 financial health checks. It will meet the other two by June 2016. The two measures which Woollahra currently fails to meet are Operating Performance (-3.5% against a benchmark of 0%) and Building and Infrastructure Renewal (which improved from 56.5% in FY12 to 89.6% in FY14 against the target of 100%). The council will meet these targets in FY16.¹³

A recent TCorp review of Woollahra Municipal Council's financial sustainability concluded:

Council is currently assessed to have a FSR of Moderate. Based on the revised information provided to TCorp for the Base Case scenario, the Outlook for Council for the next three years is Currently Positive, which means that Council is likely to improve to an FSR of Sound over the next three years.¹⁴

Impact of Amalgamation

On the available evidence, amalgamation would make no contribution to financial sustainability. A study of amalgamation options conducted by Grant Thornton Consultants on behalf of Woollahra Municipal Council concluded that the immediate implications of all options except a merger of Woollahra, Randwick and Waverley would be that the new entity would only meet 4 out of the 7 benchmarks. And the Randwick-Waverley-Woollahra option would meet 5 out of 7, no better than Woollahra alone.

As noted above, by FY16, Woollahra alone is expected to meet all of the benchmarks, while the Greater Sydney mega council would only meet 6 out of 7. The other options would be even less favourable (although Grant Thornton noted the need to better understand forecast assumptions).¹⁵

Effective Infrastructure and Service Delivery

The third category identified in the IPART paper on methodology is the capacity for the effective delivery and management of infrastructure and services.

Infrastructure

Woollahra already meets the Fit for the Future benchmarks for infrastructure management – infrastructure backlog, asset maintenance and debt servicing. On the face of it, this would suggest that Woollahra has the scale and capacity to meet government expectations, however, IPART's assessment methodology seems to demand that the council go further and 'demonstrate that they either currently have, or will have, sufficient scale and capacity with their proposed approach, consistent with the objectives identified by the ILGRP for their region'.

This seems to say that regardless of the council's actual performance, it is required to justify itself against a set of hypothetical criteria for which there is no evidentiary backing.

Service Delivery

The Review Panel provided no benchmarks for service delivery, which would have been difficult given the highly subjective nature of the outcomes in this area – different municipalities have different needs and expectations. Again, Woollahra is concerned that IPART will only look for the potential gains from economies of scale, without looking for the diseconomies of scale in service delivery.

If a local community does not share the same preferences as the majority of the residents in a mega-council, then it is likely that the associated services will be underfunded or not funded at all. For this reason, forced amalgamation on the scale proposed by the Review Panel is likely to result in the under-provision of services that are highly valued by particular neighbourhoods or communities. (In the same way, amalgamation might result in the over-provision of some services in particular communities or neighbourhoods.)

This has been described as the principle of 'correspondence' – 'each tier of government should have revenue raising and regulatory powers commensurate with its responsibilities'¹⁶ – or 'fiscal equivalence' – 'there is a need for a separate governmental institution for every collective good with a unique boundary, so that there can be a match between those who receive the benefits and those who pay for it'.¹⁷

Correspondence is most often thought of as dealing with revenue-raising, but it is also concerned with the scale of political organisation and the scope of political boundaries and their utility in capturing and revealing user preferences.

There are limits to the extent to which fiscal equivalence can be realised, but IPART's assessment methodology seems to preclude any consideration of such matters. One of the ways it might be addressed (at least in part) is through the use of regional structures such as Joint Organisations, but this has been relegated by the IPART methodology to a secondary issue.

Scale and Capacity to Engage

The fourth broad category identified by IPART is the scale and capacity to engage with communities, business and government. Local authorities would argue that they are much better positioned than a mega-council to engage with local community and business stakeholders.

The Review Panel placed a great deal of importance on the advantages from amalgamation in the capacity to partner with the federal and state governments. It is understandable that the state government might find it convenient to deal with a smaller number of local authorities when negotiating changes to policy and planning regulations, but on its own this is not a strong argument for amalgamation.

However, there are other ways in which the governance of the Greater Sydney metropolitan area might be improved, and relations between state and local governments enhanced. Woollahra is supportive of the suggested Metropolitan Council of Mayors and, as noted elsewhere, the council is open to the possible use of Joint Organizations for such purposes, depending on their range of responsibilities and how they are governed.

One of the problems with the approach that IPART has adopted of taking submissions and 'Council Improvement Proposals' from individual councils within an extremely limited timescale, is that it makes it virtually impossible for local authorities to put forward alternative solutions to address issues of capability at a regional level.

Social and Community Context

IPART's proposed methodology allows some scope for consideration of the 'social and community context of the council'. In our submission, this does not allow sufficient scope for consideration of the benefits that amalgamation is likely to bring and the adverse impacts that it will probably have on the local community.

Woollahra lies in a different water catchment from the other councils of eastern Sydney. It does not share the same transportation corridors. The Sydney Metropolitan Plan has limited impact on the municipality of Woollahra.

At the same time, the proposed amalgamation will result in a significant rise in Woollahra's rates due to significantly higher land values, and potentially a marked reduction in service standards. Based on previous mergers in NSW and elsewhere

throughout Australia, a merger would be expensive because of the costs involved in standardising administrative processes, ITC systems, accommodation, plant and equipment across divergent organisations. The cost could well exceed the money that the government is willing to offer as a subsidy. Inclusion as part of a megacouncil would weaken Woollahra's community identity, and it would be inconsistent with the wishes of the vast majority of local residents.

These are matters of great concern to the residents of the municipality, and yet the scope for recognising their preferences against IPART's assessment methodology is extremely limited.

Endnotes

¹ IPART, 'Methodology for Assessment of Council Fit for the Future Proposals', Local Government Consultation Paper, April 2015, p.6.

² NSW Independent Local Government Review Panel, 'Revitalising Local Government, Final Report', October 2013, p 32.

³ Some parts of this section are based in a paper written by Professor Gary Sturgess for the South Sydney Regional Organisation of Councils, of which Woollahra Council is a member – Gary L. Sturgess, 'Efficient Boundaries: Amalgamation, Integration and Collaboration in the Sydney Metropolitan Area', 13 October 2013.

⁴ NSW Independent Review of Local Government, 'Revitalising Local Government', Final Report, October 2013, p.73.

⁵ 'Are Councils Sustainable? Independent Inquiry into the Financial Sustainability of NSW Local Government', Final Report, Local Government and Shires Association of NSW, May 2006, p.259.

⁶ S.C. Soul, 'Population Size and Economic and Political Performance of Local Government Jurisdictions' Research Thesis submitted to the Southern Cross University to fulfil requirements for a Degree of Doctor of Philosophy, 2000.

⁷ Gary L. Sturgess, 'Efficient Boundaries: Amalgamation, Integration and Collaboration in the Sydney Metropolitan Area. A Paper for the South Sydney Regional Organisation of Councils', 13 October 2013, pp.14-15.

⁸ Gary L. Sturgess, 'Efficient Boundaries: Amalgamation, Integration and Collaboration in the Sydney Metropolitan Area. A Paper for the South Sydney Regional Organisation of Councils', 13 October 2013.

⁹ Scott Wallstein and Katrina Kosec, 'The Effects of Ownership and Benchmark Competition: An Empirical Analysis of U.S. Water Systems', *International Journal of Industrial Organization*, (2008) 26, pp.186-205; Steve Bradley, Geraint Johnes and Jim Millington, 'The Effect of Competition on the Efficiency of Secondary Schools in England', *European Journal of Operational Research*, (2001) 135, pp.545-568 at p.562; Nicholas Bloom, Carol Propper, Stephen Seiler and John Van Reenan, 'The Impact of Competition on Management Quality: Evidence from Public Hospitals', NBER Working Paper No.16032, Cambridge, MA: National Bureau of Economic Research, May 2010.

¹⁰ This effect was identified by Tiebout in 1956 – Charles Tiebout, 'A Pure Theory of Local Expenditures', *Journal of Political Economy*, (1956) 64:5, pp.416-424.

¹¹ Ian Harper et al, 'Competition Policy Review: Final Report', Commonwealth of Australia, March 2015, 'Human Services', pp.244-245.

¹² Percy Allan & Associates, 'Woollahra Municipal Council: Is its Present Scale Fit for the Future?' March 2015, p.14, computed from data provided by NSW Treasury Corporation, 'Financial Sustainability of the New South Wales Local Government Sector - Findings, Recommendations and Analysis', April 2013, pp.76-78.

¹³ Grant Thornton, 'Woollahra Municipal Council: Technical Assistance FFTF', April 2015, pp.19 & 30.

¹⁴ New South Wales Treasury Corporation, 'Woollahra Municipal Council: Financial Assessment and Sustainability Report', 16 February 2015, p.5.

¹⁵ Grant Thornton, 'Woollahra Municipal Council: Technical Assistance FFTF', April 2015.

¹⁶ 'Are Councils Sustainable? Independent Inquiry into the Financial Sustainability of NSW Local Government', Final Report, Local Government and Shires Association of NSW, May 2006, p.11.

¹⁷ Mancur Olson, Jr., 'The Principle of "Fiscal Equivalence": The Division of Responsibilities among Different Levels of Government', *The American Economic Review*, (1969) 59:2, pp.479-487 at p.483.