

## **RUNNING THE BIG SMOKE: A CRITICAL ANALYSIS OF THE KPMG (2008) APPROACH TO LOCAL GOVERNMENT REFORM IN THE SYDNEY METROPOLITAN AREA**

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**ABSTRACT:** Following a critique of the current local governance arrangements in the greater Sydney metropolitan area by Blakely and Hu (2007), an alternative approach to the *status quo* has been advocated in *Governance Arrangements for Sydney's Local Government Authorities* (KPMG, 2008). This approach is aimed at rescaling local governance in Sydney to achieve greater global competitiveness, secure better communities of interest, and ensure long-run financial sustainability. The analysis in this Report has formed the basis for policy proposals calling for *inter alia* a 'reconfiguration' of small local councils in the Sydney metropolitan area into larger units. This paper seeks to provide a critical evaluation of *Governance Arrangements for Sydney's Local Government Authorities*. It demonstrates that the empirical analysis conducted in this Report does not support the policy conclusions drawn by its authors for the amalgamation of small councils into larger municipalities. Moreover, the paper argues that the Report should have employed different arguments to those it invoked in support of the establishment of a regional authority for greater Sydney.

**KEY WORDS:** Amalgamation; local government; structural reform; Sydney

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## **1. INTRODUCTION**

Most Australians live in large metropolitan regions and it is thus hardly surprising that the institutional frameworks of these metropolitan areas are important to scholars and practitioners of regional development. Moreover, it is also unsurprising that urban growth and urban planning in the greater Sydney metropolitan area continue to stimulate public controversy. Recent impetus has come from a series of publications commissioned by Sydney First, an organisation founded by the Sydney Chamber of Commerce, which aims to 'help improve and promote Sydney' (Sydney First, 2007, p.2). The first of these policy documents by Blakely and Hu (2007) assessed governance arrangements in greater Sydney with London, Toronto, San Francisco, Frankfurt and Shanghai. Blakely and Hu (2007) concluded that Sydney lacked a 'city-wide' government, urban governance was excessively dominated by the New South Wales (NSW) government, and the local governance structure of greater Sydney was too 'fragmented'. It argued that an imbalance existed between 'functional territory' and 'administrative territory' as a consequence of rapid urban growth. While Blakely and Hu (2007) did not advance any new governance model for Sydney, they nonetheless stressed that existing governance arrangements should be rescaled to improve co-ordination through either a city-wide 'compulsory agency' or 'a kind of partnership based on voluntary participation'.

A second commissioned publication by KPMG (2008, p.2), entitled *Governance Arrangements for Sydney's Local Government Authorities*, sought to determine 'the potential benefits that may accrue from transforming the governance arrangements for Sydney's local government authorities which operate within the global city context'. KPMG (2008, p.2) advanced three main recommendations. Firstly, the NSW government should harmonise 'the optimum scale of local authorities to reduce fragmentation and inefficiency'. Secondly, a re-organisation of local government in Sydney should reduce the number of local councils 'thereby increasing their capacity to tackle the major growth and change challenges confronting Sydney'. Finally, the 'financial capacity of local authorities' in Sydney should be reformed so that 'they are self-sustaining' and have adequate service provision capacity.

A striking feature of KPMG (2008) resides in its sophisticated empirical analysis of potential cost savings, which could result from a 'reconfiguration of smaller local government authorities to a larger scale' (p.3). Some commentators have presumed that this implies that KPMG (2008) called for the amalgamation of Sydney councils, despite explicit acknowledgment in the document that this represents only one of several models that should be considered (see, for example, Grennan 2008). Focusing on the structural reform dimension of KPMG (2008), this paper shows that (a) KPMG (2008) did not demonstrate convincingly that council size is correlated with efficiency; (b) shared service models in some selected areas of service provision represent a superior arrangement compared with forced council amalgamation; and that (c) a better alternative case can be made for a 'city-wide' planning regime in Sydney than the arguments presented by KPMG (2008).

The paper is divided into six main parts. Section 2 briefly places KPMG (2008) in the context of the debate over planning in the greater Sydney area. Section 3 outlines the main findings and the major recommendations proposed in KPMG (2008). Section 4 examines the empirical methodology employed in the Report. Section 5 considers optimal scale in local government service provision and the debate surrounding this question. Section 6 demonstrates that the evidence presented in KPMG (2008) makes a compelling case for shared service provision on a regional basis across the greater Sydney metropolitan area, together with a metropolitan-wide planning authority. The paper ends in section 7 with some brief comments which place the KPMG (2008) proposals in the context of the potential trade-offs between economic efficiency and effective representative democracy.

## **2. REGIONAL PLANNING IN SYDNEY**

KPMG (2008) should be seen in the light of the contentious history of regional planning for greater Sydney, which has attracted considerable scholarly attention (see, for example, Ashton, 1995; Hamnett and Freestone, 2000; McGuirk, 2003; 2004; 2005). The post-war era has seen a shift away from prescriptive state intervention in the Cumberland County Council (1948) *Planning Scheme*, adopted in 1951, to a focus on planning efficiency to speed urban development to accommodate the rapid population expansion of Sydney (Spiller, 1999), as exemplified in *Sydney into its Third Century* (Department of the Environment and Planning, 1988). The pendulum has thus swung back to contemporary concern with housing affordability, adequate urban infrastructure, socio-

spatial disadvantage, and 'state-directed metropolitan spatial strategy' (McGuirk, 2005, p.66).

Numerous interest groups have sought to influence the debate, often contracting consultants to produce 'expert reports' proposing various combinations of municipal consolidation and 'streamlined' planning systems to accelerate development, which have added to the controversy surrounding Sydney metropolitan planning. Recent examples include *Property and Infrastructure* (NSW Urban Taskforce, 2002), *Funding Urban Infrastructure* (Allen Group, 2003), and *Who's Governing Sydney* (Blakely and Hu, 2007). *Governance Arrangements for Sydney's Local Government Authorities* (KPMG, 2008) falls squarely in this genre.

Ongoing contestation and controversy over planning in the greater Sydney metropolitan is readily explained not only as a consequence powerful groups with a strong pecuniary interest in accelerated property development, but also in the impact that planning decisions can have on existing real estate values. For example, changes in planning can have decisive effects on house prices. Thus residents associations frequently lobby for planning amendments, such as the closing of busy streets to through traffic, since they can generate significant capital gains to property owners in affected areas. The extent to which broader planning regulation enhances or impedes rent-seeking of this kind is therefore bound to be a matter of public controversy.

### **3. CENTRAL FINDINGS IN KPMG (2008)**

In essence, KPMG (2008, p.2/3) argued that while the structure of local government in Sydney had remained unchanged for forty years, its population had increased substantially and it had become a 'global city'. A resulting 'mismatch' between governance arrangements and rapid urban growth had occurred which inhibited 'operating performance, regional planning and competitiveness for Sydney'. Its seven 'key findings' are:

- A feature of the 'mismatch' was the highly asymmetric councillor/resident ratios between local councils. This should be remedied by harmonising 'greater equality in the level of elected representation'.
- Sydney's 'level of governance should be strengthened and condensed in line with a regional governance of local government authorities'.

- 'Reconfiguring current council boundaries will eliminate artificial barriers to regionally based decision making'.
- The planning system should be reformed to 'reinforce the role of elected representatives towards strategic regional planning rather than on low risk development applications'. It required three main modifications: Differentiating between 'state significant' developments and 'local developments'; exempting 'low risk merit assessed' developments; and establishing independent expert panels to consider 'regionally based developments'. This raised the question of the 'optimum scale' for Sydney councils.
- The greater Sydney metropolitan area required 'regionally based decisions' given the pressures confronting it.
- Local government restructuring should be augmented by improving 'the financial capacity and revenue raising capacity of local government authorities' since 'councils must have the organisational and financial capacity to implement regionally based planning and service delivery decisions'.
- Finally, 'significant financial savings could arise from a reconfiguration of smaller local government authorities to a larger scale'.

The KPMG Report (2008) cited various examples of cost savings from such a 'reconfiguration'. Thus, a reduction in the number of councillors to just 200 'could lead to a potential saving of 3.5 million per annum'. Similarly, 'if local government authorities were reorganised such that they each had a population of 200,000, primary per capita expenses savings could be up to \$6.6 million per annum'. In addition to these direct expenditure savings, efficiency gains could flow from larger local councils. For example, 'if the average council was to process 1,000 additional DAs per year this would result in a potential saving of around \$2 million per annum for a total of 2,000 DAs processed'. In general, 'a greater scale enhances the capacity of local government authorities to efficiently respond to a greater volume of work and increases the potential to attract skilled planning and management professionals'.

The main thrust of these recommendations has a familiar ring to scholars of structural reform in local government (see, for instance, Australian Centre for Excellence in Local Government (ACELG) 2011; Dollery, Crase and Johnson, 2006; Dollery and Robotti, 2008; Faulk and Hicks, 2011; Garcea and LeSage, 2005). Moreover, some of the claims made in the KPMG Report (2008) appear unwarranted. For example, the

proposed reduction in elected representatives echoes analogous arguments in the 2004 NSW amalgamation process. For instance, Vardon (2003) recommended fewer elected councillors as a money-saving measure, despite the fact that (a) the quantum of funds saved represented a trivial percentage of total expenditure and (b) the implicit assumption that no 'value' could be attached to the democratic representative dimension of municipal councillors. After all, one of the chief comparative advantages of local government resides in its being 'closer to the people', as exemplified in relatively low councillor/voter ratios and the resultant 'ease of access' to representatives. In addition, as we shall see, the thematic claim by KPMG (2008) that not only is 'bigger better' in local government, but that 'bigger is cheaper' cannot be sustained on theoretical and empirical grounds.

KPMG (2008, p.39) identified alternative models of local government potentially applicable to Sydney, including 'compulsory amalgamations', 'voluntary amalgamations', 'virtual regional shared service delivery and collaboration while maintaining the established identity and presence of Sydney's local government authorities', and 'collaborative business cases for the development and implementation of new services across a region to enhance purchasing power and enhance value for money', whilst retaining local councils. KPMG (2008) did not recommend any one option and added the caveat that 'decisions on governance arrangements are policy questions for government and we do not advocate a position on this point'.

However, KPMG (2008, p.39/40) did suggest that governance arrangements must consider the combined impact of several critical ingredients; 'enhanced strategic planning, economic analysis, geographical features, economic features or population density'. KPMG (2008, p.39) recommended two 'city governance options' based on (a) 'the sub-regional planning areas' that are 'identified in the Sydney Metropolitan Strategy' to improve 'strategic regional planning and decision making on major infrastructure such as public and private transport' and (b) 'the economic features of Sydney as identified in the Sydney Metropolitan Strategy' in order to bolster the 'key economic strengths in Sydney' including its 'global arc'.

KPMG (2008, p.40) contended that options (a) and (b) would 'transform service delivery' by imbuing service provision with eight desirable features: 'Regionally based planning and service delivery'; the 'streamlining' of 'back office administrative functions', like IT systems

and payroll functions; 'improved and coordinated' policy responses to 'infrastructure renewal'; enhanced asset maintenance and replacement; improved 'purchasing power for services and facilities'; 'regionalising community transport' through integrated public transport run by the state government; decreased 'governance and administration costs' as a consequence of fewer 'senior management and councillors; and lower 'charges for businesses and consumers due to more efficient processing of services'.

KPMG (2008, p.40) made five recommendations aimed at achieving an 'optimum scale':

- The NSW government should 'establish an optimum scale of Sydney's local government authorities and elected representation';
- This should be done through (a) 'consultation with communities and stakeholders'; (b) 'economic analysis to quantify the benefits for reform and the minimum scale requirements for new governance arrangements'; (c) 'the enhancement of service delivery and reforming the financial capacity of local government authorities'; and (d) the development of the 'optimum scale of local government authorities around regional communities of interest similar to those geographic regions contained in the Sydney Metropolitan Strategy';
- The NSW government 'should sponsor the development of the creation of regional authorities to allow councils to drive shared service delivery and pool resources';
- The NSW government should consider the reconfiguration of the City of Sydney area since 'it presently has a suboptimal geographical area' which excludes 'the critical economic and transport corridors' that dominate greater Sydney;
- This process should prevent the 'fragmentation of the economic strengths of some of the larger local government authorities' through establishing new local government authorities in the north-west and the south-west.

#### **4. EMPIRICAL ANALYSIS IN KPMG (2008)**

The core of empirical analysis conducted in KPMG (2008) can be found in Chapter 5, Chapter 6 and Appendices 1, 2 and 3. KPMG (2008, p.30) ‘undertook a statistically robust analysis of the influence of a number of council characteristics, including those related to size, in order to examine the potential benefits from alternative governance arrangements in metropolitan Sydney local government’. The analysis employed data drawn from 43 greater Sydney councils over 2000/01 to 2005/06. Councils already involved in structural reform were excluded from the analysis, as well as Sydney City Council because it represented an ‘outlier’. KPMG (2008, p.30) found that ‘a number of key metrics indicating local government performance are statistically correlated with measures of council size’.

The ‘key metrics’ were classified under three headings (p.30):

- (a) ‘Creating a favourable business environment: total expenses per capita; total revenue per capita’; Development Application (DA) processing speed total costs per DA; and average business rates.
- (b) Local government financial sustainability: proportion of revenue from user fees and charges; and proportion of revenue from grants.
- (c) Fiscal capacity: Debt Service Cost Ratio; and Current Asset/Liability Ratio’.

KPMG (2008, p.30) assumed that the determinants of these ‘key metrics’ were adequately captured by eleven indicators: ‘area of council (square kilometres); population density ; population growth ; Aboriginal and Torres Strait Islander population; non-English speaking population; residential population in council boundary; number of business properties ; revenue from user fees and charges; revenue from grants; staff numbers; and DAs processed per year.

The empirical analysis (p.30) ‘aimed at testing the hypothesis that providing some council functions at a regional scale has the potential to deliver benefits in terms of reduced average costs to council and/or increased service levels’. It argued that ‘the advantage of the analytical method followed in this report, so-called ‘panel data analysis’, is that the influence of any individual characteristic unique to a particular council (such as population size) can be evaluated while simultaneously



accounting for the effects (if any) of a range of other characteristics (such as population density and the proportion of population from a non-English speaking background). KPMG (2008, p.30, footnote 76) noted that ‘the only other study of NSW councils to employ a multivariate analysis of the relationship between size and council service provision was Byrnes *et al.* (2003), who found that scale economies exist in the provision of waste collection services, particularly in metropolitan councils’.

KPMG (2008, p.31) contended that its analysis demonstrated that ‘there are potential gains from certain services being delivered at a larger scale through reform of governance arrangements’:

- Councils with larger populations proved more adept at DA processing;
- Councils with a greater proportion of business properties levied lower rates on these businesses;
- Councils with high population densities usually levied lower rates on business;
- Councils with larger populations incurred lower employee costs per capita; and
- ‘Councils that are larger in terms of population exhibit marginally lower primary expenses per capita’.

While these findings appear at first sight to support the twin propositions that not only is ‘bigger cheaper’ (as evidenced by lower per capita costs), but also that ‘bigger is better’ (as indicated by faster DA processing), the ‘devil is in the detail’ in the analysis. For instance, in its examination of ‘total expenses from ordinary expenses per capita’, where per capita primary expenses encompass ‘the level of direct average services costs covering the costs on employment, materials and contract and others’, KPMG (2008, p.31) concluded that ‘councils with a larger population tend to incur lower total expenses from ordinary expenses per capita’. However, it noted that ‘the variation in ordinary expenses per capita for the majority of councils indicates that other factors may be driving this indicator’. To control for the influence of other determinants, KPMG (2008, p.32/33) investigated the putative influence of five other factors: spatial area; population density; population growth; the number of council staff; and non-English speaking people.

After controlling for these factors, KPMG (2008, p.33) concluded that ‘our results indicate that for the average council an increase in population

of 10,000 residents would result in a decrease of per capita primary expenses of around \$33.30'. Thus, 'if a council was organised to have a population of 50,000 residents it could reduce total expenditure by around \$1.6 million per year', if it had 'a population of 100,000 this saving is potentially around \$3.3 million per annum', and for those councils with a population of 200,000 'this saving is potentially up to \$6.6 million per annum'.

This conclusion cannot be accepted on face value. For example, in the case of per capita primary expenses, numerous factors not considered in the analysis can explain the variance between councils other than the five influences examined. For instance, differences in service quality, service quantity and the service mix could readily account for observed differences between councils of equivalent size. Similarly, the variation in per capita costs could be attributed to differences in efficiency arising from differential managerial efficiency. Many other possibilities exist, such as the age characteristics of the populations or topographical variation, which are considered below.

## **5. OPTIMAL SCALE IN AUSTRALIAN LOCAL GOVERNMENT**

Amalgamation has always been the favoured policy instrument for improving the operational efficiency of local authorities by Australian policy makers (Vince, 1997; Dollery and Soul, 2000). This long-run trend has been closely followed over the past twenty years; all Australian local government jurisdictions have embarked on local council amalgamation programs, with the sole exception of Western Australia (ACELG, 2011; Dollery, Byrnes and Crase, 2008a). Underlying these structural reform programs has been the assumption that 'bigger is better', based largely on the proposition that substantial scale economies characterise local council service provision (ACELG, 2011; Dollery, Byrnes and Crase, 2008b).

This has been disputed in the literature but has continued to hold sway over policy makers despite its uncertain empirical basis (ACELG, 2011; Byrnes and Dollery, 2002). A further unfortunate aspect has been the conflation of population size with scale economies. Indeed, population size has become a proxy for scale economies in policy making. On this basis, state and territory governments have compulsorily amalgamated councils on the premise that larger populations necessarily implied greater economies of scale.

The doctrine of 'bigger is cheaper' cannot be sustained on either conceptual or empirical grounds. For example, Dollery and Fleming (2006, p.274) have demonstrated that specific scale characteristics apply to different services. Thus, 'the most efficient level of production will depend on the type of service' which implies that 'where local government produces a range of different services, each with its own unique production characteristics, no single size of government will be able to produce all services at the minimum possible cost for each service'. Similar arguments have been made abroad (see, for example, Dollery, Garcea and LeSage, 2008). For instance, from Canadian council consolidation, Sancton (2000, p.74) concluded that 'there is no functionally optimal size for municipal governments because different municipal activities have quite different optimal areas'.

As a general rule, 'labour-intensive, customer-orientated services, such as municipal rangers, health inspectors, etc., generate few scale economies because their idiosyncratic nature means that an increased volume of services requires a correspondingly larger number of employees' (Dollery and Fleming, 2006, p.274). By contrast, capital-intensive services, such as sewage disposal and domestic water supply, typically generate substantial economies of scale because high fixed capital costs can be spread across more households. Moreover, Dollery, Wallis and Allan (2006) have demonstrated that over the past three decades service provision in Australian local government has shifted away from a capital-intensive 'services to property' orientation towards a labour-intensive 'services to people' bias. Thus the impact of scale economies on production costs has steadily fallen anyway.

Dollery and Fleming (2006, p.275) drew two main policy implications from their analysis. Firstly, whether economies of scale exist depends on the local service/function under consideration. Whether or not aggregate economies or diseconomies characterize council service activities as a whole cannot be determined since other factors associated with organizational size, such as economies of scope, etc., are involved. Secondly, because scale economies depend on the service in question, this means that 'the ability of small councils to accrue scale economies by purchasing services with substantial scale economies from other service producers, or to enter into "resource-sharing" arrangements with neighbouring local authorities in any event removes much of the force of the "bigger is cheaper" argument' (p.275).

Drawing on Boyne (1995) on the use of population size as a proxy for scale economies, three additional arguments can be adduced. Firstly, the proposition that population size represents a measure of scale implies that

population size and service output are closely positively correlated. This assumption formed the basis for the influential NSW study by Soul (2000), commonly cited by Australian advocates of amalgamation. In his doctoral thesis, Soul (2000) considered the impact of council size (measured by total population) on gross per capita expenditure (calculated as total expenditure divided by total population) and concluded that high population size delivers lower level of gross expenditure per capita for total population levels between 100,000 and 316,000 people in NSW local government.

But the proposition that population size is a satisfactory proxy for service output is false. Worthington and Dollery (2002) have shown that numerous 'non-discretionary' factors can affect the aggregate costs of municipal service provision, quite separately from the number of residents in a given council jurisdiction of defined population size. For example, physical factors such as precipitation, soil type, temperature range, topography, etc., all influence the costs of service provision, with population held constant. Along similar lines, demographic factors play a crucial role. For instance, the age characteristics of a local council jurisdiction decisively affect municipal costs. Thus large proportions of young and elderly people, substantial seasonal fluctuations in the number of residents, and the like, have significant effects on costs.

Dollery, Byrnes and Crase (2007) have demonstrated that socioeconomic factors can have a marked impact on council expenditure. For instance, the level and distribution of income and wealth in a given local government jurisdiction will influence commercial development, housing, public amenities, etc., all of which affect the costs of service provision.

Secondly, service quality has substantial effects on local council costs. While Australian state governments typically mandate minimum uniform standards in local service provision, Worthington and Dollery (2001) have shown that local authorities frequently exceed these minimum levels. As a consequence, coverage by paved sidewalks, public park size and amenity quality, sports facilities, street lighting, and many other municipal services vary widely between different local council precincts within the same local government jurisdiction. These quality variations will affect the costs of service provision independently of population size. Worthington and Dollery (2001) have also demonstrated that the cost required to meet a given mandated service standard (like water purity

standards) often differ dramatically between councils of similar population size because of exogenous factors beyond their control.

Thirdly, the decentralisation theorem (Oates, 1972) holds that the efficient provision of services requires that decision-making be made by the level of government 'closest' to the people who consume the services in question. Worthington and Dollery (2001) have shown that Australian local government is characterised by immense diversity. It is thus not surprising that, despite the imposition of uniform standards by state governments, local councils of similar population size often vary the mix of services to meet local community demand. It follows that council service provision policy affects local service costs.

The sceptical thrust of the academic literature on amalgamation has been echoed in a host of national and state local government inquiries over the past decade. For example, the Hawker Report (2003) noted that mergers were not a 'panacea' and instead called for partnership arrangements with councils through regional bodies. The South Australian Financial Sustainability Review Board (FSRB) (2005) disputed empirically any relationship between council size and council performance, questioned claims made regarding savings generated by amalgamation, and concluded that alternative models of council cooperation should be pursued. The NSW Local Government Independent Inquiry (LGI) (2006) found that population density and not population size represented the main element in council cost structures and thus recommended that arrangements other than amalgamation be pursued. Although the Local Government Association of Queensland (LGAQ) *Size, Shape and Sustainability* Inquiry (2006) found that some benefits flowed from mergers, it pointed to high costs, and concluded that only voluntary amalgamation held promise. The Western Australia Local Government Association (WALGA) (2006) rejected the efficacy of consolidation and argued that state/territory and industry-owned service provider models were more suitable to Western Australian conditions. The national PriceWaterhouseCoopers (PWC) (2006, p.149) contended that efficiency, effectiveness and scale could best be improved through regional service provision, shared service arrangements, outsourcing, and state-wide purchasing initiatives, rather than council mergers. Finally, the Local Government Association of Tasmania Inquiry (LGAT) (2007) argued that forced amalgamations were unlikely to achieve lasting community benefit and recommended resource sharing and 'pool-style arrangements', such as sector-owned service providers. By contrast, the Queensland Department of Local Government (2007) presented strong

arguments for amalgamation, stressing the greater financial resources available to bigger post-amalgamation councils.

Perhaps the most empirically persuasive finding on amalgamation derives from ACELG (2011), which noted that amalgamation seldom resulted in savings and generally cost much more than anticipated. Thus amalgamation processes predicated on an assumption of cost savings, like the Victorian episode, are bound not to meet expectations in this respect. However, ACELG (2011) argued that mergers tend to improve the strategic capacity of local councils and pointed to the Victorian amalgamation program as a case in point. This conclusion concurs with the findings of Dollery, Crase and Johnson (2006) that larger councils typically have greater capacity.

Of all Australian forced amalgamation programs, the 1994 Victorian experience has received the most attention by scholars. The evidence is mixed. For example, Gerritsen (1997, p.226) noted that the 'proportion of local government outlays covered by the category "administrative expenses" has proved resilient', and mergers saw 'serious declines in local government capital expenditure'. Similarly, Kiss (1997, p.67) questioned whether any costs savings occurred. However, Smith (1997) argued that the new larger council entities had greater capacity. Moreover, the separation of Victorian local water utilities appears to have been successful when compared with NSW (Byrnes *et al.*, 2010). It should be noted that the Delatite Shire merger was de-amalgamated in 2002 (Chen, 2002; ACELG, 2011, pp.121-125). While the reasons for the de-merger are complex, ACELG (2011, p.124) have concluded that 'hasty and poorly planned amalgamations, which do not involve adequate consultation, will result in poor outcomes and disaffected communities'.

On balance, the literature shows that while amalgamation seldom yields savings of any kind, it does seem to improve the capacity of merged local councils. This serves to support the KPMG (2008) recommendation that regional planning by larger entities would serve Sydney more effectively than present arrangements.

## **6. CRITICAL ANALYSIS**

A central flaw in KPMG (2008) is that its chief recommendations do not follow from the empirical analysis. After all, the main thrust of the Report (2008, p.2) is that a 'mismatch' existed between existing local government arrangements and the imperatives stemming from rapid

urban growth which had resulted in barriers to 'improved operating performance, regional planning and competitiveness for Sydney'. Moreover, the Report advocated a 'reconfiguration' of the current structure of local government which would see fewer, much larger local councils in Sydney with far higher voter/councillor ratios. As we have seen, the major problem with this conclusion is that the empirical estimations did not satisfactorily demonstrate that per capita costs bore a systematic negative relationship to the population size of Sydney municipalities, since not only was the variance in per capita costs between individual councils large, but (as the Report concedes) other factors may account for per capita cost differentials. Put differently, the Report has not shown that 'bigger is cheaper' in terms of local government service provision.

This is surprising since KPMG (2008, p.40, footnote 86) explicitly recognised that per capita expenditure cannot measure local government efficiency, observing that 'the total population may not be a good indicator to outputs' since 'often the number of children and elderly, the number of households, number of businesses, and the size of covered land can be more accurate indicators to their outputs'. It qualified this admission by invoking the unwarranted assumption that 'if such detailed output indicators are broadly proportional to the entire population, per capita expenses can be considered to be a reasonably good indicator to the efficiency of local government's service delivery'.

However, this heroic assumption does not place 'the cat back into the bag'. As we have repeatedly noted, there are a host of factors that can affect per capita costs which do not involve council size. It thus cannot be concluded by KPMG (2008) that 'bigger is always cheaper' in local government service provision.

A better case for the consolidation of Sydney local government service provision can be made in terms of shared services models.<sup>1</sup> Shared services in local government service provision hinge on two propositions. Firstly, following Oakerson (1999), local service provision can be separated from local service production. Thus while a local council can provide a service financially, it can be produced through a variety of institutional arrangements, such as shared service and resource sharing

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<sup>1</sup> The proposition that shared services are superior to council amalgamation has been endorsed by most recent public inquiries, including FSRB (2005), (LGI) (2006), LGAQ (2006), WALGA (2006), LGAT (2007), Hawker Report (2003) and PWC (2006).

agreements (Dollery and Akimov, 2008a; 2008b; Kearney, 2005), outsourcing and competitive tendering (Hodge, 1996; O'Looney, 1998), and state-wide entities (Dollery, Hallam and Wallis, 2008). Secondly, it has been established empirically that whereas some local government functions and services are characterised by scale economies and/or economies of scope, many other activities exhibit decreasing diseconomies of scale and/or scope (Deller *et al.*, 1988; Byrnes and Dollery, 2002). This means that economic gains accruing from shared service models are necessarily restricted to only those functions and services that manifest scale economies or scope economies. In essence, regional service provision in local government should thus focus exclusively on selected services and not the full range of municipal activities.

In NSW, the LGI (2006) commissioned Byrnes (2005) and Allan (2006) to investigate the types of services most amenable to sharing between councils. Byrnes (2005) found that councils could feasibly 'either pool or share service provision on a regional basis' in 'fire protection', 'emergency services', 'health administration and inspection', 'noxious plants', museums, 'water and wastewater', 'tourism and area promotion', and 'saleyards and markets'. Moreover, Allan (2006) identified numerous 'back office' and 'front office' activities suitable for sharing.

Using these arguments, KPMG (2008) could have made a stronger case for constructing constellations of councils within the greater Sydney metropolitan area which cooperate through shared service models. An alternative solution to the same problem would involve the establishment of Special Purposes Vehicles to provide specific services with significant scale economies, such as Sydney Water. This would ensure that available efficiency gains from larger scale would be captured while at the same time securing local autonomy through existing local councils.

A second pillar that KPMG (2008) could have adopted for a 'city-wide' planning authority to deal with regional questions affecting the greater Sydney region could have invoked inter-jurisdictional externalities (see, for example, Oates, 1972). Positive and negative spatial externalities are a pervasive feature of local government, especially in large metropolitan areas, where decisions made or activities carried out in one council jurisdiction can have decisive effects on other council jurisdictions. For instance, the establishment of large housing developments, which involve substantial numbers of people, typically impose significant congestion



costs on surrounding jurisdictions. In addition, the theoretical solution to these problems, which uses charges and subsidies to 'internalise' these externalities, is not generally available to Australian local authorities since it falls outside of their powers. Under these circumstances, the optimal approach resides in assigning decision-making authority to a regional body to consider the metropolitan ramifications of policy decisions. Thus in greater Sydney, a 'city-wide' governmental entity would govern functions which affected the 'whole-of-Sydney', like regional transportation.

The case for a 'city-wide' authority for Sydney, analogous to the Greater London Authority, justified on grounds of externalities is not new. After all, as we have seen, this was one of two alternative policy options presented by Blakely and Hu (2007). Furthermore, the creation of a 'city-wide' authority is by no means incompatible with the continued existence of numerous small local councils in the greater city metropolitan area. Indeed, if local autonomy over local 'place-shaping' (Dollery, Grant and O'Keefe, 2008) is to have any meaning, then the retention of existing small councils is essential. Using the example of greater Los Angeles, Oakerson and Svorny (2005) have demonstrated that small municipal entities are compatible with sensible regional planning arrangements.

The problems associated with re-scaling metropolitan governance when an existing network of local authorities is already in place has been considered in the academic literature (see, for example, Quinlivan, 2000; Brenner, 2004; and Courchene, 2005) and various ingenious new forms of governance have been proposed (see, for instance, Hooghe and Marks, 2002). However, in order to place the KPMG (2008) proposals in context, it is instructive to briefly consider two diametrically opposed real-world approaches to this problem. In the first place, the Greater London Authority (GLA) was established in 2000, replacing the Greater London Council (GLC) abolished in 1986. The GLA consisted of a directly elected mayor and an elected London Assembly, with powers over transport, policing, economic development, as well as fire and emergency planning, delivered through four subsidiary agencies. In essence, the GLA is responsible for coordinating land use planning in Greater London under its statutory London Plan, which individual London borough councils are legally obliged to follow. Local government services are delivered by 32 borough councils and the City of London. The GLA was created to improve the coordination between the local authorities in the greater London metropolitan area and it can overrule individual borough councils, if it determines this is in the broader metropolitan interest. Some

work has been directed at assessing the performance of the GLA and it appears to operate effectively (see, for instance, Andrews, 2004; Brownill and Carpenter, 2009).

The City of Brisbane represents an alternative ‘centralist’ approach to resolving metropolitan-wide coordination problems since it is the sole governmental authority responsible for all local government functions in the greater Brisbane area. Following the passage of the City of Brisbane Act 1924, in October 1925 the 20 existing councils were abolished and merged into City of Brisbane (Hogan, 1982). Given the paucity of empirical research into Australian local government, very little is known about the comparative performance of Brisbane, by far the largest Australian council, with a population in excess of two million people, and its only metropolitan-wide municipality. However, the sole empirical study by Yetano (2009), which compared the performance management processes in the City of Brisbane with that of the City of Melbourne, found neither enjoyed any marked advantage. However, any informed judgment on comparative performance of Brisbane relative to other Australian councils must await further empirical research.

## **7. CONCLUDING REMARKS**

This paper has attempted to provide a critical appraisal of KPMG (2008) and its policy implications for reforming metropolitan governance arrangements in greater Sydney. It has argued that while KPMG (2008) claims that local council amalgamation across greater Sydney would generate cost savings for ratepayers and enhanced efficiency cannot be sustained empirically. Indeed, available evidence, such as ACELG (2011) and Dollery, Crase and Johnson (2006), suggests that strategic capacity would improve as a consequence. Given the rapid population growth experienced in metropolitan-wide Sydney, additional strategic capacity would be advantageous. However, as we have seen, larger local authorities inevitably come at a cost, which includes less immediate relationships between elected representatives and constituents. Given the inherent desirability of vibrant local democracy for local choice and local autonomy, this trade-off between council capacity and council democracy is regrettable.

However, this paper has argued that the trade-off can be nullified, or at least diminished, by introducing a two-tier system along the lines of the GLA and Oakerson and Svorny (2005) proposal for greater Los Angeles.

In this way the democratic strengths of smaller local government entities could be retained, along with a comparatively high degree of local autonomy and local 'place-shaping', and at the same time a metropolitan planning authority could provide greater coordination through a Sydney-wide approach.

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