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**The State of Play in Australian Local Government**

by

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# **The State of Play in Australian Local Government**

Brian Dollery \*\*

## **Abstract**

The previous two decades have seen enormous change in Australian local government. This paper seeks evaluate this transformation process by examining the views expressed in two contemporary volumes on the subject. Reshaping Australian Local Government: Finance, Governance and Reform (Dollery, Marshall and Worthington 2003) provides a broad analysis of the causes and consequences of change across the entire spectrum of local government activity in Australia. By contrast, the Economics of Australian Local Government (Dollery, Crase and Johnson 2005) (forthcoming) focuses on the economic dimensions of the transformation process. This paper attempts to trace the major themes explored in both books and then distil their main conclusions. \*

Key Words: Administrative reform; Australia; local government; structural change

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\* Sections 2 and 3 of the paper are adapted from the concluding chapters to both books.

## 1. INTRODUCTION

Since the late 'eighties, Australian local government systems in all states and territories has been transformed by successive waves of legislative change, administrative reform, and structural adjustment. To a large extent, the absence of formal constitutional recognition for local government in the Australian federal system has made municipal councils a statutory creature of state government legislatures and thus easy prey to manipulation since the powers and functions of local authorities are entirely determined by the relevant state enabling acts and administrative regulations. Moreover, the process of transformation is by no means complete. Over the recent past, the Commonwealth government has expanded its role in local governance and now often deals directly with the local government sector thus trespassing on ground previously occupied almost exclusively by state governments. The end result is not yet in sight.

One way of considering the change that has swept through Australian local government is through the prism of two books on the subject. *Reshaping Australian Local Government: Finance, Governance and Reform* (2003), co-edited Brian Dollery, Neil Marshall and Andrew Worthington, represents a 'broad-brush' approach to the problem by providing a synoptic description of the transformation process across all facets of Australian local government, thereby effectively replacing a similar and earlier edited volume entitled *Australian Local Government: Reform and Renewal* (Dollery and Marshall 1997). A second book, presently in the final stages of production, adopts a rather more closely defined approach by focusing on the economic aspects of the changes that have occurred. The tentatively named *Economics of Australian Local Government*, written by Brian Dollery, Lin Crase and Andrew Johnson of the University of New England's Centre for Local Government, is an amalgam of the economic foundations of local governance and an economic analysis of the nature of the changes that have taken place. A recapitulation of the central themes of these two monographs represents the subject matter of the present paper.

The paper itself is divided into two main parts. Section 2 provides a brief synoptic outline of the central findings of *Reshaping Australian Local Government: Finance, Governance and Reform* (2003). Section 3 examines the chief conclusions arrived at in the *Economics of Australian Local Government*.

## **2. RESHAPING AUSTRALIAN LOCAL GOVERNMENT**

*Reshaping Australian Local Government: Finance, Governance and Reform* (2003) sets out to examine some of the major contemporary issues confronting Australian municipalities at the dawn of the 21st century. The book is an edited volume made up of individual chapters by specialists that considered particular aspects of Australian local government from several disciplinary perspectives, with individual contributions examining a range of concerns and policy dilemmas in some detail. The collection as a whole also provides a useful review of the transformation of the local government sector in recent years. This section of the paper now attempts to draw together some of these insights and place them in the broader thematic context of future local governance in Australia.

The section itself is divided into two main parts. In the first part, the paper seeks to assess the achievements of Australian local government over the recent past, especially in the areas of management, democracy and finance. By contrast, the second section considers future directions that might assist in overcoming some of the problems confronting Australian local government in the new millennium. In particular, the focus falls on the potential significance of developing sound intergovernmental consultative bodies, encouraging the growth of regional organizations, enhancing the efficiency and effectiveness of local government service delivery by entrenching the principle of comparative advantage in all of its operations, and stimulating more discourse and inquiry into local governance.

### **2.1 Achievements of Australian Local Government**

#### ***Management***

One of the most conspicuous achievements of local government over the past decade lies in the manner in which Australian local government has reformed its internal functions and processes. Councils have restructured their organizational frameworks to cater for the outsourcing of services, developed commercial capabilities to compete in the business arena, adopted an orientation towards outcomes as opposed to inputs, and introduced a range of corporate strategic practices. These activities are all features of the New Public Management (NPM) that has substantially influenced the operation of public agencies around the world. In Australia, the impact has been particularly comprehensive. So much so, in fact, that in Caulfield (Chapter 2) suggests that

Australian local government has emerged as an international leader in the extent to which it has adopted and implemented the new managerial style.

To a considerable degree, the NPM was thrust upon councils by state legislation, and subsequently encouraged by both Commonwealth and state agencies. However, the exercise amounted to far more than a top-down imposition by higher levels of government. Many local authorities were willing recipients of the new strategies and viewed them as critical tools with which to cope with rising community expectations and declining sources of revenue. Indeed, a number of councils across all states have used the precepts and techniques of NPM to respond creatively to the particular needs of their communities. This is by no means a surprising result; Australian municipalities have a long history of being at the forefront of management in the Australian public sector arena (Wettenhall 1988).

In essence, the changes adopted by many municipalities appear to have been well targeted and effective. For example, in Queensland community attitude tracking surveys taken over the course of the 1990s reveal high levels of public satisfaction with local government's activities. Respondents expressed greater confidence in the role of councils as service provider than the other spheres of government (LGAQ 2002, p. 23). There are undoubtedly large variations in the effectiveness and efficiency of the performances of individual municipalities, both within and between states, as Geoff Baker indicates (Chapter 7). Nevertheless, it would seem that overall the sector has performed well.

While local authorities will doubtless continue to refine their internal structures and seek to improve outcomes, such gains are likely to be marginal in the foreseeable future. Further significant increases in efficiency will probably only eventuate when there is much improved coordination and alignment of activities between state agencies and councils. This will involve rethinking the nature of intergovernmental mechanisms. In particular, it will necessitate attention being given to the principle of subsidiarity – that is, each function of government should be devolved (where possible) to the lowest level of government, where such action best serves the interests of the community.

Another challenge facing local government will involve the continuing shift away from traditional hierarchical administrative structures that have characterized councils in the past. Increasingly, as Joe Wallis indicates (Chapter 9), managers will have to adjust to operating environments based on market

competition and the interaction of policy networks. Change of this order will require the acquisition of fresh skills and expertise.

### *Democracy*

The reform spotlight has fallen so heavily on management in recent years that the democratic dimension of local government has, to a considerable extent, been overshadowed. Some commentators would put the even stronger view that a strident preoccupation with obtaining improved economic performance has had a detrimental affect on civic values. In this volume, Rosemary Kiss (Chapter 6) argues in part that state reform programs – and particularly the impact of amalgamations - have substantially weakened the democratic legitimacy of municipalities.

The concerns raised by Kiss certainly emphasize the need for serious and sustained debate about the functions of local government within the broader Australian polity. At one level this process should involve an examination of the constitutional status of the sector, its roles and responsibilities vis-à-vis the state, and the nature of its relationships with higher spheres of government. In common with issues of service provision, such questions need to be tackled in the context of a formal intergovernmental structure and supported by highly developed protocols.

At a broader level, wide-ranging dialogue surrounding the nature of the democratic mechanisms that underpin the function of local authorities is surely also necessary. One of the salient features of the reform processes across all the states in the 1990s was the absence of serious discussion about the theoretical principles on which local government should be based. The whole question of representative and participatory democracy, and the linkage between the two concepts, needs to be properly explored. Dynamic communities require sophisticated political structures that involve elements of both representative and participatory democracy. The appropriate mix of measures necessary to achieve the constructive involvement of constituents will vary both between localities and between states.

The question of governance, however, needs to move beyond traditional notions of representation and participation to embrace consideration of a wider range of issues. These will include corporate governance perspectives (which Marshall examines in Chapter 8) and matters that pertain to local government failure, such as ‘voter apathy’ and ‘iron triangles’ (discussed by Dollery in

Chapter 11). Equally important is an understanding of the wider fragmented and fluid environment in which municipalities now operate. Councils share their regional space and responsibilities with a range of autonomous bodies, whose actions, either directly or indirectly, have a significant bearing on the cultural, economic, social life of the community. Such bodies comprise boards and committees appointed by state authorities, state and Commonwealth government departments, adjoining councils, as well as regional organizations. The ability of elected members and officials to achieve strategic goals will depend upon their capacity to interact, and negotiate successfully, with these agencies. Such activity further reinforces Wallis' argument in his chapter: it will be necessary for participants to build sustainable policy networks across diverse interests in order to secure appropriate policy outcomes. The final section of this chapter examines ways in which dialogue of this kind might be fostered.

### ***Local Government Economics***

Considerable progress has also occurred over the past decade in economics of local government. In common with higher tiers of government in the Australian federation, public sector reform has drastically changed the way in which local government approaches its core functions. Moreover, microeconomic reform, and especially National Competition Policy, with its key ingredients of competitive neutrality and deregulation, has transformed the operation of the Australian economy. Local governments have thus had to adjust to not only to a different internal regime, but also to new external realities. It is therefore not at all surprising that elected representatives and council managers alike have experienced severe difficulties coming to terms with an entirely new environment. Despite these difficulties, much has been achieved.

In essence, the institutional structure and managerial practices of Australian local government changed almost beyond recognition. Under the influence of NPM councils have become much less hidebound and bureaucratic and much more responsive to changes in their outside environment. Local government managers now have much greater latitude to act autonomously in terms of the NPM doctrine of 'letting managers manage', but also simultaneously face much more accountability with the establishment of separate cost centres, which link administrative responsibility with resource expenditure. Employment patterns within the municipal sector appear to have changed to accommodate these new developments. Executive positions are now widely advertised to attract 'new blood', and executive recruitment is often aimed at hiring individuals from

outside of the organization in order to stimulate fresh approaches to the problems confronting local government. Managerial remuneration has risen proportionately over the past decade, occasionally to the chagrin of constituents. Commensurate with the greater challenges facing councils, managers now possess greater institutional freedom to pursue alternative solutions.

Substantial change in the external economic environment has also fostered an institutional revolution in Australian local government. Microeconomic reform has resulted in a much more flexible and deregulated market economy in Australia, with significant repercussions for the entire public sector, including local government. In essence, the principle of competition, with its purported benefits of enhanced economic efficiency, has been brought to bear on individual councils. Compulsory competitive tendering and outsourcing have become standard instruments in the policy armouries of local governments in their quest for greater efficiency. With the contracting out of service production and delivery now a viable possibility for municipal managers, the nature of Australian local government is shifting from service production and provision to service provision *per se*. The old nexus between service provision and service production has been severed. Councils are now charged with providing services, in the sense of paying for their production and delivery, and then arranging the best possible means of actually producing these services. Production may occur entirely through outsourcing to the most economical contractors, remain an integral part of a council's activities through 'in-house' manufacture, or be divided through some kind of public-private partnership. Emphasis is on providing 'best value' to ratepayers on a case-by-case basis. The efficiency-inducing impact of this change can hardly be over estimated. Instead of the old doctrinaire insistence on council provision and production of municipal services, with all of its notorious waste and inefficiency, the introduction of actual and potential competition for the right to produce and deliver services means that not only those activities subjected to competitive tender become subject to market forces, but also goods and services still produced in-house will be affected by the possibility of outsourcing. Thus even people and capital resources still hired directly by councils themselves to produce and deliver services are obliged to become more efficient under the threat of outsourcing.

The introduction of the competitive principle to municipal activities has necessitated profound institutional changes in the operations of Australian local government. The relevant Commonwealth and state government empowering



legislation had to be thoroughly digested and applied in practice – no mean feat in itself. Tender and other procedures had to be developed and perfected to meet the new challenges. Managers had to streamline existing council operations to ensure that they could rise to potential competition by contractors from the private sector. This meant *inter alia* extensive training for employees and frequent restructuring of service departments. At the same time, the global revolution in information technology had to be accommodated and incorporated into day-to-day operations. It is to the great credit of those people in Australian local government that these sea changes were navigated with great skill on the whole.

One of the most important changes that have taken place in the institutional milieu of Australian local government resides in the nature of financial reporting. Christine Ryan (Chapter 4) outlines the substantial changes that have accompanied the introduction of *AAAS 27 Financial Reporting by Governments* that now forms the framework for all public agency reporting in Australia, including local government. This methodology obliged municipalities to move from cash-based reporting to accrual-based reporting. The rationale for this change derived from the need to provide financial information in a form more accessible to the general public and to bring accounting practice more into line with that employed in the private sector. Whilst the complexities of the new reporting framework appear to have been admirably mastered by many municipalities, Ryan nevertheless argues that two main conceptual problems remain unresolved. In the first instance, it is not at all clear that *AAA 27* is entirely suitable for the valuation of assets and the associated problem of asset depreciation in the public sector. And secondly, the question of revenue recognition is problematic. Ryan contends that, despite the progress that has been achieved in council financial reporting, these areas need to be revisited.

In addition to the revolutionary transformation wrought by public sector reform, NPM and microeconomic reform, Australian local governments had to face at least three further sources of change. Andrew Johnson (Chapter 3) provides an excellent analysis of the triad of pressures brought to bear on councils by severe constraints on revenue raising, unfunded mandates from higher levels of government, and rapidly rising expectations from constituents. Johnson shows how the current financial crisis confronting Australian local government derives in part from the inability of municipalities to raise sufficient funds to adequately discharge their duties, especially in the area of infrastructure development and maintenance. Rate capping by state authorities, insufficiently indexed grants from state and Commonwealth governments, and a marked

reluctance by the public to pay ‘realistic fees and charges’ have meant that the growth in local government income has been rapidly outstripped by the demands on its resources. This problem has been intensified over the past decade by the inexorable downward shift of responsibilities from higher tiers of government, which local government has been constitutionally powerless to resist. Moreover, not only have state governments, in particular, placed the burden of additional functions on the unwilling shoulders of councils: in many cases these responsibilities have been unaccompanied by additional resources, or at least insufficient resources. The need to augment and maintain a costly and aging physical infrastructure has further intensified upward cost pressures. Compounding these cost and revenue pressures has been a growing ‘expectations gap’ derived from changing public perspectives on the appropriate role of local government. Johnson argues persuasively that people are no longer satisfied by the traditional ‘services to property’ role of Australian local government and demand instead a new and more resource intensive ‘services to people’ orientation. A substantial and rapidly increasing divergence between the abilities of local governments and the desires of their constituent groups has resulted.

One method of tackling the ostensibly intractable problem of inexorably rising costs and insufficient revenue resides in enhancing the efficiency of Australian local government. Andrew Worthington (Chapter 10) has demonstrated that tremendous progress has been made towards measuring efficiency in local government and establishing appropriate benchmarks against which to evaluate the operations of individual councils. We have seen that a number of reforms have sought to achieve the goal of greater economic efficiency. For instance, the managerial revolution in local governance, with its attendant internal changes to municipal operations, has been instigated in order to make councils more cost effective. Similarly, the introduction of the competitive principle also represents an attempt to boost the efficiency of municipal resource use by allowing managers to use the cheapest available organizational solution to service production and delivery. A third policy option has sought to improve municipal efficiency by enlarging individual councils through amalgamation. This policy is based on (the largely empirically unsubstantiated) proposition that substantial economies of scale and scope derive from municipal size. Thus councils with larger populations are deemed to be able to produce and deliver services at lower costs than their smaller counterparts. Although we will examine the question of amalgamations, as well as policy alternatives in the form of ‘virtual councils’ and resource sharing, later in this chapter, for the present we simply wish to emphasise the far-reaching nature of structural

reform in Australian local government over the past decade. As Paul May has indicated (Chapter 5), amalgamation has not been applied uniformly across all state and territory jurisdictions in Australia. Indeed, a continuum exists from the drastic ‘forced’ amalgamations undertaken in Victoria at the one extreme, to the ‘voluntary’ and concomitantly leisurely pace of restructuring in New South Wales at the other extreme. Nevertheless, considered as a whole, amalgamation has served as one of the major sources of change in Australian local government and thus serves to illustrate further the massive transformation of the sector over the past decade. The fact the affected municipalities have overcome many of the hurdles involved in amalgamation again underlines how well the sector has coped with rapid change.

## **2.2 Future Directions**

### ***State/Local Partnership Agreements***

The book has stressed the importance of developing suitable intergovernmental mechanisms if some of the issues that have been identified are to be successfully addressed. The benefits to be gained from encouraging such activity have not been lost on state governments: indeed, over the past two or three years, they appear to have adopted a far more inclusive approach to the local government sector. All states seem to have exhibited an increasing willingness to collaborate with municipal leaders and have begun to construct more extensive consultative arrangements to facilitate interaction. However, the nature of this involvement varies significantly across jurisdictions.

Tasmania undoubtedly leads the field in terms of its ‘whole-of-government’ approach to engaging its municipalities. In 1999, the State Cabinet approved the development of a system of Partnership Agreements with the local government sector. These agreements are intended to improve service delivery, and achieve specified social, economic and environmental objectives. The Agreements work at three levels. The first involves senior state agency managers negotiating with individual councils. Both parties attempt to identify priority issues of mutual concern, and find suitable solutions. Projects undertaken so far relate to tourism, information technology, sport and recreation, health, and heritage. A similar process takes place at the regional level and comprises groupings of councils. Finally, at the State level, the Premier’s Local Government Council has been set up to consider state-wide matters, such as waste management and planning coordination. The Council consists of representatives of the

Tasmanian Local Government Association and senior officials of state agencies (Scott 2002).

South Australia has gone down a similar path to Tasmania, but is somewhat less advanced. The State's decision to move in this direction followed a review in the late 1990s that examined the scope of interaction between state agencies and local governments. When it transpired that this activity was quite extensive, State Cabinet decided to launch 'The State/Local Government Partnerships Program' in 2002. The new venture was to be shaped and implemented by an appointed forum. Chaired by the Minister of Local Government, the forum comprises representatives from the South Australian Local Government Association, metropolitan and rural members of parliament, chief executive officers from state agencies, and senior managers from councils. The Partnership Program is intended to be a functional reform process directed at improving cooperation between state and local governments and addressing strategic issues of importance. Recently, the program has begun to operate on a regional basis, though this is not yet as clearly articulated as the Tasmanian approach (Proctor 2002, pp. 7-9).

Victoria has similarly embarked upon a strategy that contains some of the elements of the South Australian and Tasmanian approaches. In the wake of the 1999 election, the State government sought to regenerate a collaborative working relationship with the councils. An annual Regional and Rural Mayors Summit, chaired jointly by the Minister for State and Regional Development, and the Minister for Local Government, has been formed. The Local Government Consultative Council, which meets four times each year, has also been convened by the Minister for Local Government. Municipalities are represented in regional groupings and meet with relevant state agency officials on particular issues. Moreover, a bi-monthly forum consisting of council chief executives and officers from the Department of Local Government meet to consider matters relating to management (Digby 2002, p. 4). However, it seems reasonable to suggest that the Victorian initiative is still in its very early stages of development.

Current initiatives in Western Australia are even more recent. A year after the election of the Gallop Government in 2001, Cabinet outlined measures to introduce a State-local partnership arrangement based on a set of agreed principles. The model involves the Western Australian Local Government Association working with State authorities on policy formulation and decision-making in areas where both spheres of government are major stakeholders. A

critical feature of the new framework is the establishment of a State and Local Government Council to oversee the partnership process. The Council consists of the Premier, Treasurer, key ministers, and local government representatives. Initial deliberations will focus upon building consultative protocols, and developing a number of shared policy projects (Burges 2002, p. 20). It remains to be seen how the outcomes of these intentions will actually evolve over the next few years

In contrast to the broad approach of these states, Queensland and New South Wales have chosen agency or issue-centred strategies. Queensland's Department of Local Government uses the Integrated Planning Act 1999 to coordinate state and local planning. The Act provides for the establishment of Regional Planning Advisory Committees that encompass two or more local government jurisdictions. These Committees are not general planning forums. Instead they have been created to formulate policy relating to specific economic, social or environmental concerns. The Advisory Committees can make recommendations, but these can only be implemented through the voluntary cooperation of constituent councils. The Committees are not incorporated and have no authority to manage funds. Their function is essentially that of planning and coordination. Seven such bodies have been established in Queensland since 1999 (Meppem *et al* 2002, Appendix B)

The Department of Urban Affairs and Planning in New South Wales has been given responsibilities similar to Queensland's Department of Local Government; it employs the provisions of the Environmental Protection and Assessment Act to integrate the State's planning procedures. *Plan First* (2001) brings together all the State's environmental and related planning activities under one heading. Emulating the Tasmanian approach, *Plan First* operates at three broad levels. At the ground level, after due consultation with residents, individual councils prepare 'whole of community' land use strategies, which include economic and social perspectives. In regional terms, a forum consisting of community and business representatives, state agencies and members of parliament, generates cross-regional proposals. Finally, at the State level, the Department of Regional Affairs and Planning monitors and coordinates the relevant planning activities of all state agencies. The Minister presides over the entire process and may amend local and regional intentions to ensure they conform to State requirements. *Plan First*, however, differs from Queensland in so far as the local government sector is treated as only one participant among many.

Clearly, of all the state strategies outlined above, the Tasmanian initiative would seem to offer the most potentially effective intergovernmental framework. Partnership Agreements embrace a ‘whole-of-government’ approach that provides for structured and equitable interaction between players. When supported by protocols and the imprimatur of the most senior echelons of the state government, agreements will possess a high degree of credibility. They also provide an appropriate forum in which to consider the issues raised in the previous sections; the need to reconsider the financial situation of local authorities, especially the unfunded mandate (this is taken up in more detail later in the chapter), and the respective roles and responsibilities of the two levels of government. There is obvious scope here, too, to apply the subsidiarity principle. Finally, a system-wide perspective such as this facilitates an honest appraisal of the extent of the disparities existing between metropolitan and regional areas, and the best means of redressing them.

However, significant obstacles stand in the way of developing inclusive partnership arrangements. Not least of these is the mutual suspicion that has existed between state and local governments in some states for many years, even decades. Recently, the National President of the Local Government Managers Association went so far as to observe that ‘we have seen some state governments regard local government with disdain’ (Oxley 2002, p. 3). While this comment was directed largely at the Victorian reforms of the 1990s, it also reflects the frustration felt in some quarters at the sector’s long-standing subservience to state governments. Even in South Australia, where relations between local governments and state agencies have been relatively benign, breaking down adverse perceptions has required a determined effort. For instance, Proctor (2002, p. 11) has noted that ‘while we can make a difference in the way individual public servants in state and local government relate to each other, it is a very slow process indeed achieving institutional change’. The creation of partnership agreements will clearly take patience and time and will need to be shaped by the particular political culture of the state involved.

A second major difficulty confronting the emergence of comprehensive partnership agreements is the logistical difficulties involved in determining the shape of structural arrangements. How do officials align and coordinate dozens of state programs with 68 local governments, in the case of South Australia, or 156 in Queensland? No doubt one of the factors underlying the success of Tasmania’s approach is the relatively small size of the state, and the limited number of state agencies and councils (29 in all) involved. In the more

populous jurisdictions that possess administrative and infrastructure frameworks of substantially greater complexity, the difficulties are significant.

We suggest that one long-term solution to this problem may be to encourage the growth of Regional Organisations of Councils (ROCs). The benefits that these entities offer are now considered.

### ***Regional Organisations of Councils (ROCs)***

ROCs are voluntary groupings of neighbouring councils. Though not well known in the broader public arena, they have been an established feature of the Australian local government landscape for many years. The first ROC was established in Tasmania in 1922. Others were formed in all states over the course of the following decades. There was a sudden increase in the numbers established during the early to mid-1990s as a result of federal government support for regional development. By 1995, Northwood (1995, p. 1) estimated that there were about 50 such bodies in Australia covering almost 45 per cent of councils, and around 75 per cent of the population. This number fell during the 1990s as a result of the amalgamation programs implemented by South Australia, Tasmania and Victoria. In 2001, it is estimated that there were some 30 to 40 ROCs in operation (Marshall and Witherby 2002, p. 1).

The majority of ROCs consist of between five and fifteen councils (with the largest having 18). Size and population varies enormously; the Western Sydney Regional Organization of Councils (WSROC), for example, is formed from 11 councils, covers 5851 square kilometres, and contains 1,500,000 residents. By contrast, the Murray Regional Organization of Councils has only 10 members, but is spread over 63,257 square kilometres (some 7.8 per cent of New South Wales) and comprises just 45,532 constituents. The average ROC is financed by a set fee from member councils, supplemented by a pro rata contribution based on population or rates income. Participating councils appoint two or three individuals to sit on the ROC board. These representatives almost always include the mayor, along with another councillor and/or the chief executive officer. Most ROCs are supported by administrative structures and specialist committees.

Joining a ROC offers a number of benefits for participating councils. First, meetings provide an opportunity to exchange ideas and consider issues of common interest. Such interaction also allows (often) disparate entities to foster a sense of cohesion and regional identity. Second, forums of this nature

encourage the development of common policy on issues such as housing, soil and water management and records management. Because ROCs have access to expertise, data and experience that is drawn from across a range of councils, outcomes are more likely to be well informed. Thirdly, ROCs can assist in the coordination and rationalisation of activities across jurisdictions. Outcomes may range from a quite modest brochure for walking trails, for instance, to a set of complex environmental planning documents.

Fourth, ROCs facilitate resource sharing and joint purchasing arrangements. Such practices allow members to develop superior technical specifications addressed to their particular needs, and to provide for economies of scale in the use of expensive equipment. Smaller regional groupings benefit in this regard at least as much as the larger urban ROCs. Over a three and half year period in the late 1990s, for example, the Riverina Eastern Regional Organization of Councils (2001, p. 6) delivered savings of over \$2.5 million to its 13 members through joint purchasing.

Finally, and perhaps most importantly, ROCs function as regional lobbyists. When a group of councils can provide a united front on a particular issue, their views will usually carry much greater weight with the relevant federal and state authorities. Submissions are also more likely to be thoroughly researched and better argued. There is little doubt that some ROCs have become highly refined and knowledgeable in the techniques and strategies they employ. It is clear that many have achieved significant successes with their lobbying activities. Probably the most impressive outcome in this regard was the Western Sydney Regional Organization of Council's success in persuading the New South Wales government to appoint a separate Minister for Western Sydney.

Certainly, there have been some very successful ROCs in Australia in recent years that have benefited from most or even all of these factors. Moreover, successes have not been confined only to the metropolitan areas. Several groupings of councils in regional and remote areas have formed highly effective organizations. It remains true, nonetheless, that the largest and most influential ROCs are situated around the capital cities.

Not all ROCs succeed. Some are uninspired groupings that achieve only just enough to keep the entity intact. Others are disbanded after only a short period. A few experience a period of considerable achievement and then cease to exist. It remains uncertain, however, just what combination of characteristics is necessary to create a high-performing ROC. There is no clear mix of such



variables as rates income, geographical size, population density, cultural homogeneity, length of time since establishment, or industry type, which might explain why some ROCs are more successful than others. Rather, it seems that the critical attributes that contribute to a successful ROC are the intangible factors of commitment, teamwork, regional vision, trust, openness, communication, leadership, and a willingness to cooperate.

These last features, of course, correspond quite closely with Wallis' notion of 'network' forms of governance where players interact in terms of shared values and operational understandings. Indeed, from this perspective, ROCs offer a framework for providing a stable, long-term structure for regional governance in Australia. ROCs evolve from the bottom-up, creating their own institutional arrangements and infrastructure requirements as they grow. This approach ensures that each grouping is attuned and adaptive to its particular regional needs. Because they emerge from the grass roots, ROCs are likely to enjoy a legitimacy and credibility in the eyes of constituents that an imposed level of government would take many years to achieve.

A system of regional governance is a desirable development in Australia. ROCs offer many of the benefits of larger, formal administrative structures while simultaneously preserving the autonomy and sense of community valued by individual local authorities. Moreover, the ROC concept remains equally applicable in an amalgamated local government environment: even the largest merged municipality is unlikely to cover a whole region. The post-amalgamation experience in Tasmania and South Australia indicates that the need for groupings of councils remain as strong as ever. Indeed, in both states new configurations of ROCs have begun to emerge.

Possibly the most important characteristic of ROCs resides in the fact that they offer state governments a potentially very efficient and effective means of developing partnership arrangements. A ROC enables just a single point of contact for state agencies in areas such as health, housing and welfare. An arrangement of this sort facilitates a broad appreciation of regional requirements whilst at the same time catering for the needs of smaller areas.

### ***Local Government Efficiency***

Much has been achieved in making Australian local government more efficient and effective. Managerial practice has improved sharply, institutional structures have been radically redesigned to promote efficiency-enhancing competition in

the form of outsourcing and public-private partnerships, financial reporting has been strengthened, massive structural change has been absorbed, and in general councils are now much more client-focussed than in the past. Nevertheless, substantial problems remain to be satisfactorily resolved in future.

In the first place, although Andrew Worthington cogently demonstrated that most of the technical obstacles to performance measurement have been overcome, fully transparent benchmarking has yet to materialise. This is in large part due to the fact that in many state jurisdictions, local governments still produce unaudited data on their own economic performance. Moreover, in some instances this data is tardy in forthcoming. Thus, despite significant econometric advances in the statistical measurement of economic efficiency, little reliance can often be placed on the results of benchmarking exercises because of flawed or incomplete data.

In an era of public sector transparency, it is simply unacceptable that inefficient councils are permitted to disguise the fact that they lag behind their counterparts in service delivery. As Andrew Johnson has argued, local governments can hardly call for greater financial sacrifices from ratepayers and larger funding contributions from higher levels of government in the absence of reliable benchmarking data on their own performance. Moreover, it seems grossly inequitable that a 'tail' of poorly performing councils can wag the body of the 'dog' of municipalities genuinely attempting to lift their game. The long-run cumulative effect of a system of 'self reporting' that enables inept councils to conceal their inefficiencies will surely be a 'race to the bottom'.

There is thus an urgent need for state-based local government associations, such as the NSW Local Government and Shires Association, to ensure that accurate and timely data is employed in annual benchmarking exercises. This will have at least three beneficial effects. Firstly, public confidence in municipal performance appraisal will grow and with it the esteem in which local government is held. Secondly, state and Commonwealth governments will be reassured that the grant funds they transfer to local governments are diligently and efficiently expended. And finally, reliable benchmarking will enable individual councils to compare their own performance with like municipalities and adjust their behaviour accordingly.

Various institutional possibilities for gathering accurate current data exist. Perhaps the 'first-best' option would be for local government representative bodies in each state and territory to lobby their provincial legislatures allow

state departments of local government to collect and audit performance information under the force of law. Individual councils that fail to produce reliable information by an assigned date could be punished by a reduction in the level of their grants. Should this option be resisted by state authorities on cost or other grounds, then local government associations could simply collect the data themselves and submit it to external audit by public accounting companies. Whatever data collection and oversight procedure is employed, it is critical that it be transparent and trustworthy.

Local government restructuring remains another concern. Although the process of local government consolidation is complete for all intents and purposes in some state jurisdictions, most notably Victoria and Tasmania, in other large states, like Western Australia and New South Wales, the prospects for restructuring have yet to be explored in detail. Proponents of municipal amalgamation have insisted that larger local governments can achieve significant economies of scale and scope with substantial cost savings. By contrast, opponents of amalgamation have typically disputed the existence of considerable scale and scope economies and pointed to practical problems faced by rural and regional councils situated vast distances from their neighbouring municipalities. Available Australian empirical evidence on economies of scale and scope is mixed and extant international data moot (see, for example, Byrnes and Dollery 2002a).

In his chapter, Paul May argues that concerns over any adverse impact the amalgamation of small councils into larger administrative units on democratic representation can be met with the creation of ‘virtual councils’. According to this view, existing small councils can maintain their current representational structure whilst at the same time pooling and sharing resources with adjacent municipalities by forming virtual councils. Under this kind of ‘have your cake and eat it’ arrangement, the purported advantages of low ratios between voters and elected representatives can be conserved while simultaneously enjoying the alleged benefits of any scale and scope economies that may arise. Whereas utopian schemes of this ilk appear at first sight to resolve many of the potential trade-offs between democratic participation and economic efficiency, as May argues, the crux of the matter surely lies not only in the division of any pecuniary benefits, but also the allocation of costs. It is hard to see how these problems will be resolved in the fractious ‘real-world’ of Australian local government.

A much more promising (and older) alternative amalgamated large councils resides in resource sharing between adjacent small councils. Dollery (1997) has argued that the resource-sharing model enjoys both theoretical and empirical support. For instance, councils are statutorily obliged to fulfil a number of different functions, many of which will have different geographic zones or ('benefit regions') over which their benefits are spread. Thus street lighting typically benefits people in the immediate vicinity whereas large public parks may attract people from afar. Spillovers (or externalities) of the latter kind lend themselves to cost-sharing arrangements between jurisdictions whose residents are likely to benefit. Similarly, in cases where economies of scale can be demonstrated, such as domestic waste tip sites, adjacent councils can benefit by sharing these resources and bearing the associated costs on a per capita (or equivalent) basis. If resource sharing is undertaken on a case-by-case basis, then the political pitfalls of virtual councils can be avoided since no formal and binding long-term agreement has been made to agglomerate all council functions. Trial and error in particular and promising service areas can be employed to test for the existence of scale economies, and if they do not generate significant cost savings then the resource-sharing 'experiment' can be abandoned.

Local government restructuring in Australia is an 'unfinished' process that will require a good deal more attention in future. Both the theoretical and empirical arguments that 'bigger is better' are not presently convincing. Moreover, structural alternatives to amalgamation are available, such as resource sharing and virtual local government. Additional discourse and inquiry are urgently required in this area.

### ***Generating Discourse and Inquiry***

One of the most problematic issues facing local government today is the low profile of the sector in the public consciousness. Unlike its state and federal counterparts there is very little informed dialogue about functions, structures and purposes of Australian local government. The last – and only – time such dialogue took place with a national focus occurred during the early 1980s, following the establishment of the Advisory Council for Inter-Government Relations (ACIR) by (then) Prime Minister Fraser. The Council subsequently produced 13 discussion papers and three reports on local government. Balmer (1989, p. 7) observed that the Council's great achievement lay in the following:

‘...[T]he debate it generated in local government circles. Each discussion paper was circulated in draft form and comment on its contents was encouraged. As the reports themselves were developed, they too were widely circulated and seminars held to discuss their tentative proposals, as well as written comment obtained from government departments and other agencies. This process resulted in public servants from all three spheres of government and the elected members of local government developing a deeper understanding of its place within the federal system and its potential for a more widespread contribution to public life’.

Undoubtedly the Council’s efforts did a great deal to lift the public image of local government across Australia and helped persuade premiers to formally recognise the sector in state constitutions. They also encouraged federal authorities to put national constitutional recognition of local government to referendum in 1988 (which then failed to carry).

Given the changed political climate, it is unlikely that another body like the ACIR will emerge in the near future. Rather, the role of the state and national local government associations probably offers the most likely possibility of promoting discourse. During the late 1980s and early 1990s the Australian Local Government Association (ALGA) set about revitalising the sector as a whole and, in particular, building a cohesive and coordinated stance on critical issues. The ALGA itself emerged as a forceful and influential lobby with a sophisticated and well-researched approach to policy development. The result was substantial success for the Association in persuading the federal government to support desired courses of action. During the late 1990s the ALGA has been redoubling its efforts to promote the importance of local authorities in national affairs. It has expanded its influence in critical forums and is now represented on 70 federal councils and committees. Such strategies have undoubtedly served to lift the profile of local authorities in professional circles around Australia.

Many of the state associations have also worked hard to project local government more firmly into the community’s consciousness. Though these endeavours have certainly born much fruit, the raising of a national awareness of the achievements of councils continues to be hampered by the narrow territorial perspectives of some state associations. At the grass roots level, councillors and managers receive little information about what is taking place

in other states. The partnership initiatives developed by Tasmania and South Australia, for example, though familiar to senior administrators in adjoining states, took a long time to filter down through the system. One of the benefits of having a federal structure is that it allows various jurisdictions to experiment with different approaches to policy issues. The outcomes of these experiments need to be widely disseminated for the benefit of the local government sector as a whole.

Finally, the universities are well positioned to play a critical role in building local government's public profile. They can contribute by offering courses that both recognise the distinctiveness of the sector, and provide appropriate training for municipal practitioners. As the sophistication and complexity of council activity increases, career-oriented managers are discovering – in line with their counterparts in other spheres of government - that they need to supplement their undergraduate degree with a post-graduate qualification. This has usually involved undertaking a Masters of Business Administration, or Masters of Public Policy/Public Management.

The generic management skills imparted by qualifications such as these undoubtedly served local government well during the 1990s. It is doubtful, though, that they can continue to meet the evolving needs of the sector into the 2000s. Studies in business management are typically oriented towards the private sector, while public policy and public administration courses cater largely for more conventional government agencies. The specific requirements of local authorities, however, differ substantively not only from the private sector, but also increasingly from those of state and federal bodies. Characteristics which distinguish the operation of councils from other spheres of government have been alluded to in almost all the previous chapters contained in this volume. Two further examples are worth mentioning here. First, where there is a separation of roles between the legislature, executive and judiciary in state and federal of government, these roles are fused at the municipal level. This situation significantly alters the dynamics of institutional activity and the manner in which managers interact with elected members. Second, the strategic dimension of local government activity is especially difficult because managers have to adopt a 'whole of community' perspective. This involves attempting to embrace the competing demands of a spectrum of citizen interests, as well as delivering a diverse range of services. The complexity of this exercise in large urban municipalities probably exceeds that undertaken by any single state or federal government department. Practitioners need to understand and accommodate the nature of such activities if the local

government sector is to function effectively and reach its full potential in the future.

With local government growing in scope and maturity, and assuming an increasingly salient position as an economic driver in the national polity, it is time to develop university degrees designed specifically for needs of the sector. These courses would be constructed in close collaboration with industry bodies like the Local Government Managers Association, and offered at post-graduate level – perhaps as a Master of Local Governance.

Serious engagement with the universities would bring the added benefit of generating increased academic interest in the sector (which is unfortunately very limited at the moment). Major research studies relating to local government serve to stimulate public debate about the role and direction of municipalities. Dialogue of this kind, in turn, can only promote the status and credibility of the sector as a whole.

### ***3. ECONOMICS OF AUSTRALIAN LOCAL GOVERNMENT***

The *Economics of Australian Local Government* (2005) presents the economic principles that underpin Australian local government and examines some of the major policy issues confronting Australian municipalities. The book is divided into three main parts. Part A sets the scene by briefly outlining the functions of Australian local government in Chapter 2 and assessing the financial pressures on local authorities in Chapter 3. Part B of this book is devoted to an analysis of the economic principles and economic models that underpin an understanding of contemporary Australian local government. Chapter 4 examined the economic basis for sub-national jurisdictions, like municipal councils, in a federal system of government from various perspectives developed by economists. Chapter 5 considered the economics of local government charges. Chapter 6 focused on the economics of local government taxation. Chapter 7 looked at the economics of intergovernmental grants and the highly developed Australian system of dealing with horizontal vertical fiscal imbalance and horizontal fiscal imbalance.

Part C of this book is devoted to an analysis of the economic foundations of various salient policy questions in Australian local government. Chapter 8 outlined various alternative models of local governance that are feasible in the Australian municipal milieu. Chapter 9 considered the contentious debate over council amalgamation that has been a feature of Australian local government

for over a century. Chapter 10 examined the significance of economies of scale in municipal service provision. Chapter 11 assessed efficiency measurement and its implications for local governance in this country. Taken together, these four chapters provide a sound analytical basis for examining the thorny problem structural reform in Australian local government and rational policy formulation on this explosive question.

The remaining chapters in Part C of the volume deal with other important economic issues in Australian local government. Chapter 12 examined the economics of the so-called purchaser/provider split and its policy ramifications. Chapter 13 considered the apparently intractable problem of cost shifting, first raised in Chapter 3, in more detail. Chapter 14 explored the phenomenon of local government failure and the arguments surrounding its existence and severity. Finally, chapter 15 discussed the topical question of local economic development.

This section of the paper now attempts to draw together some of the insights that emerge from *Economics of Australian Local Government* (2005) and place them in a broader context of future local governance in Australia.

The section itself is divided into two main sections. Section one considers the economic principles and economic models of local government developed in Part B of the book and attempts to distil their essence from the point of view of managing municipal councils in the most efficacious manner. In particular, we examine the implications of the economics of fiscal federalism and the economics of local government fees and charges. The second section deals with the local government policy analysis conducted in Part C of the text, with special emphasis on the design of optimal organization of municipal service provision in Australia.

### **3.1 Some Useful Economic Principles**

The paper now attempts to crystallize some of the more important economic principles that emerged from these chapters. Two themes will be discussed; the economics of fiscal federalism and the economics of local government fees and charges.



### *Theory of Fiscal Federalism*

Chapter 4 was devoted to a survey of the ‘meta-theoretical’ dimensions of economic literature as it bears on the question of federal systems of governance and the role and efficacy of local government within this broader framework. Four substantive strands of this literature were considered: The principle of subsidiarity and decentralized government; the theory of fiscal federalism and its implications for the structure and organization of government in a federal system; the question of competitive federalism and intergovernmental competition developed by Tiebout (1956); Albert Hirschman’s (1970) concepts of ‘exit’ and ‘voice’ in the context of competitive federalism and their applicability in improving the efficacy of local governance.

What are the specific policy implications of this discussion for Australian local government? In the first place, the case for decentralized federal government that derives from the theory of fiscal federalism has major ramifications for both the assignment of functions between the different levels of government and the spatial architecture of government structures. By explicitly adopting the principle of subsidiarity, the correspondence principle developed by Oates (1972) holds that each function of government in a federal system should be provided by the smallest (i.e. lowest level) of government consistent with no spatial spillovers into adjacent administrative jurisdictions. Local governments should thus provide all local public goods and services that have purely localized benefits. By the same token, public goods and services with regional, state and national benefit regions should be provided by regional authorities, state and territory governments, and the Commonwealth government respectively. Moreover, where the provision of municipal council services entails either positive externalities (i.e. where individual councils provide services enjoyed by people from other municipal jurisdictions) or negative externalities (i.e. where individual councils provide services that impose costs on the residents of surrounding jurisdictions), then either some higher tier of government with a larger benefit region should provide the service in question or a higher authority should use its general tax revenue to subsidize and penalize the respective affected municipal jurisdictions to the extent of the impact of the externalities.

A further significant implication of the theory of fiscal federalism concerns the design of local government boundaries. In principle, the correspondence principle prescribes that the spatial boundaries of any given municipality should be coterminous with the benefit regions for the services they provide. In

practice, Australian state and territory local government boundary commissions often seek a ‘community of interest’ when determining council boundary alterations (in an implicit application of this principle).

Secondly, competition between governments at the same level in a federal system (Tiebout 1956) and competition between governments at different levels in a federal system (Breton 1996), allied to the concepts of exit and voice (Hirschman 1970), have interesting normative and positive implications for the design and regulation of local government. In general, horizontal competition between governments and vertical competition between governments in a federal system should be encouraged since citizens (as consumers of government services) will benefit in terms of greater choice.

However, an immediate caveat is necessary. In the specific circumstances of the Australian federation, the existence of vertical fiscal imbalance between the three tiers of government, together with the political imperatives to balance budgets and limit the tax burden, have given rise a malevolent form of governmental competition in the guise of cost shifting – a phenomenon examined in depth in Chapter 3 and Chapter 14. Australian local government has suffered severely due to this problem since it is constitutionally, financially and legally bound to follow the dictates of higher tiers of governance.

A second caveat concerning the generally benevolent nature of horizontal and vertical competition between the various jurisdictional authorities in a federal system should be to qualify the relative impact of local government on Australians compared to higher tiers of governance. Even with the recent expansion of the range of services provided by municipalities across Australia, including some significant human services, like aged care in various non-metropolitan areas, critically important public services, such as education, health, and law and order, fall outside the ambit of councils. This contrasts sharply with comparable advanced federal countries in the Anglosphere, like Canada and the United States, in which these functions are typically handled by the local government sector. Accordingly, the benefits attached to migration away from poor local service provision are relatively low in Australia compared with the substantial costs of moving residence. This obviously diminishes the significance of inter-jurisdictional Tiebout-style migration in search of better municipal service between adjacent local government areas in Australia.

Nevertheless, Breton-type competition between different tiers of government in the Australian federation seems to be achieving greater significance given the

blurring of responsibilities for various kinds of services, including some services delivered by local government. Moreover, this process appears to have accelerated over the recent past owing largely to Commonwealth government overtures made directly to local governments - in stark contrast to previous initiatives that involved municipalities which traditionally were negotiated with state governments rather than local government. Although the final outcome of this evolving process is still unclear, it is possible to discern the genesis of a new form of inter-governmental competition in Australia. In essence, the Commonwealth appears to be trying to use local government as an alternative instrument of policy delivery in competition with existing state and territory government programs, especially in areas of human service delivery, like Aboriginal assistance programs. Developments in this direction accord with the thrust of the economics of local government; competition between different government jurisdictions over the quality and price of services, including vertical Breton-style competition, should improve actual services consumed by the affected populations.

Despite the comparatively limited role of inter-governmental competition in Australia, Hirschman's (1970) concepts of 'exit' and 'voice' represent important methods of maintaining and even improving the quality and range of municipal services. Chapter 4 sought to demonstrate that though actual physical migration is not significant, 'exit' is still an important factor in at least two respects. Firstly, *potential* exit undoubtedly influences the behaviour of councils, particularly in the sense that local authorities often actively try to attract new businesses and new developments to their areas by offering various inducements, including improved services. Furthermore, complaints by existing commercial enterprises are frequently acted upon when they are backed by threats of migration to other municipal jurisdictions.

'Voice' is an even more important method of enhancing efficiency in Australian local government. Chapter 4 identified various avenues through which 'voice' could be expressed; we argued that if 'voice' could be made more effective, then so too would the operational performance of municipal councils be improved.

### ***Economics of Local Government Charges***

Chapter 5 examined the economics of local government charges as a method of financing local government. It was argued on empirical grounds that the significance of charges and fees was growing in Australia as a source of

municipal finance. International practice with generic ‘user charges’ was reviewed, with particular emphasis on American and British experience in the area. Chapter 5 outlined and assessed alternative user charge methodologies and various attendant equity questions.

Some vital economic principles emerged from this analysis. They generally derive from two well-established conditions for decentralized taxation in the literature on local public finance (Wildasin 1986). Firstly, where possible, taxes should be levied on immobile factors of production or immobile consumers to avoid distortions. Mobility will result in tax avoidance through tax flight. Secondly, local residents should pay for local goods to prevent them from shifting the tax burden for local services on to residents of other jurisdictions.

In the case of local government charges and fees, rather than local government taxation, these somewhat abstract principles of local public finance translate into specific rules very useful in determining the structure of municipal fees and charges. In the first place, since most goods and services provided by Australian local government are not ‘pure’ public goods, but rather ‘impure’ public goods with both public good and private good properties, efficient pricing requires that the service users themselves should bear at least some proportion of the financial burden involved in producing the services. For instance, the major beneficiary of domestic waste removal is the household itself, hence its private good attribute. However, the health and other disadvantages attendant upon non-removal necessarily mean that domestic waste removal also possesses some of the characteristics of a public good. Accordingly, council intervention is essential to ensure it occurs regularly. This means public financial subsidies either in terms of enforcing household payment of user charges through legal sanction using relevant bylaws and council inspectors or subsidizing removal directly from general revenue. In general, to the extent that a given municipal service generates externalities, it should be subsidized proportionately from general revenue. For example, the beautification of traffic circles and other public places through attractive gardens has few private good attributes but an overwhelming public good dimension and thus should be financed through general revenue instead of individual charges and fees. By contrast, domestic water consumption generates a preponderance of private benefits for the household concerned and therefore consumption should be rationed through prices imposed on individual households.

However, even if a particular municipal service is designated as being a public good or service, this does not imply that the subsidy required from the council in question has no limits. The general microeconomic principle involved may be stated as follows: Where a municipal good or service is deemed to generate positive externalities, then a locally-financed subsidy is warranted not exceeding the monetary benefits of the service to the local community. If the council good or service yields externalities enjoyed by people outside of the particular council jurisdiction, and needs a subsidy in excess of the monetary flowing to the local community, the additional funds should be sort from a higher tier of government, like a regional authority or state government. In other words, the financial value of the service accruing to non-residents should be funded by means of inter-governmental grants.

A final qualification should be added to the subsidization of municipal services. In general, subsidies should be directed towards local consumers of the council service rather than towards the service itself. The basic principle underpinning this proposition is not only to limit ‘free-riding’ by non-residents, but also to maximize the benefits of the subsidy by ensuring that it accrues to consumers of the service rather than in other uninterested persons. For example, if a local history council museum is deemed to generate positive externalities in the form of education and enlightenment, in addition to any private benefits that people might derive from its use, then ticket prices should be subsidized according. Municipal swimming pools represent a similar case. Consumers thus receive the full benefits of the subsidy. Of course, the existence of transactions costs, legal stipulations, and other considerations, often make it difficult to aim subsidies directly at the users of a specific service, thereby obliging local authorities to subsidize the service itself. Toilet facilities in public parks are representative of this kind of service.

In the second place, equity and merit good considerations can impose serious limitations on the use of local government charges. Merit goods may be defined as goods and services the consumption of which society wishes to encourage whereas demerit good consumption is discouraged by the community. For instance, while it is an easy matter to impose user charges on the use municipal library facilities, this may be considered inappropriate in the light of the merit good characteristics of books and reading. Moreover, it might seem inequitable to discourage reading on poor residents by charging them to withdraw books. However, in the case of demerit goods, like littering and spitting in public places, imposing fees and charges by way of fines is not only reasonable given public preferences, but also cannot be described as inequitable. Nevertheless, it

should be added that equity arguments are typically inadvisable in a local government context since the wider question of income and wealth differences between members of society is clearly best addressed at the national level through the social security system given the inherent mobility of citizens between municipal jurisdictions.

### **3.2 Implications for Policy Debates**

What general lessons can be learned from this Part C of book that can inform policy discourse and policy making in Australian local government? The preceding discussion has sought to distil some of the central economic principles operating in the local governance. The paper now addresses the broader question of appropriate criteria to invoke for the design of optimal organization of municipal service provision in Australia.

Despite the existence of useful economic principles and a formidable literature on New Institutional Economics (Wallis and Dollery 1999) to guide the construction and modification of local government institutions, especially the economic theory of fiscal federalism and a taxonomy of generic models suitable for Australian conditions (discussed in Chapter 8), it should still be stressed that there is no ‘silver bullet’ for optimal institutional design since ‘one size does not fit all’ in the contemporary municipal context. After arriving at much the same conclusion, Oakerson (1999, p. 122) argued that ‘if there is no “one right way” to organize a local public economy, the appropriate focus of inquiry is on governance’. Accordingly, ‘what is needed to guide the process of both metropolitan and non-metropolitan organization is not a blueprint but a set of principles for designing institutions of local governance’. Oakerson (1999, pp. 122-124) himself set out six ‘key principles’ for governing the modern American metropolis, many of which are also equally applicable in the Australian institutional milieu.

In line with this argument, we therefore conclude this book with a synoptic description of several pivotal principles for the organization of contemporary Australian local government. In the first place, the vibrancy of *local democracy* should be seen as an important objective of public policy in its own right and thus a worthy recipient of public finance. People are not only vitally interested in their immediate environment, but also seem to possess a basic psychological need for an enduring ‘sense of place’. Representative local democracy over well-defined spatial areas is thus essential to meet these needs. Although the elevation of healthy local democracy as a primary goal of Commonwealth and

state and territory local government policy may appear odd in a highly successful Australian federal democracy, critics often contend that the relatively low ratio of elected councilors to voters in small Australian municipalities is superfluous and an unnecessary impost on the ratepayer. Indeed, in the 2004 round of forced amalgamations in NSW, state government-appointed 'facilitators' made much of the cost of elected representation and the role of compulsory council mergers in reducing this 'unnecessary' cost see, for instance, Varden 2003).

If it is necessary to defend local government democracy as a legitimate target of public resources, then both efficiency and equity arguments can readily be brought to bear. For instance, effective 'empowerment' of local communities is nowadays widely viewed not only as an essential ingredient in the success of municipal service provision, in the sense that enfranchised citizens acquire 'ownership' of service programs, but also by far the best means of generating accurate information about preferences concerning the quality and mix of council service. Accordingly, a low constituent/representative ratio facilitates the free flow of information between people and their representatives and thus enhances the policy formulation process. Oliver (2001) has argued that three crucial dimensions of local government democracy, namely contact between constituents and councils, attendance at council meetings and attendance at ratepayers association functions, decline as municipal size increases. In his analysis of the efficiency of preference revelation in Australian local government, Percy Allan (2003) maintains that small councils, characterized by low jurisdictional populations with substantial representation, provide a better decision-making unit in terms of the appropriateness and effectiveness of service provision since they are 'closer to the people'. Similarly, equity grounds are plentiful. For example, ancient natural justice demands that local taxation take place only when efficacious democratic structures are in place.

Oakerson (1999, p. 122) presents several additional and telling arguments in favour of local democracy. In terms of the structural foundations of local governance, he contends that 'only citizens can make the trade-offs required to determine the number and variety of local governments in a metropolitan or non-metropolitan area' and thus 'give citizens a broad range of options and let them choose, community by community, how to constitute their local governments'. From this analytical bedrock follows specific advice to local government policy makers: Do not proceed with any particular structural reform, such as an amalgamation of several small councils, without a referendum or analogous democratic decision rule; do not allow municipal

boundary changes without explicit democratic approval; and do not attempt to ‘sweeten the pill’ by attaching (or removing) public monies from larger consolidated councils since this introduces extraneous influences and thus distorts voter preferences in favour of securing additional funding.

An interesting international literature exists on the phenomenon of ‘local government failure’ with an embryonic Australian strand (Byrnes and Dollery 2002b; Dollery 2001; 2002; 2003a; 2003b). Australian work on the prevalence of government failure suggests that it is more likely to occur at the municipal level because of voter apathy, virulent political entrepreneurship, inexperienced and amateur elected representatives, amongst a host of factors unique to local government. The implication of this research is that local democracy is comparatively inefficient relative to state and national political markets and it may thus be used to gainsay the arguments presented above in favour of local democracy. Two points need to be raised in this connection. Firstly, even if local government failure is more common than government failure at higher levels in the Australian federation, this does not mean that federal or state governments can in any way substitute for local government as either a preference revelation mechanism or a ‘voice’ at the local level. Imperfect local government is obviously superior to no local government. Moreover, knowledge of the nature and extent of local government failure makes it much more amenable to improvement. Secondly, a cogent theoretical case has been made that political markets are efficient, notwithstanding numerous blemishes. For example, Wittman (1995, p. 2) contends that ‘nearly all of the arguments claiming that economic markets are efficient apply equally well to democratic political markets, and, conversely, that economic models of political-market failure are no more valid than analogous arguments for economic-market failure’.

Secondly, the *distinction between the production of goods and services and the provision of goods and services* is crucial in local government. ‘Provision’ refers to collective choices that determine goals, standards, and arrangement for service, whereas ‘production’ means the more technical process of transforming inputs into outputs. Put differently, Oakerson and Svorny (2005, p. 516) draw a distinction between provision authority that embraces ‘making decisions about raising revenue and how to spend it – in other words, deciding on the set of services that are to be provided with public funds’, including ‘the authority to make rules governing behaviour’, like urban zoning, and production which is ‘the actual process of producing and delivering the services on which the authority has decided’. Numerous policy tools exist in municipal governance



linking provision with production: self-production, coordinated production, joint production, intergovernmental contracting, private contracting, franchising, and vouchering. Among these options, intergovernmental contracting and private contracting are presently the most widely practiced methods in Australian local government.

The separation of production and provision, likened to the more general distinction between ‘steering’ and ‘rowing’ in the public sector (Dollery 2003a), has profound implications for local government policy making in Australia. If small councils enjoy a comparative advantage in provision authority owing to the relative efficiency of their democratic processes in terms of preference revelation and the ordering of service priorities and expenditure hierarchies, then they should form the fundamental jurisdictional unit in a local government system. By contrast, the potential comparative disadvantage that small councils may suffer in producing services with significant scale economies, scope economies, administrative and technical expertise, amongst a host of other factors, can be offset through outsourcing, sharing or otherwise devolving production authority. Opponents of this argument, exemplified by Lowery (2000), contend that the transactions costs attendant upon a split between production and provision can be reduced through the consolidation of smaller councils into larger jurisdictions through ‘democratic choice’ in big municipalities rather than through complex intergovernmental arrangements that cope with inter-jurisdictional externalities.

Finally, in general *municipal size and municipal efficiency bear no systematic relationship* in Australian local government. Various arguments support this contention. In the first place, if council dismissals by state governments are taken as indicative of local government ‘failure’, or the broader category of official investigations into councils by state Departments of Local Government, or the even larger group of ‘at risk’ councils is considered, then it is immediately apparent that the size of the municipal jurisdiction cannot explain the patterns involved. Indeed, these measures of local government failure seem randomly distributed amongst councils regardless of size (Murray and Dollery 2005a; 2005b). Local government authorities ranging from large councils, like the Liverpool City Council, intermediate regional councils, such as Wagga Wagga, through to small shire councils, like Murrirundi, have all ‘failed’. This is hardly surprising since a significant number of local government failures arise from factors, such as financial mismanagement, ‘deadlocked’ councils unable to make decisions, and corruption, completely unrelated to council size.

Secondly, as we saw in Chapter 11, both theoretical considerations and empirical evidence on scale economies suggest that whereas capital-intensive local goods may exhibit economies of scale, by contrast labour-intensive local services may be characterized by diseconomies of scale. Accordingly, where municipalities produce a wide range of local goods and services, there can be no *a priori* expectation that on balance scale economies are substantial. For instance, Chicione and Walzer (1985, p. 38-39) argue that 'scale economies are technology specific' so that 'the most efficient level of production therefore depends on the type of service'. Thus 'no single size of government is likely to be appropriate for all collectively produced services'. On the one hand, 'labour-intensive, user-orientated services may have few economies of scale' while on the other hand 'major economies are possible when capital-intensive services are produced large scale, like sewage disposal, public transportation, water supply and hospitals'. It follows that 'support for a large centralized [local] government structure to take advantage of lower costs through scale economies loses some prescriptive quality when service production is separate from service provision'. Therefore 'no considerable cost advantages need be expected due to structural variation'.

Thirdly, other potential advantages accruing to municipal size might also be muted by similar considerations. For example, scope economies and the ability to employ administrative and technical expertise are often assumed to accompany larger councils. In particular, regional, rural and remote Australian councils find it notoriously difficult to acquire specialized staff. However, this can be overcome through resource sharing with neighbouring local authorities or other outsourcing arrangements.

Over the past several years it has been possible to discern a growing fluidity in Australian federalism. Although Australian political history is replete with examples of failed attempts to change the national constitution, including efforts to accord local government formal recognition, increasing links between the Commonwealth government and the state and territory local government systems is testament to the evolution of a new and more complex set of relationships between the three tiers of government in the Australian federation. Municipal councils have become vehicles for the delivery of services, especially human services, previously in the exclusive domain of the federal and state governments. This process has already affected the operation of municipal governance and it is likely to have further ramifications for the organization of local government and the assignment of functions across the three levels of government. We argue that three essential building blocks

should guide the design of these new arrangements: The importance of local democracy; the distinction between service provision and service production; and the fallacy that ‘bigger is better’ in municipal governance.

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