LAKE MACQUARIE CITY COUNCIL IN COMPARATIVE PERSPECTIVE:

REPORT ON AMALGAMATION AND FINANCIAL SUSTAINABILITY

This Report was prepared by Professor Brian Dollery on behalf of New England Education and Research Proprietary Limited, in conjunction with Wayne Jack, Finance Director of the Lake Macquarie City Council, for the Lake Macquarie City Council. The views expressed in this Report do not necessarily reflect the views of any organisation, including Lake Macquarie City Council.

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EXECUTIVE SUMMARY

This Report was prepared by Professor Brian Dollery on behalf of New England Education and Research Proprietary Limited, in conjunction with Wayne Jack, Finance Director of the Lake Macquarie City Council, for the Lake Macquarie City Council. In the brief given to Professor Dollery, Lake Macquarie City Council requested a formal report with three main aims:

- Provide an analysis of the efficacy structural reform in Australian local government, including an assessment of the effectiveness of forced amalgamation programs, which considers the academic literature on council mergers, as well as the findings on the efficacy of amalgamation in recent national and state public inquiries into local government, and draws salient conclusions on the utility of amalgamation as an instrument of local government reform. This analysis is undertaken in **Chapter 2** of the Report.
- Provide an analysis of the problem of financial sustainability in Australian local government by examining the findings of recent national and state public inquiries into local government financial sustainability. This analysis is undertaken in Chapter 3 of the Report.
- Provide a comparative analysis of the performance of the Lake Macquarie City Council relative to NSW Category 5 Councils (Lake Macquarie; Newcastle; Shoalhaven; Tweed; and Wollongong) in the NSW Division of Local Government's *Comparative Information on NSW Local Government Councils 2008/09*, the Wyong Shire Council which neighbours on Lake Macquarie City Council and the average performance of all local councils in NSW as determined in *Comparative Information on NSW Local Government Councils 2008/09*. This analysis is undertaken in Chapter 4 of the Report.

With respect to these three objectives, the analysis conducted in the Report arrived at the following central conclusions:

Chapter 2 demonstrated that, in general, amalgamation programs had failed to achieve their intended aims. In particular, projected cost savings and efficiency gains purportedly flowing from forced mergers had not been realised. This conclusion was in full accord with the findings on compulsory amalgamation of the recent national and state public inquiries into local government.

Chapter 3 considered the causes, consequences and cures of the problem of fiscal stress in Australian local government by examining the findings of recent national and state public inquiries into local government financial sustainability. It concluded that (a) formidable conceptual and measurement difficulties surrounded financial performance evaluation in local government, with no agreed definition of 'financial sustainability'; (b) all Australian local government jurisdictions are afflicted by severe financial distress and that the primary symptom of ongoing financial unsustainability resides in a large and growing local infrastructure backlog; (c) the degree of financial distress differs by type of council, with the problem most acute in rural and remote councils; and (d) since most of the factors causing financial unsustainability are external to local government, such as cost shifting, limitations on revenue-raising, rate-capping, mandated service provision, structural change through amalgamation cannot improve the financial sustainability of local government.

Chapter 4 conducted a comparative analysis of the performance of the Lake Macquarie City Council relative to NSW Category 5 Councils (Lake Macquarie; Newcastle; Shoalhaven; Tweed; and Wollongong), the neighbouring Wyong Shire Council and the average performance of all local councils in NSW. It found that (a) Lake Macquarie City Council is the second largest municipality among its six comparator councils, below Wollongong, but far above Newcastle, but with respect to FTE employment it fell below Newcastle, Wollongong and Wyong, despite its proportionately greater population; (b) Lake Macquarie City Council collected less revenue per capita than any of the other six councils, particularly compared with Wollongong and Newcastle, where the difference was marked, and thus it imposed a proportionately lighter financial burden on its residents; (c) Lake Macquarie City Council spent far less relative to the other six councils and it can thus be concluded that, other factors being equal, Lake Macquarie City Council is more efficient than its comparator councils; (d) residential rates, farmland rates and business rates per assessment were comparatively light in the Lake Macquarie City Council jurisdictional area, which thus imposed a lower rates burden on its local community; and (e) rates of increase in rates and attendant annual charges, as well as trends in user charges and fees, were lower in the Lake Macquarie City Council jurisdictional area. In sum, Lake Macquarie City Council performed markedly better than its comparator councils, Wyong Council and the NSW average.

The Report concluded in Chapter 5 which found that no case at all existed for Lake Macquarie City Council to be involved in amalgamation proposals with neighbouring local authorities. Instead the Report found that Lake Macquarie City Council should pursue the goals of its recent Service Review, especially with respect to revenue-raising activities.

CHAPTER 1: INTRODUCTION

1.1 Introduction

In common with other comparable local government systems in similar developed countries, Australian local government has been subjected at vigorous reform since the early nineteen nineties (Dollery, Crase and Johnson, 2006). In *Local Government Reform: A Comparative Analysis of Anglo-American Countries,* Dollery, Garcea and LeSage (2008, p. 2) have observed that during 'the past two decades most, if not all, municipal governments throughout the world have been subjected to a series of reforms', especially in 'economically advanced democracies' where 'such reforms are the most recent iteration of a series of municipal modernisation initiatives undertaken at various points in history since their respective municipal systems were established'. The aim of these reform episodes has been 'to eliminate problems that are deemed to hamper either municipal governance or other governance structures within each political system'.

The motivation for local government reform has been remarkably similar across the Anglophone countries of Australia, Britain, Canada, Ireland, New Zealand and the United States. Dollery, Garcea and LeSage (2008, p. 3) have observed that reform programs 'aimed at the municipal sector and elsewhere were driven largely by the widespread belief that the various tiers of government were performing their core functions sub-optimally from both an efficiency and an effectiveness perspective'. This led to the 'prevailing view inside and outside governmental circles' that various types of municipal reforms were 'essential to ensure that governments had the capacity to perform their functions efficiently, effectively and according to the fundamental tenets of democratic governance'.

However, local government reform has proved controversial across all Anglo-American local government jurisdictions. For example, Dollery, Garcea and LeSage (2008, p. 3) have noted that many reform programs 'have engendered a substantial degree of public controversy while they were being developed and implemented'. The nature of this controversy has 'revolved around questions concerned with the need for reforms, the goals and objectives of reforms, their precise nature and scope, the processes by which they were developed and implemented, and their effects on various facets of governance, management and service provision at the local, regional and national levels'. All Australian local government jurisdictions have been subjected to extensive reform processes and controversy has also been a characteristic of Australian reform programs, particularly in the case of structural reform, usually undertaken in the Australian milieu by means of forced amalgamation, often in regional, rural and remote local council areas.

Despite the heavy historical reliance of Australian local government policy makers on council amalgamation, typically on grounds that 'bigger is better' or 'bigger is cheaper, the efficacy of council mergers as an instrument of local government reform has not been borne out by its consequences. Indeed, as we shall see in Chapter 2 of this Report, there are firm grounds for rejecting amalgamation in favour of modes of local government reform, not least ongoing 'internal reform' by councils themselves. Furthermore, as we shall see in Chapter 3 of this Report, the sources of financial unsustainability in local government are multifarious and multi-faceted and most certainly not uniquely attributable to the size of local councils alone. In addition, as we shall see in Chapter 4 of this Report, in comparison to other similar councils in NSW, Lake Macquarie City Council fares well on most counts. It would thus seem clear that any moves aimed at amalgamating Lake Macquarie City Council with neighbouring local authorities in its immediate vicinity are out of step with empirical reality. Moreover, as we shall see in Chapter 5, much more promising avenues of improvement exist compared with amalgamation.

If we consider the conceptual and empirical literature on local government amalgamation, the marked stress on amalgamation by Australian local government policy makers is perplexing (see, for example, Dollery, Crase and Johnson, 2006). In particular, the literature is decidedly dubious on council consolidation as a means of improving operational efficiency. This has led some leading scholars of local government, such as Andrew Sancton (2000, p. 83), to dismiss the efficacy of amalgamation on the grounds that 'the efficient delivery of municipal services does not require large municipalities'. Along similar lines, Percy Allan (2003, p. 80) has observed that in Australia 'at the administrative level the efficiency and effectiveness of a local council is not a function of size' and 'all the empirical evidence suggests that bigger is not better when it comes to local government'.

If council amalgamation is flawed as this literature suggests, then how should local government policy makers tackle the problem? One way is to invoke the distinction drawn by Dollery and Crase (2006) between *structural change* and *process change* as methods of improving the operational efficiency and financial sustainability of local government entities. Dollery and Crase (2006, p. 453) have observed that whereas 'structural change involves a reorganization of the machinery of local government,' by contrast 'process change refers to modification in the methods employed by municipalities'. Put differently, while structural change involves modifying the number, size and type of local councils in any given jurisdiction, process change implies transformation in the methods used by local authorities.

Process change possesses at least two advantages over structural change in the form of compulsory council consolidation (Dollery and Crase, 2006). In the first place, it is not inevitably a 'top-down' externally imposed method of transforming the operation of a local council. Indeed, well-designed process change should incorporate the 'bottom-up' collaboration of council employees in the re-invigoration of the workings of a local authority. Since successful transformation depends heavily on accurate knowledge of the operation of a local council, in which council staff have a decided comparative advantage over external state government policy makers, as well as the enthusiastic cooperation of employees, it is obvious process change can have significant strengths.

Secondly, process change offers cost advantages in comparison with structural change. It is typically difficult to measure the long-term consequences of either structural change or process change in complex organizations, like local councils, which provide a wide range of services. This is further complicated by the fact that local government is not a for-profit entity, but rather a 'service organisation,' which inevitably involves trades-offs between the economic attributes of least-cost service provision and the consultative representative decision-making processes required by local democracy. Nonetheless there can be little doubt that the costs involved in structural change are typically far greater than those associated with process change. The costs of amalgamation typically include 'the direct financial costs of reorganization (including the costs of consultants' reports, departmental submissions, redundancy pay, redeployment and retraining, etc.), the costs of disruption to the ongoing business of government, and the social and psychological costs (including the stresses and strains caused by extra work pressures, job insecurity, the loss of morale, redundancy, etc.)' (Boston, Martin, Pallot and Walsh, 1996, p. 88). Moreover, in small regional, rural and remote councils, additional indirect costs of consolidation often involve powerful negative economic and social multipliers which reduce the economic and social sustainability of small communities to the point where they can no longer survive.

These factors suggest that confronted by a choice between structural or process solutions to the question of improving the operational efficiency of local government, where the eventual outcome is not only difficult to determine *ex ante*, but also problematical to measure *ex post*, policy makers should avoid structural change unless there are compelling reasons to the contrary. Moreover, structural change is almost impossible to reverse whereas process change found to be defective is comparatively easy and cheap to undo.

The pragmatic realistic premises underlying the case for process change has been reflected in recent initiatives undertaken by the Lake Macquarie City Council. In common with other local authorities across NSW, the Lake Macquarie City Council faces difficult challenges. Not only has there been a significant transformation of local government service provision as NSW councils have moved beyond the traditional narrow emphasis on 'roads, rates and rubbish' towards broader objectives of promoting the cultural, economic, environmental, and social wellbeing of communities, but community expectations of local government have simultaneously increased. In addition, higher tiers of government have devolved various functions to local government, often without adequate accompanying funding. The resultant financial pressures derived from providing a greater range of services at generally higher standards in the presence of substantial 'cost-shifting' have been compounded in NSW by 'rate-pegging'

Against this background, in October 2008 the Lake Macquarie City Council launched its Service Review project as a major internal evaluation of its operations. Key objectives of the Service Review included:

- Assessing the financial sustainability of Lake Macquarie City Council against various Australian measures of financial sustainability in local government;
- Identifying service levels and standards which best met the requirements of the local community;
- Being 'socially and environmentally responsible' in its service provision;
- Being perceived as 'a leading local government entity in achieving exceptional results and setting benchmarks in local government';
- Producing an efficient and effective organisation that is outcome driven;
- Maximising opportunities to increase revenue, including entrepreneurial activities;
- Exploring strategic partnerships, shared services and alliances with other councils, government bodies and private enterprise;
- Exploring a greater regional approach to service delivery, shared services and resources;
- Identifying 'opportunities to engage with other levels of government' to address unnecessary constraints, cost shifting, over-regulation, and a fairer distribution of funding; and
- Providing 'a foundation for continuous improvement beyond the timeframe of the Service Review'.

The approach adopted in the Service Review ensured that it made maximum use of the 'internal' resources of the LMMC rather than relying on expensive external consultants. The project was thus managed 'in-house' by Council officers with the assistance of an External Reference Panel. This *modus operandi* minimised the cost of the Service Review while ensuring a balance between 'internal' and 'external' input. A further notable feature of the Service Review was the use of 'staff groups', comprised of employees from throughout Lake Macquarie City Council. More than 150 staff members voluntarily participated in addition to their normal roles, with many other staff assisted the groups as 'subject experts' and 'key stakeholders'. The extensive involvement of staff from all levels in Lake Macquarie City Council ensured that the Service Review was a thoroughly ‘bottom-up’ exercise, which spread ‘acceptance’ and ‘ownership’ of the Service Review process amongst employees. The fruits of the Service Review have been manifold and ongoing, notably in the development of new revenue-augmenting ventures with other local councils, public bodies and regional entities.

2.1 Outline of the Report

In essence, this Report has four main aims:

1. To consider the conceptual and empirical literature on local government amalgamation, including the findings of a host of recent public inquiries into local government, in order to determine whether it offers promise to the Hunter councils.

2. To consider the nature, causes and solutions to the problem of financial sustainability in Australian local government as established in the spate of a host of recent public inquiries into local government financial sustainability.

3. To consider how Lake Macquarie City Council compares with other NSW councils in its own category, selected other Hunter councils, and the NSW average performance.

4. To consider the policy implications of the findings of the Report on 1, 2 and 3.

The Report comprises three substantive separate chapters 2, 3 and 4, each concerned with aims 1, 2 and 3 respectively, while Chapter 5 considers aim 4:

Chapter 2 is divided into three main sections:

- Section 2.2 considers structural reform in local government, and especially enforced council amalgamation, as the predominant policy instrument used by state and territory governments to enhance the effectiveness of local government.

- Section 2.3 outlines the findings of the recent host of national and state inquiries on financial sustainability in local government on the efficacy of council mergers.

- Section 2.4 ends Chapter 2 with some brief concluding remarks in section 2.4.

Chapter 3 is divided into two main sections:

- Section 3.2 outlines the findings of the inquiries into financial sustainability in Australian local government in chronological order.

- Section 3 ends Chapter 3 by drawing some general conclusions on financial sustainability in Australian local government.

Chapter 4 is divided into three main parts:

- Section 4.2 outlines recent trends in the performance of the Lake Macquarie City Council by way of background.

- Section 4.3 examines Lake Macquarie City Council relative to NSW Division of Local Government Category 5 Councils Coffs Harbour, Newcastle, Shoalhaven, Tweed and Wollongong, as well as the Wyong Shire Council, and the NSW state average.

- Section 4.4 completes Chapter 4 with some brief concluding remarks recapitulating the empirical findings of the comparative analysis.

The Report concludes with a brief **Chapter 5**, which summarises the main findings of the Report on (a) council amalgamation; (b) financial sustainability in local government: and (c) the comparative performance of Lake Macquarie City Council relative to NSW Division of Local Government Category 5 Councils Coffs Harbour, Newcastle, Shoalhaven, Tweed and Wollongong, as well as the Wyong Shire Council, and the NSW state average. It also draws out the policy implications of these findings

CHAPTER 2: AMALGAMATION IN AUSTRALIAN LOCAL GOVERNMENT

2.1 Introduction

In common with local government systems in many other developed countries, Australian local government has been subjected to vigorous reform over the past two decades. In general, three main engines of reform have been employed:

Firstly, state governments have sought to improve council effectiveness by modernising local government enabling acts to give local councils the flexibility to adapt to rapidly changing circumstances. This approach has attempted to 'encourage local authorities to adopt a strategic community leadership role and has given them the powers to promote the economic, social and environmental well-being of their communities' (Cole 2003, p. 184). It has also allowed local councils to make greater use of market instruments, such as 'outsourcing', competitive tendering, public/private partnerships, and the like.

Secondly, and in paradoxical contrast to this increased autonomy, Commonwealth and state governments have simultaneously attempted to shape the behaviour of local councils through more prescriptive legislation and mandated intergovernmental grants with respect to (a) the way in which local authorities discharge their responsibilities and (b) the quality and mix of services they provide. This has exacerbated the problem of 'cost-shifting', where additional compulsory responsibilities placed on local government are either under-funded or not funded at all (Hawker Report 2003).

Thirdly, state governments have periodically imposed programs of structural reform of differing degrees of intensity, which have often involved compulsory municipal amalgamation, especially in regional, rural and remote areas of Australia. Over the past fifteen years, South Australia, Victoria, Tasmania, New South Wales, Queensland and the Northern Territory have all witnessed extensive municipal restructuring through council consolidation. This heavy emphasis on amalgamation as a major instrument of local government reform underlines the traditional view of

Australian local government policymakers that ‘bigger is better’ in local governance (Dollery and Crase 2004; Dollery, Byrnes and Crase 2008).

An important consequence of these amalgamation episodes has been a growing scepticism over the economic, political and social outcomes of council mergers. As a result, local councils across Australia have explored alternative models of local government that present alternatives to heavy-handed state government-enforced amalgamation. These models are usually based on shared service arrangements and have displayed high levels of ingenuity (see, for instance, Dollery, Crase and Johnson, 2006). In other words, although it is still too early to confidently predict the demise of the ‘bigger is better’ amalgamationist philosophy in Australia, it would seem that enthusiasm for council amalgamation is on the wane.

Chapter 2 is divided into three main sections. Section 2.2 considers structural reform in local government, and especially enforced council amalgamation, as the predominant policy instrument used by state and territory governments to enhance the effectiveness of local government. Section 2.3 outlines the findings of the recent host of national and state inquiries on financial sustainability in local government on the efficacy of council mergers. Chapter 2 ends with some brief concluding remarks in section 2.4.

2.2 Structural Reform and Council Amalgamation in Australia

For more than a century, structural reform in the form of forced mergers has always been a central policy response by Australian state and territory governments to real and perceived problems with local councils (Vince, 1997). Over the years, the effects of episodic forced amalgamation policies have been dramatic. For example, Table 1 shows the impact of amalgamation on the numbers of local councils from 1910 to 2008:

Table 2. 1: Trends in Australian Local Councils, 1910 to 2008

STATE	1910	1967	1982	1990	1995	2008
NSW	324	224	175	176	177	152
VIC	206	210	211	210	184	79
QLD	164	131	134	134	125	73
SA	175	142	127	122	119	68
WA	147	144	138	138	144	140
TAS	51	49	49	46	29	29
NT	0	1	6	22	63	16
TOTAL	**1067**	**901**	**840**	**726**	**841**	**557**

Source: Revised version of Department of Infrastructure, Transport, Regional Development and Local Government (2010, Table 3.1).

Table 2.1 demonstrates that the total number of local authorities decreased from 1,067 to 557 (i.e. 48%) from 1910 to 2008, despite the fact that the total Australian population increased from 4,425,083 to 20,209,993 in 2004 (ABS, 2007).

While other policy initiatives have also been attempted, perhaps most notably the redesign of the various state Local Government Acts over the past twenty years, as well as prescriptive legislation to aimed at shaping council behaviour, structural reform centred on compulsory (and occasional voluntary) council amalgamation seems to have retained an iron grip on state government policy makers, despite not only disappointing results from amalgamation programs, but strong theoretical and empirical reasons to the contrary. It is thus important to examine the various arguments surrounding amalgamation.

2.2.2 Scepticism on the Results of Amalgamation

Whereas the proposition that "bigger is better" in local government may still represent accepted consensus amongst state and territory local government policy makers, successive episodes of council amalgamations in Australia have eroded this consensus to the point where open scepticism amongst the broader local government community has become the order of the day, especially in non-metropolitan areas of the country.

In large part, this cynicism derives from a disillusionment with the observed outcomes of actual amalgamation programs. For example, despite extravagant claims from proponents of both South Australian and Victorian council mergers in the nineties, the economic results of these programs have been most disappointing. Thus, while the Victorian government claimed at the time that its radical reform process would generate direct cost savings of 20%, the actual outcome has been a mere 8.5%, most of which has flowed from competitive tendering and not the amalgamation program (Allan, 2003, p. 75). Similarly, the South Australian authorities heralded savings of 17.4%, but in fact only achieved 2.3% (Allan, 2003, p. 75). It should also be added that these realised savings did not take into account the massive indirect costs of council consolidations, such as lower economic activity and falling employment in rural and regional areas.

As a consequence of these disappointing outcomes, many in the Australian local government community are no longer convinced that municipal restructuring based primarily on amalgamation represents an effective means of improving council performance.

This scepticism is widespread. For instance, following the NSW Government Inquiry into the optimal structure of local government in the Sydney metropolitan area, the Inquiry Commissioner Sproats (2001, p.36) concluded the purported benefits of amalgamation that were derived from empirical evidence were 'suggestive rather than conclusive'. Moreover, in their analysis of both the international literature and Australian experience on municipal consolidation, Dollery and Crase (2004, p. 274) argued that 'there are scant grounds for anticipating substantial financial benefits to flow from amalgamation, except possibly in terms of local government capacity and scope economies'.

In an analogous vein, in his assessment of the outcomes of recent amalgamation programs in New Zealand, Australia (Victoria and Tasmania), Britain, and Canada (Nova Scotia and Ontario) in his book *Merger Mania,* Andrew Sancton (2000, p. 83) concluded that 'the efficient delivery of municipal services does not require large municipalities'. Percy Allan (2003, p. 80) has presented a strong case that in Australia 'at the administrative level the efficiency and effectiveness of a local council is not a function of size' and 'all the empirical evidence suggests that big is not better when it comes to local government'. Finally, a recent report into local government consolidation by the Australian Centre for Excellence in Local Government (ACELG) (Aulich, Gibbs, Gooding, McKinlay, Pillora and Sansom, 2011, p.10) observed that with respect to amalgamation the weight of evidence finds few cost savings and 'strongly indicates that such savings need to be ploughed back into other areas, notably asset management'. Thus 'we can conclude that any efficiency gains from consolidation should not be expected to deliver significant reductions in rates and charges, as has often been claimed'.

Similar findings have been established by Allan (2001), Bish (2000), Dollery (1997), Dollery (2003), Jones (1989), Katsuyama (2003), May (2003), Oakerson (1999), and Thornton (1995), amongst a host of other scholars.

2.3.3 Reasons for Disappointing Outcomes of Local Government Amalgamation

Why has council amalgamation generally failed to improve the effectiveness of Australian local government? Dollery *et al.* (2006) have identified five main economic arguments typically advanced in favour of amalgamation and assessed the validity of these arguments in Australian local government.

2.3.3.1 Economies of scale

Advocates of amalgamation typically premise their arguments on the existence of significant economies of scale in Australian local government. This has proved largely illusory.

The term 'economies of scale' refers to a decrease in average cost as the quantity of output rises and are frequently cited as a rationale for larger council jurisdictions. Thus, the bigger the jurisdictional unit, the lower will be the per capita costs of service provision. In comparison to its counterparts in comparable countries, except New Zealand, Australian local government has a predominantly 'services to property' focus in terms of the goods and services it provides. However, despite its relatively narrow range, Australian local governments still provide a wide array of goods and services that are produced by many different technological means. Thus, for a given benefit region for a given type of service, there is no *a priori* reason for different goods and services to exhibit the same cost characteristics.

However, there is every reason to expect that no uniform pattern of economies of scale will emerge across the range of good and services produced by Australian councils. For instance, it is highly unlikely that the optimal service district for libraries will coincide with, or even resemble, optimal service districts for, say, domestic garbage collection, public parks, or sewage treatment services (Dollery, 1997). Thus while larger councils may capture economies of scale in some outputs, they could equally reap diseconomies of scale in other areas. Sancton (2000, p. 74) has put the argument in a nutshell: ‘There is no functionally optimal size for municipal governments because different municipal activities have quite different optimal areas’.

After evaluating the international and Australian empirical evidence on economies of scale in municipal service provision, Byrnes and Dollery (2002) drew three main conclusions:

- ‘Given the mixed results that emerge from the international evidence, it seems reasonable to conclude that considerable uncertainty exists as to whether economies of scale do or do not exist’ (Byrnes and Dollery, 2002, p. 405).

- Existing Australian empirical work was almost uniformly miss-specified and thus did not measure scale economies at all.

- From a policy perspective, the lack of empirical evidence of significant economies of scale in municipal service provision shed ‘considerable doubt on using this as the basis for amalgamations’.

Thus while ‘advocates of amalgamation have based their arguments on the proposition that substantial efficiency gains would flow from the formation of larger local authorities', to the contrary 'research on economies of scale in local government does not support this proposition' (Byrnes and Dollery, 2002, p. 405).

Even where economies of scale are significant, this may still not be relevant to optimal municipal size if provision of the service can be separated from production of that service (the so-called purchaser-provider split), since scale economies typically only arise during the production phase. Councils too small to achieve all economies of scale on their own can nevertheless accrue the advantages of any scale economies by purchasing the good or service in question from other public agencies, private firms or shared service entities that are large enough production units to secure economies of scale.

By contracting with commercial firms or other governments, as well as through analogous joint purchasing agreements with other councils, such Regional Organizations of Councils (ROCs), small councils can provide the quantity and quality of services desired by their limited number of constituents and simultaneously enjoy the cost advantages deriving from scale economies in production (Witherby et al., 1999). Some evidence exists to support this contention. For instance, Dollery et al. (2005) have shown that the Riverina Eastern Regional Organization of Councils (REROC) has secured considerable economic advantages from the scale economies through joint arrangements between its members. Similarly, Oakerson (1999) cited several examples of the savings that can be reaped from separating provision from production through outsourcing and other analogous techniques.

2.3.3.2 Economies of scope

Economies of scope refer to the economic advantages that flow from providing a broad range of goods and services in a single organization, like a local council. In particular, economies of scope arise when the cost of producing a given set of services in a single organization is lower than the cost of those services being produced by a number of specialized organisations. The standard explanation for this lower cost of production derives from the fact that a single organisation can attribute the cost of fixed inputs or 'overheads', like central administrative staff, computing facilities, and so forth, across many of the services it produces. Thus, if related services are provided by a single council, lower total production costs may follow (Dollery and Fleming, 2006).

In the context of the Australian local government amalgamation debate, scope economies represent an *a priori* theoretical argument against many small local authorities each providing their own services. It is also an argument against the fragmentation of existing large municipalities into several fully autonomous or privatised business units. However, economies of scope can support the concept of several small and adjacent municipalities forming some umbrella organisation, like ROCs and regional alliances of council, in an attempt to capture scope economies.

2.3.3.3 Local government capacity

A proposition sometimes advanced in the Australian debate over amalgamation is that larger councils tend to possess greater levels of administrative and other expertise, in part due to the fact that their size permits the employment of specialist skills that cannot be acquired readily by smaller municipalities. Given the increasing burden placed on Australian local government by its state and federal counterparts, through cost shifting and other activities, it is held that this confers a significant advantage on larger municipal units because it enables them to accomplish a wider and more complex range of tasks in a more efficient manner.

There seems to be considerable merit in this argument. Small regional and rural councils do struggle in terms of expertise and cannot always use consultants in an effective and prudent way. However, since it is in many respects a variant of the economies of scope argument for amalgamation, many of the same reservations apply. For instance, ROCs may also be able to pool their resources to acquire the skills in question, at no greater cost than to single and larger councils. Moreover, large councils which already possess adequate expertise will not benefit.

2.3.3.4 Administration and compliance costs

A fourth economic argument often put forward in support of local government amalgamation is that larger consolidated councils economise on their direct costs of administration and the compliance costs imposed on individuals who participate in the local political process. Administrative costs include the compensation paid to elected and appointed officials and staff and the overheads (buildings, supplies, utilities, etc.) required to support those officials. Compliance costs include the costs incurred by municipal voters to keep informed on issues and candidate positions and the potential cash and time costs of registering an opinion by participating in hearings, meetings, voting, etc. Fewer local governments can reduce these costs in aggregate.

If it is argued that council amalgamations will reduce administrative costs, then this is analogous to arguing that there are economies of scale in the administration of local government, just as there may be scale economies in the production of public services. However, there is obviously no guarantee that such opportunities will always, or even usually, exist. It could just as easily be argued that administrators become less effective the further removed they are from their constituents and operations they are supposed to coordinate. If this is the case, then diseconomies of scale could result, with larger governments requiring proportionately more administrators (perhaps with more layers in the administrative hierarchy). Administrative scale economies could thus be a factor in favour of both larger and smaller local government units. In this instance, administrative economies become an empirical issue.

However, it can be argued on grounds of public choice theory that greater difficulties are involved in monitoring large municipalities. Ratepayers, as voters, cannot easily acquire the necessary information to assess whether or not councils are providing 'value for money'. By contrast, smaller councils are often less complex operations with a greater degree of transparency and consequently more amenable to scrutiny by ratepayers. If smaller municipalities are indeed subject to closer and more informed scrutiny, then it can be anticipated that they could experience greater public pressures to deliver local public goods more efficiently (see, for example, Boyne, 1998; Bailey, 1999).

Empirical support exists for this contention. An implication which derives from the public choice paradigm, amenable to empirical analysis, is that a 'fragmented' local government system, containing numerous municipal entities, should be more efficient than a 'concentrated' system, with a few, large councils. After a study examining American empirical evidence on this question, Boyne (1998, p. 252) concluded that 'the broad pattern of evidence suggests that lower spending is a feature of fragmented and de-concentrated local government systems'. By contrast, 'consolidated and concentrated tend to be associated with higher spending'. This may mean that 'the technical benefits of large units with big market shares, such as economies of scale and scope, are outweighed by competitive and political costs, such as disincentives toward fiscal migration and problems of public scrutiny'. After his analysis of the empirical literature, Sancton (2000, p. 75) reached the same conclusion: 'The public choice perspective shows us that it is no longer obvious that the existence of many municipalities within the same city-region causes wasteful overlap and duplication'

It need hardly be added that numerous other problems also arise from amalgamation, especially in rural and regional areas. Chief amongst these are a reduction in the vibrancy of local democracy, less political representation and lower public participation, various deleterious effects on local economic development, including decreased economic activity, rising unemployment and the formation of 'ghost' towns, and a loss of 'sense of place' on the part of local residents.

2.4 National and State Inquiry Findings on Amalgamation

Over the past decade, a series of national and state inquiries into local government have been undertaken into the financial sustainability of local government. These public inquiries have generated important insights into the problems confronting Australian local government. They have examined potential solutions to these problems, including council amalgamation. It is thus important consider the findings of these inquiries.

At the state level we have witnessed the South Australian Financial Sustainability Review Board (FSRB) (2005) *Rising to the Challenge* Report, the Financial Sustainability of NSW Local Government ('Allan Report') (2006) *Are Councils Sustainable*, the Local Government Association of Queensland (LGAQ) (2006) *Size, Shape and Sustainability* Inquiry, the Western Australian Local Government Association (WALGA) (2006) *Systemic Sustainability Study*, the Local Government Association of Tasmania (LGAT) (2007) *Review of the Financial Sustainability of Local Government in Tasmania*, the Queensland Local Government Reform Commission (QLGRC) (2007) *Report of the Local Government Reform Commission*, the Queensland Treasury Corporation (QTC) (2008) *Financial Sustainability in*

Queensland Local Government and the NSW Independent Pricing and Regulatory Tribunal (IPART) (2009) *Review of the Revenue Framework for Local Government.*

At the national level, we have seen the Commonwealth Grants Commission's (CGC) (2001) *Review of the Operation of Local Government (Financial Assistance) Act 1995,* the House of Representatives Standing Committee on Economics, Finance and Public Administration ('Hawker Report') (2003) *Rates and Taxes: A Fair Share for Responsible Local Government*, the PriceWaterhouseCoopers (PWC) (2006) *National Financial Sustainability Study of Local Government* and the Productivity Commission's (PC) (2008) *Australian Local Government Revenue-Raising Capacity.*

The weight of deliberations of these national and state public inquiries strongly suggests that the heavy emphasis placed on council mergers by local government policy makers has been misplaced.

2.4.1 Hawker Inquiry (2003)

A noteworthy feature of the Hawker Report (2003) lay in its broad nature. Although originally designed to investigate cost shifting, the terms of reference were expanded to encompass almost all other aspects of contemporary local governance (Dollery, 2005). After outlining the evidence which it had considered in its deliberations, the Hawker Report (2003: 84) set out two kinds of 'efficiencies gained by amalgamations':

- In general, large councils had a 'more secure and adequate financial base, are better able to plan and contribute to economic development, are more effective community advocates, and interact more effectively with government and business'. In addition, 'structural reform can deliver economies of scale and can enable councils to employ a wider range of professionals so they can offer a wider range and usually higher quality of services'.

- Amalgamations yielded 'savings' as evidenced in the South Australian and Victorian amalgamation episodes, Western

> Australian projections that structural reform of small councils could produce 'notional annual savings' of a total of $74.4 million or 5.2 per cent of total municipal expenditure and sizeable 'savings projections' from five New South Wales mergers.

However, this was immediately followed by an evaluation of 'why amalgamations may not work'. Three main lines of argument were pursued Hawker Report (2003: 89):

- The 'multitude of challenges' confronting 'small rural councils' often mean that 'amalgamations are not viable'.

- Amalgamation was not a panacea; other structural solutions involving 'mentoring with a larger more prosperous council' or 'membership of a regional organization of councils' are superior.

- 'Continued cost shifting' by state governments diminished the efficiency enhancing effects of amalgamation.

Against this background, the Hawker Report (2003:90) made two recommendations: Recommendation 13 stated that 'the Commonwealth Grants Commission, in consultation with the LGGCs in each State, assess the efficiencies of amalgamations or regional cooperation of local government, and use available mechanisms to adjust FAGs grants for the benefit of the sector at large'. In order to encourage mergers, 'councils should not be financially penalized through a net loss of FAGs for the benefit of the sector at large'. Recommendation 14 held that the Commonwealth 'continue to develop partnership arrangements with local government on the delivery of Federal programs and service delivery; and as appropriate, engage established regional organizations of councils, or similar regional bodies, which have demonstrated capacity, in regional planning and service delivery'.

2.4.2 South Australian Financial Sustainability Review Board (FSRB) (2005)

While overwhelming focus of the FSRB (2005) fell on the definition, measurement and assessment of 'financial sustainability', it did consider council size and it drew various conclusions on amalgamation. In essence, the FSRB (2005: 49) found that 'there is no strong relationship between a council's organisational size and either a strong financial position or a good annual financial performance' (FSRB 2005, 49). Moreover, 'the size and density of councils played little role in explaining the observed differences in the sustainability of the long-term financial performance and position of councils'. The Final Report thus concluded that 'because relative growth rates, size and density of councils altogether explain only a fraction of the differences observed in the sustainability of the long-term financial performance and position of councils, other financial characteristics must be more important contributors'.

The FSRB (2005: 85) also evaluated the claims made by the South Australian Local Government Boundary Review Board, prior to its structural reform program which reduced the number of councils from 118 to 68 in the post-1995 period, especially the forecast 'recurrent savings' of $19.4 million per annum and 'one-off savings' of $3.9 million. The FSRB (2005: 85) found that 'whether the ongoing savings have in fact continued is a moot point' since 'fewer, larger councils are not the instant or easy fix that many would like to believe', particularly in 'non-metropolitan areas dominated by the "tyranny of distance" and other impediments'.

On the basis of this analysis, the FSRB (2005: 85) concluded that 'amalgamation brings with it considerable costs and often exaggerated benefits'. Accordingly, alternative models of council cooperation should be pursued, since there are 'many intermediate forms of cooperation/integration among councils, with amalgamation being the most extreme (and confronting) form of integration'. The FSRB (2005: 85) then considered the most promising alternative options and found that numerous 'voluntary arrangements' in shared services and joint enterprise had proved successful in the South Australia, with both regional organisations of councils and area integration models represented the best models for council cooperation.

2.4.3 Financial Sustainability of NSW Local Government ('Allan Report') (2006)

In common with the bulk of the public inquiries into local government, the Allan Report (2006) in NSW concentrated mainly on fiscal viability. However, Chapter 10 of *Are Councils Sustainable* examined the question council size and council efficiency which underpinned the case for council mergers. It observed *inter alia* that 'past local government amalgamations were based on the primary rationale that larger councils with larger populations could exhibit greater economic efficiencies' because bigger local authorities would exhibit 'lower administrative costs, smaller unit costs of representation, increased purchasing power, improved utilisation of depots, plant and equipment and draw from a more diverse funding base' (Allan Report, 2006:259/60). Furthermore, the Report (2006: 261) noted that uncertainty exists 'as to whether such a concept has a sound empirical basis'. It concluded that 'achieving increased economies of scale and greater efficiencies through forcible amalgamation seems questionable and generally not desirable from a local government or community perspective'.

2.4.4 Queensland Size, Shape and Sustainability (SSS) Program (2006)

Chapter 4 of the *Size, Shape and Sustainability: Guidelines Kit* (LGAQ 2006, 4/5) considered structural change in Queensland local government context. It proposed four different 'options for change': 'Merger/amalgamation'; 'significant boundary change'; 'resource sharing through service agreements'; and 'resource sharing thorough joint enterprise'. Chapter 4 examined the 'advantages' and 'disadvantages' of each of these options. With respect to amalgamation, it argued that the benefits which can flow from council mergers could include a 'sufficient resource base', a reduction in the 'total costs of government', scale economies, lower staff levels, an 'opportunity to review' operations, rationalisation of assets, 'cross-border' facility and service utilisation, better promotion of economic development, improved growth management, the 'formalisation' of communities of interest, increased political lobbying power, and potential for 'full-time' elected representatives. On the other hand, potential costs embraced 'exposure' to liabilities of other councils, addressing 'major difference in rates', fewer grants, high costs of 'integrating' constituent councils, dealing with 'widely differing organisational cultures', creating 'differing levels of service in some areas', diluting existing representation, and the loss of direct representation by 'small areas'. In addition, Chapter 4 stressed the importance of the 'voluntary' nature of any amalgamation proposal to its ultimate success.

2.4.5 Western Australian Systematic Sustainability Study (2006)

While the bulk of the WALGA (2006) was devoted to financial sustainability, council mergers were also considered. Chapter 8 of the Report considered council consolidation as part of the broader range of alternative models of service delivery. WALGA (2006) argued that a 'state/territory' model and an 'industry-owned service provider' which delivered selected services on a regional basis for member councils were the most promising options. In terms of council amalgamations, the Report was emphatic, noting that 'there was little prospect that forced amalgamations would achieve any lasting community benefit' on grounds that 'there is a growing literature and operating experience to this effect elsewhere in Australia' (WALGA 2006: 70). In short, Chapter 8 argued that the main benefits which purportedly derived from amalgamation 'can be obtained by methods other than enforced structural reform'.

2.4.6 PriceWaterhouseCoopers Report (2006)

Whereas the PWC (2006) *National Financial Sustainability Study of Local Government* placed heavy emphasis on local government financial sustainability, it did at least consider structural reform. With respect to amalgamation, PWC (2006) drew four main conclusions:

- In regard to state-based inquiry findings on amalgamation, PWC (2006:15/16) observed that while 'the sustainability report undertaken in SA indicated that sustainability may be more linked to policy skills rather than size, evidence from other states indicates that scale, and implicitly size, does assist in improving sustainability'. Moreover, this 'divergence in results is largely due to the majority of SA being an unincorporated zone, which would minimise the incidence of rural councils that cover large areas with a small population base and limited opportunities for economies of scale'. However, scale economies could best be achieved through 'regional or shared service provision, outsourcing, and use of state-wide purchasing agreements'.

- PWC (2006: 72) argued that while 'structural reform through amalgamations is necessary in some instances, each potential amalgamation needs to be assessed carefully to avoid the risk of simply creating large inefficient councils'. It stressed the fact that 'remote councils' faced 'higher cost structures' largely due to the tyranny of distance, which no amalgamation process could remove.

- Section 2.6.2 of the PWC (2006: 75) report examined the effects of Australian council consolidation programs and concluded that 'mergers can bring greater financial strength and stability to councils, however, simply merging a number of adjoining unviable councils is unlikely to increase financial sustainability to the stage where there is a single viable council and it may decrease effectiveness and result in greater disputes between councillors based on parochial interests'.

- Finally, in its formal recommendations, PWC (2006: 149) contended that 'efficiency, effectiveness and scale' could be improved through regional service provision, shared service arrangements, outsourcing, state-wide purchasing initiatives, and the like, rather than by means of council amalgamation.

2.4.7 Local Government Association of Tasmania (2007)

LGAT (2007) was focused almost exclusively on financial sustainability. However, section 6.3 considered the question of structural reform. LGAT (2007: 65) argued that 'forced amalgamations have limited prospects for achieving lasting community benefit'. Moreover, while small councils often 'lack administrative and technical capacity compared with larger councils' and 'council amalgamations will generate a greater range of services and improved quality of service', nonetheless the 'main benefits of amalgamation can usually be obtained by methods other than enforced structural reform', most frequently 'resource sharing and pool-style arrangements'. In particular, following WALGA (2006), LGAT (2007: 68) recommended that Tasmanian local government should investigate the introduction of (a) a 'state/territory' model comprising a 'two-tier local and regional government' providing some services provided at local level and other services at the regional level with elected arrangements in place for both systems and (b) 'sector-owned service providers', where these entities could be 'specially established sector entities', single councils operating under contract to other councils, private sector providers, LGAT itself or a regional council.

2.4.8 Queensland Local Government Reform Commission (2007)

While the specific council amalgamation recommendations of the Queensland Reform Commission (2007) were set out in detail in *Report of the Local Government Reform Commission*, this document provided little justification for the structural reform process, which instead was advanced in Queensland Department of Local Government, Planning, Sport and Recreation (DLGPS&R) (2007) *Local Government Reform: A New Chapter for Local Government in Queensland* (Dollery, Wallis and Crase, 2007). It argued that the rationale for local government reform in Queensland was 'not unique to Queensland' and had four main strands: (a) the need to address the 'medium to long-term sustainability' in local government; (b) the 'need for greater collaboration in infrastructure and regional planning'; (c) the need for local councils in Queensland to avoid their current 'internally focused parochial mindset' and instead consider the 'bigger picture'; and (d) the need to reduce the 'inconsistency of performance and service delivery across the local government sector' (DLGPS&R, 2007: 11).

Drawing on the PWC (2006) Report, it was argued that 'large numbers of Australian local councils were 'non-sustainable' and faced severe local infrastructure backlogs, with these problems are 'typically more acute in smaller councils', especially in 'rural or remote areas'. In addition, it invoked the preliminary financial analysis by the QTC as at March 2007, and stressed the fact that 43% of councils fell in the 'weak' or below categories. Section 2.4 of *Local Government Reform* stressed that the financial assistance provided to local councils in Queensland by higher tiers of government in terms of per capita grants in was the highest in Australia at $88.50. Chapter 4 pointed to the well-known problems of acquiring administrative and technical staff and the impact of this on local government capacity, particularly small non-metropolitan councils. It contended that 'large councils with greater financial resources would be significantly better placed to establish robust regionally-based employment frameworks' (p.39). Finally, Chapter 5 considered structural reform programs in New Zealand, the Northern Territory, South Australia, Tasmania and Victoria, which it assessed as generally successful.

2.5 Concluding Remarks

Given the pivotal importance of structural change in local government reform, as we have we seen, it was addressed in 8 inquiries, often at great length. In comparison with other modes of reform, this attention is striking, no doubt derived from the heavy historical reliance on amalgamation as the main engine of reform in Australian local government. The most interesting aspect of the deliberations of the inquiries on structural change is that they echo scepticism in the academic literature on compulsory council consolidation, which we reviewed in section 2.2 of Chapter 2. Indeed, the weight of opinion in the public inquiries suggests that the traditional Australian stress on council mergers has been misplaced.

The Hawker Report (2003) conceded that while structural reform could deliver scale economies and amalgamations had evinced savings, mergers was not a 'panacea'. It recommended that FAGS methodology should be adjusted to accommodate amalgamation, but called for partnership arrangements with local government through regional organisations of councils and similar regional bodies. The FSRB (2005) disputed empirically any relationship between council size and council performance, as well as questioning claims made regarding savings generated by amalgamation. It concluded that alternative models of council cooperation should be pursued. The LGI (2006) found that population density and not population size represented a crucial element in council cost structures. It thus recommended that arrangements other than amalgamation be pursued. Although the LGAQ (2006) contended that some benefits could flow from council mergers, it pointed to high costs, and concluded that only voluntary amalgamation held promise. WALGA (2006) rejected the efficacy of consolidation and argued that state/territory and industry-owned service provider models were more suitable to WA conditions.

In its formal recommendations, PWC (2006: 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 by means of council mergers. LGAT (2007) argued that forced amalgamations were unlikely to achieve lasting community benefit and it recommended resource sharing and 'pool-style arrangements', such as state/territory models and sector-owned service providers. In contrast to these other inquiries, the DLGPS&R (2007) presented strong arguments in favour of amalgamation, stressing the greater financial resources available to bigger post-amalgamation councils.

A central irony over the treatment of amalgamation in these public inquiries resides in the fact that while the weight of opinion has moved decisively against compulsory council mergers, they have remained a highly favoured policy instrument amongst state government policy makers.

In Chapter 2, we have argued that structural change programs that simply rely on the blunt instrument of council amalgamations have not been effective in Australian local government. Moreover, we have shown that most of the arguments presented in favour of amalgamation are generally misconceived. Even when weight can be placed on these arguments, alternative methods of reform involving partnerships between councils are in any event likely to be much more effective in achieving the same aims.

CHAPTER 3: FINANCIAL SUSTAINABILITY IN AUSTRALIAN LOCAL GOVERNMENT

3.1 Introduction

In common with many other local systems in comparable countries, Australian local government has experienced straitened fiscal circumstances over the past twenty years. In its *Review of the Operation of Local Government (Financial Assistance) Act 1995,* the Commonwealth Grants Commission (CGC, 2001, pp. 52-53) identified five main reasons for the acute level of financial stress faced by many local authorities. These factors include the devolution of responsibility for service delivery from higher tiers of government; 'cost-shifting'; the increased complexity and standard of local government services demanded by state governments; 'raised community expectations' of municipal services; and 'policy choice' involving the voluntary improvement and expansion of municipal services by individual councils.

This analysis is by no means complete. For example, as Johnson (2003) has observed, the CGC (2001) list does not include the fact that in many instances local councils have also added to these financial problems by artificially holding their rates and charges at unsustainably low levels. The CGC (2001) list also ignored 'internal' governance and management factors that are potentially crucial. Nevertheless, the CGC report did serve to lay the foundations for subsequent investigations into local government sustainability.

As we saw in Chapter 2, the past decade has witnessed a host of Australian national and state inquiries into local government which have not only provided valuable insights into the financial problems experienced by the sector, but also generated a useful analysis of the meaning of financial sustainability in local government.

At the national level, the following inquiries have focused on financial sustainability:

- PriceWaterhouseCoopers (PWC) (2006) *National Financial Sustainability Study of Local Government*

- Productivity Commission (PC) (2008) *Assessing Local Government Revenue Raising Capacity.*

At the state level, the following inquiries have focused on financial sustainability:

- South Australian Financial Sustainability Review Board's (FSRB) (2005) *Rising to the Challenge* Report

- Financial Sustainability of NSW Local Government ('Allan Report') (2006) *Are Councils Sustainable*

- Western Australian Local Government Association (WALGA) (2006) *Systemic Sustainability Study*

- Local Government Association of Tasmania (LGAT) (2007) *Review of the Financial Sustainability of Local Government in Tasmania*

- Queensland Treasury Corporation (QTC) (2008) *Financial Sustainability in Queensland Local Government*

Chapter 3 explores the problem of financial sustainability in Australian local government through the prism of these national and state inquiries.

Chapter 3 is divided into two main parts: Section 3.2 outlines the findings of the inquiries into financial sustainability in Australian local government in chronological order. Chapter 3 ends in section 3 which draws some general conclusions financial sustainability in Australian local government.

3.2 FINANCIAL SUSTAINABILITY

3.2.1 South Australian Financial Sustainability Review Board Report (2005)

The SA Financial Sustainability Review Board (FSRB) was established by SALGA on 14th February 2005 to examine 'the financial position and prospects of councils in

SA'. The FRSB (2005) considered the problem of defining 'financial sustainability' as a means of assessing the long-term solvency of SA councils. It argued that no universal agreement existed on the meaning and content of 'financial sustainability' Australian local government and proposed the following definition:

> 'A council's long-term financial performance and position is sustainable where: (i) continuation of the council's present spending and funding policies; (ii) likely developments in the council's revenue-raising capacity and the demand for and costs of its services and infrastructure; and (iii) normal financial risks and financial shocks, altogether are unlikely to necessitate substantial increases in council rates (or, alternatively, disruptive service cuts)' (2005: 10).

The FRSB (2005: 15) advanced four financial indicators 'for assessing a council's financial sustainability':

- Net financial liabilities as the chief financial indicator of a council's 'indebtedness to other sectors of the economy';

- Operating surplus or deficit as the key financial indicator of the 'intergenerational equity of the funding of the council's operations';

- Net outlays on the renewal or replacement of existing assets as the chief financial indicator of the 'intergenerational equity of the funding of the council's infrastructure renewal or replacement activities'; and

- Net borrowing or lending as the key financial indicator of the 'impact of the council's annual transactions – both operating and capital – upon the council's indebtedness to other sectors of the economy'.

The central conclusion of the FSRB (2005b, 19/20) came in the form of Recommendation 2.3(1) which set out in a 'statement of principles' governing 'key financial sustainability indicators', comprising six factors:

- A local council is financially sustainable financial if 'its net financial liabilities are at levels at which the associated interest payments (less interest income) can be met comfortably from a council's annual income (i.e. by current ratepayers) without the prospects of rates increases which ratepayers would find unacceptable (or disruptive service cuts)';

- The net financial liabilities of a specified local authority 'can be too low where they are (a) associated with current ratepayers being asked to bear an inequitable proportion of the cost of future service potential or (b) below levels that include more than enough room to absorb unexpected financial risks or financial shocks';

- Annual operating financial performance of a local council is sustainable 'if operating deficits will be avoided over the medium- to long-term, because such deficits inevitably involve services consumed by current ratepayers being paid for either (a) by borrowing and so by future ratepayers or (b) by deferring funding responsibility for the renewal or replacement of existing assets onto future ratepayers';

- A local authority's operating surplus can be too high 'where it (a) is associated with current ratepayers being asked to bear an inequitable proportion of the cost of the council's future service potential or (b) is above a level that includes more than enough room to absorb unexpected financial risks or financial shocks';

- The annual capital financial performance of a municipality is sustainable 'if capital expenditure on the renewal or replacement of existing assets on average approximates the level of the council's annual depreciation expense, because any shortfall of such capital expenditure against annual depreciation expense would involve future ratepayers being left with an excessive burden when it comes to replacing or renewing the council's non-financial assets'; and

- Finally, net borrowing of a local council can be too low 'where, over the planning period, it results in the council's net financial liabilities as a ratio of non-financial assets falling well below the targeted ratio'.

These principles formed the benchmarks that the FSRB employed to assess South Australian councils. In its application of these principles, the FSRB (2005: 6.4(1)) established that 33 councils were either 'unsustainable' or 'vulnerable', which accounted for about 50% of the South Australia's population, 30% of metropolitan councils and 40% of country councils.

3.2.7 Independent Inquiry into NSW Local Government Report (2006)

The Independent Inquiry into the Financial Sustainability of NSW Local Government (NSW (LGI)) was instituted by the NSW LGSA. In Chapter 11, the Inquiry called for the use of selected financial KPIs which should bear 'a strong predictive relationship with the degree to which a council's finances are likely to be sustainable in the long term, being based upon generally-accepted key analytical balances'. These KPIs are reproduced in Table 3.1.

Table 3.1: NSW LGI (2006) Key Analytical Balances

Analytical balances	Definition	Denominator for comparative ratio
Net debt	Interest-bearing financial liabilities less holdings of cash and securities other than externally restricted cash and securities	Total operating revenue
Net financial liabilities	Total liabilities less financial assets net of holdings of externally restricted cash and securities	Non-financial assets plus holdings of externally restricted cash and securities
Net interest expense	Annual interest expense less interest earnings on holdings of cash and securities other than externally restricted cash and securities	Total operating revenue
Operating surplus/(deficit)	Operating revenue before capital amounts less operating expenses less depreciation expense less net interest expense	Own-source revenue
Net borrowing/ (lending)	Capital expenditure less capital revenues less depreciation expense less operating surplus/(deficit)	Annual capital expenditure on new or enhanced assets
Annual renewals deficiency	Annual depreciation expense less annual capital expenditure on existing assets	Annual capital expenditure on renewal or rehabilitation of existing assets
Renewals backlog	Cumulative past annual renewals deficiencies	Non-financial assets

Source: LGI (2006: 272, Table 11.2).

The Inquiry (2006: 273) then prescribed ‘benchmark values’ based on the ‘average’ NSW council, with upper and lower ‘safe’ limits, with the caveat that ‘these values should be adjusted on account of each council’s individual circumstances’, depending whether the local council under review is ‘developed’ or ‘developing’, and whether it is ‘growing’ or ‘declining’. These ‘indicative benchmark values’ are reproduced in Table 3.2.

Table 3.2: NSW LGI (2006) Indicative Benchmark Values for Council Financial KPIs

Financial Key Performance Indicators	Average Council Data	Proposed Council Target	Proposed Upper Limit	Proposed Lower Limit
Net debt as % of total revenue	10.5%	100%	150%	50%
Net financial liabilities as % of total capital employed	2.2%	10%	15%	5%
Net interest expense as % of total revenue	0.6%	15%	20%	7%
For general government activities: Operating surplus as % of own-source revenue	-4.5%	5%	10%	0%
For commercial activities only: EBIT as % of non-financial assets	0.9%	5%	7%	3%
Net borrowing as % of capital expenditure on new or enhanced assets	1.3%	50%	60%	30%
Annual renewals deficiency as % of renewals capital expenditure	40.2%	0%	10%	-10%
Infrastructure backlog ($M) as % of total infrastructure assets (estimated at fair value)	8.1%	0%	1%	0%

Source: LGI (2006: 273, Table 11.3).

In respect of Table 3.2, the LGI (2006, 274) stressed that ‘if used, each of these ratios should be adhered to, not just some of them’. In addition, the LGI (2006: 276) prescribed the conditions that must be met should a council wish to be classified as ‘currently healthy’ in financial terms: A given council should be ‘a modest net debtor’ with borrowings or debt making up only ‘a minority of the total capital invested in the council’s infrastructure and other assets’ and at the same time ‘the associated expense burden should not be a substantial proportion of the council’s annual operating revenues’. While this represented a minimum requirement, ‘for a council’s financial performance to be assessed as “currently healthy”’ and to ‘involve a margin of comfort to cope with the usual assortment of financial risks and financial shocks’ the council must meet three further criteria:

- The council in question should ‘generally be running an operating surplus rather than an operating deficit’;

- The local authority should not exhibit a 'significant infrastructure renewal backlog' and its capital expenditure over the financial year on infrastructure renewal and replacement should 'on average over time be about the same level as the council's depreciation expenses'; and

- Annual net borrowing should not be 'putting any pressure on the council's targeted net financial liabilities ratio'.

Despite these stipulations, the Final Report (2006: 283) conceded that financial sustainability is a 'controversial' concept, but nevertheless concluded that 'a council's finances should be considered sustainable in the long term only if its financial capacity is sufficient – for the foreseeable future – to allow the council to meet its expected financial adjustments over time without having to introduce substantial or disruptive revenue (and expenditure) adjustments'.

3.2.3 Western Australian Systematic Sustainability Study (2006)

In January 2006, WALGA) commissioned a review which culminated with the Final Report of the WA *Systematic Sustainability Study* (WASSS) group entitled *In Your Hands: Shaping the Future of Local Government in Western Australia.*

The assessment of WA local government in the Final Report is based largely on Access Economics (2006b) commissioned by WASSS; a feature in common with the SA, NSW and PWC reports. It is thus not surprising that the definition of financial sustainability shares a great deal with these other three reports. The Access Economics (2006b: 55) defined financial sustainability as 'a council's finances are sustainable in the long term only if its financial capacity is sufficient – for the foreseeable future – to allow a council to meet its expected financial requirements over time without having to introduce substantial or disruptive revenue (and expenditure) adjustments'.

This definition of financial sustainability involves comparing long-run fund-raising ability with long-term expenditure needs. In this context, 'financial capacity' refers to the operating and capital finance which can be raised using existing ‘revenue-raising and financing policies’ as well as ‘any additional funding were the council to increase its revenue-raising efforts to levels commensurate with those displayed with higher-effort councils’. By contrast, ‘financial requirements’ has two components: Capital and operating expenditure sufficient to meet statutory requirements and ‘expected spending pressures’ (both of which imply asset maintenance and renewal); and a ‘margin of comfort’ adequate to meet any ‘future financial shocks’.

This approach financial sustainability requires an analysis of individual council accounts. It is made operational by examining a council’s ‘underlying operational deficit’ as a proportion of its ‘own-source’ revenue. According to Access Economics (2006b: 56), ‘persistent operating deficits’ thus imply a council’s revenue-raising efforts are ‘too low’ whereas ‘excessive operating surpluses’ mean that a municipality’s revenue-raising efforts are ‘too high’. A ‘benchmark’ deficit of 10 per cent of the operating debt ratio was arbitrarily set; councils with a ratio in excess of 10 per cent were assessed as ‘financially unsustainable’.

However, Access Economics (2006b, p.56/57) advanced four caveats against the blanket application of the underlying operational deficit criterion of 10 per cent of the operating debt ratio:

- Councils failing to meet this cut-off mark are not necessarily unsustainable ‘on the grounds that a 10 per cent deficit could be eliminated if necessary by “manageable” increases in rates and other charges’ since this deficit could be eliminated by a one percentage point increase in rates and charges over the ‘no-policy change’ option in ten years.

- Current operating deficits do not take into account the ‘spending pressures that will arise as councils address their infrastructure backlogs’. Operating debt ratios should thus be adjusted on the understanding that deferred infrastructure maintenance and renewal has effectively subsidized current consumption by councils. Nominal interest rates on the accumulated backlog should therefore be notionally charged to account for this historic subsidy.

- Current operating deficits do not ‘allow for the additional financial capacity available to those councils with below-par revenue-raising efforts’. Thus councils which have ‘under-charged’ with rates and charges require adjustment to their operating deficits to the extent of this imputed under-charging.

- Finally, ‘another candidate for the adjustment of currently-observed operating deficits when assessing the financial sustainability of councils would be the impact of likely expenditure trends on a no-policy change basis on account of population shifts and ageing along with environmental imposts’. This latter category is sometimes termed ‘non-discretionary’ variables in the literature since it refers to costs over which councils have no control!

On this basis Access Economics (2006b, pp. 57/58) constructed a summary table and chart depicting all WA local councils, adjusted to reflect the caveats outlined above, according to their financial sustainability.

Table 3.3: WASSS (2006) Financial Sustainability by Type of Councils

Type of council	Councils with unsustainable long-term finances:			
	Number	**% of total**	**% of type**	**% of State pop.**
Metropolitan	3	4%	10%	5%
Regional, with large towns	19	23%	70%	11%
Regional, without large towns	61	73%	71%	5%
Above-average growth	13	16%	45%	8%
Declining population	53	64%	75%	9%
Largest 25%	11	13%	31%	12%
Smallest 25%	24	29%	69%	1%
All WA councils	**83**	**100%**	**58%**	**21%**

Table 3.3 shows that 83 (out of 142) WA councils (or 58%), serving around 21 per cent of the WA population, are unsustainable. Access Economics (2006b: 58) compared this outcome with its earlier calculations for the South Australian and NSW inquiries based on broadly the same technique: 'In NSW, 25 per cent of that state's councils were assessed as financially unsustainable, with such councils serving 17 per cent of the state's population' whereas 'in SA, 50 per cent of that state's councils were assessed as financially unsustainable, with such councils serving 50 per cent of the state's population'.

3.2.4 PriceWaterhouseCoopers Report (2006)

The PriceWaterhouseCoopers (PWC) (2006) *National Financial Sustainability Study of Local Government* was commissioned by ALGA to determine 'key financial issues' affecting financial sustainability and develop recommendations for improving sustainability. The PWC Report (2006) took a national perspective on financial reform and financial sustainability.

PWC (2006, 95) defined financial sustainability as the 'financial sustainability of a council is determined by its ability to manage expected financial requirements and financial risks and shocks over the long term without the use of disruptive revenue or expenditure measures'. This involves two elements:

- Councils should maintain 'healthy finances', given current expenditure and revenue policies and foreseeable future developments.

- Councils must ensure infrastructure expenditure 'matches' asset planning.

This definition was applied to a stratified sample of 100 local authorities drawn from all state and territory local government jurisdictions using five financial KPIs:

- 'Operating surplus' representing 'total operating revenue less total operating expenses'.
  If an operating deficit exceeds 10% of total revenue, then it places the council at financial risk. In the PWC sample of 100 Australian local councils, 16% of all councils were unsustainable.

- 'Interest coverage' measuring a council's ability to pay interest on its debt and calculated as the ratio of 'Earnings Before Interest and Tax' (EBIT) to 'borrowing costs'.
  A ratio value below 3 indicates unsustainability. Almost 36% of the PWC sample failed on this KPI.

- 'Sustainability ratio' or the ratio of capital expenditure to depreciation which measures changes in the asset base of councils.
-
  If the ratio exceeds unity, then the asset base is increasing. In the sample, the median ratio was 1.8, with only 8 per cent of councils falling below 1. However, the PWC Report (2006: 97) stressed that the sustainability ratio must be 'interpreted with care' due to infrequent and inconsistent asset valuation procedures.

- 'Current ratio' or the ratio of current assets to current liabilities. This is intended to measure a council's capacity to meet its short-term debt obligations; a sustainable council must have a current ratio at least equal to unity. 21% of the sample fell below this level.
- 'Rates coverage' or total rates revenue as a proportion of total costs.

  An arbitrary 'benchmark' of 40% was taken to indicate 'adequate self-funding' and 48% of all councils exceeded this figure. However, a significant majority of rural councils fell short.

The Report drew three main conclusions from its work on the sample of 100 local councils, spelt out in terms of the seven DOTARS council categories:

- Most 'large' metropolitan councils were 'generally viable', with some 'stretched' owing to 'service expansion', and 'internal reform' is necessary.

- 'Urban Fringe' councils have 'mixed' sustainability, 'internal reform' is needed, and 'only some' councils need 'additional' funding.

- 'Rural Remote' and 'Rural Agricultural' exhibited 'pronounced' sustainability problems, required 'internal reforms', and most should receive 'extra funding' for the 'renewal of existing community infrastructure'.

The second approach adopted in the PWC report involved extrapolation using the KPIs in the (FSRB, 2005), LGI (2006) and WALGA (2006) state inquiries and the MAV 'viability index' to all Australian local councils in order to ascertain infrastructure sustainability. The MAV 'viability index' comprises three elements:

- ‘Cumulative long-term debt’ relative to annual rate income;

- ‘Cumulative underlying operating surplus/debt’; and

- ‘Rate effort, rates affordability and population growth’.

The PWC Report (2006, 111) summarised its findings as follows:

- 20 to 40% of all Australian councils ‘could be unsustainable’.

- In monetary terms, NSW has the most acute ‘financial viability issues’.

- The average annual per council ‘underspend’ on ‘existing infrastructure renewals’ lies between $1.3 million and $1.7 million.

- In order to remedy the annual infrastructure shortfall plus the accumulated infrastructure backlog, the ‘average’ council would need to spend an additional $2.6 million to $3.3 million per year.

The PWC Report (2002: 117) concluded:

- Around 40 per cent of all Australian local councils ‘are currently not sustainable’.

- A ‘significant proportion’ of all councils – ‘10% to 30%’ – face ‘sizeable sustainability challenges’.

3.2.5 Local Government Association of Tasmania Review (2007)

Access Economics was requested by LGAT to assess the financial sustainability of Tasmanian local government and produced a Final Report entitled *Review of the Financial Sustainability of Local Government in Tasmania* (LGAT, 2007).

Access Economics considered financial sustainability and contrasted it with ‘financial viability’ (LGAT, 2007: 23/25). It observed that ‘it is important to note that a council being classified as financially “unsustainable” does not imply the Council's financial viability is necessarily in question’. In other words, ‘financial unsustainability’ in the long term refers only to the unsustainability of a council's current revenue-raising and expenditure policies since council finances can ‘almost always’ be adjusted with increases in rates and/or expenditure reductions, even if this comes at ‘a considerable cost to ratepayers and the community’. It argued that ‘there can be no doubt that the local government sector is, and will always be, financially “viable” in the sense that it will always be able ultimately to meet its debt service obligations’ because ‘ratepayers are bound to meet all outstanding obligations under the Local Government Act’ and therefore the ability of a local authority to levy property taxes means that it cannot go bankrupt in the usual commercial manner.

Access Economics defined financial sustainability as ‘the extent to which a council's financial capacity is sufficient - for the foreseeable future - to allow the council to fund the spending that is necessary to meet both its existing statutory obligations and any associated spending pressures and financial shocks without having to introduce substantial or disruptive revenue (and expenditure) adjustments infrastructure assets means non-financial assets excluding any holdings of land’ (LGAT, 2007: vii). It is immediately evident that this definition echoes earlier definitions developed by Access Economics for the SA, WA and NSW inquiries discussed earlier; a suspicion verified by a corresponding observation in the Final Report (LGAT, 2007: 24).

Drawing on this definition and earlier work for the SA, NSW and WA inquiries, Access Economics set out six financial KPIs and associate benchmark values reproduced in Table 3.4.

Table 3.4: LGAT (2007) Key Financial Indicators and Benchmark Values for Tasmanian Councils

Indicator	Denominator	Target Range	
		low	high
Net financial liabilities ratio	Capital employed	3%	12%
Net interest expense ratio	Operating revenue	2%	5%
Operating surplus ratio	Own-source operating revenue	2V2%	71/2%
Net borrowing ratio	Enhancement capex	25%	50%
Annual renewals gap ratio	Desired renewals capex	-10%	10%
Infrastructure backlog ratio	Infrastructure assets	0%	5%

Source: LGAT (2007: Table 1.1).

The Final Report (LGAT, 2007: 1) noted that ‘a council should set target values for these financial indicators based upon the following broad principles’:

- A local council's financial situation is in ‘a healthy state if its net financial liabilities (and associated debt) and any infrastructure backlog are at levels where the resultant and prospective net interest expense can be met comfortably from annual income (i.e., by current ratepayers) at the existing rating effort’.

- A local council's operating financial performance is ‘satisfactory if it is running a modest operating surplus before capital revenues, indicating that costs incurred in the year in question (including both routine maintenance and annual depreciation of non-financial assets) are at least being met by today's ratepayers and not being transferred to tomorrow's ratepayers, with revenues sufficient to finance current operations’.

- A local council's capital financial performance is satisfactory if both (a) its actual renewals capex broadly matches the annual desired levels of such expenditure and (b) its annual net borrowing does not put any long-term pressure on achievement of the Council's targeted net financial liabilities ratios.

The results of this exercise demonstrated that 6 Tasmanian councils (about 20%), serving 8% of the population, could be classified as ‘unsustainable’ on the benchmark values. This implied that these councils faced ‘substantial or disruptive revenue (or expenditure) adjustments’ to correct imbalances in the long-term finance. This can be compared with the following results from the Access Economics analysis of SA, NSW and WA, which established that:

- 50% of SA councils were financially unsustainable, serving about 50% of the population;

- 25% of NSW councils were financially unsustainable, serving 17% of the population; and

- Just over 50% of WA councils were financially unsustainable, serving 21% of the population.

In Tasmania, an additional 5 councils (some 17%), serving 14% of the population, were classified as ‘vulnerable’.

3.2.6 Productivity Commission Report (2008)

The threefold Terms of Reference (TOR) for the Productivity Commission’s (PC) study into assessing the capacity local government to raise revenue obliged the PC to investigate:

- The capacity of different types of councils (e.g. capital city, metropolitan, regional,
  rural, remote and indigenous) to raise revenue and the factors contributing to capacity and variability in capacity over time;

- The impacts on individuals, organisations and businesses of the various taxes, user charges and other revenue sources available to local government; and

- The impact of any State regulatory limits on the revenue raising capacity of councils.

In addition, the Commission was expressly forbidden from investigating the scope for local government to borrow. It is thus apparent that the PC had to investigate hypothetical capacity to raise revenue rather than real-world revenue accrual. This severely limited the usefulness of *Assessing Local Government Revenue Raising Capacity* published in April 2008.

The Commission assessed (a) the revenue-raising capacity of local government and (b) the factors contributing to capacity. It identified two methods of determining the capacity of local authorities to raise revenue:

- The fiscal capacity of a local government which is measured as the aggregate income net of tax of its local community, where aggregate income represents the ability of a community to purchase local government and private goods and services. Accordingly, the higher the fiscal capacity of a local government, then the higher its potential to raise revenue.

- The willingness of the local community to pay for council services. In practice, the amount of revenue that a local government can actually raise from its local community depends on what the local community requires by way of services. Thus, the higher the level of desired services, the greater the willingness to pay.

The PC (2008) found that fiscal capacity differed by category of local government. Thus capital city CBD councils had the highest fiscal capacity, due to high business income, parking and traffic fine revenue and comparatively small resident populations. By contrast, most remote councils, without mining and petroleum activity, had low fiscal capacity, particularly indigenous councils. On average, 'urban developed', 'urban regional' and 'rural' councils had intermediate levels of fiscal capacity, whereas 'urban fringe' councils generally had lower levels of fiscal capacity. The PC (2008) found that revenue-raising effort, measured as the ratio of own-source revenue to fiscal capacity, also differed by the category of local government.

3.2.7 Queensland Treasury Corporation Report (2008)

The Queensland Treasury Corporation (QTC) assessed the financial sustainability of local council participating in the LGAQ SSS Program. Its definition drew heavily on the SA FRSB (2005): financial sustainability means that a given council is able 'to manage likely developments and unexpected financial shocks in future periods without having at some time to introduce economically significant or socially destabilising revenue or expenditure adjustments' (QTC, 2008: 16).

The QTC (2008) broke this definition down into several different elements, such as operating performance sustainability and depreciation sustainability, and then developed specific indicators for each of them and normative values for these indicators. For example, 'fiscal flexibility' was defined by the QTC (2008: 42) as 'the capacity of a local government to respond to changing circumstances (including unforeseen financial shocks) by adjusting revenue and/or expense levels or by maximising balance sheet management'. Fiscal flexibility was deemed to have three core aspects: own-source revenue; self-generated revenue; and debt capacity. Considering 'self-generated revenue', the QTC (2008: 44) defined this as 'net rates, utilities and charges plus sales (contract and recoverable works) and other fees and charges as a percentage of total operating expenditure (including interest and depreciation'. For self-generating revenue, the QTC prescribed the following normative minimum value, described as the 'self-generated revenue ratio minimum indicative measure' set as 'the QTC minimum benchmark ratio for self-generated revenue is a contribution of at least 60.0 per cent of operating expenses'. A similar approach was adopted for each of the other areas of the financial operation of councils. The QTC (2008) therefore adopted the reasonable view that there is no single ideal indicator for financial sustainability.

In essence, the QTC (2008) Financial Sustainability Review (FSR) assessed financial sustainability the in terms of the capacity of a given council to:

- Meet its commitments in the short-run, medium-term and long-term;

- Manage unforeseen financial shocks and adverse changes in its economic environment; and

- Manage ‘core business risks’.

The QTC FSR considered the past financial performance and a long-term (10-year) financial forecast, an evaluation of the council in question on several quantitative and qualitative indicators, discussion with senior council officers on strategic objectives, as well as macroeconomic considerations more generally.

Using this methodology, the QTC (2008) ranked councils on six dimensional scale: Very strong, strong, moderate, weak, very weak and distressed, which referred to the generic capacity of a council to meet its financial commitments in the short, medium and long-term, its ability to manage unforeseen financial shocks and any adverse changes in its business and general economic without the need for significant revenue or expense adjustments, and its capacity to mange core business risks. The results of the FSR exercise are outlined in Table 3.5:

Table 3.5: QTC (2008) FSR Rating Outcomes

RATING DISTRIBUTION					
Very Strong	**Strong**	**Moderate**	**Weak**	**Very Weak**	**Distressed**
1	11	55	28	12	2
0.9%	10.1%	50.5%	25.7%	11.0%	1.8%

From Table 5 we can see that 61.5% of the 109 councils reviewed were rated Moderate and above, whereas 38.5% of councils were rated Weak, Very Weak or Distressed.

These results are decomposed into outcomes for particular indicators under each of the five groups of indicators in Table 3.6.

QTC RATING	RATING DISTRIBUTION						
Rating	**Number rated**	**Operating margin > -4%**	**Self-generated income > 60%**	**Interest cover > 6 times**	**Cash holdings > 3 months**	**Asset replacement >1.1 times**	
Very Strong	1	1 100%	1 100%	1 100%	1 100%	1	100%
Strong	11	7 64%	11 82%	9 82%	11 100%	10	91%
Moderate	55	39 71%	43 71%	39 71%	55 100%	47	85%
Weak	28	4 14%	17 68%	19 68%	26 93%	9	32%
Very Weak	12	2 17%	4 58%	7 58%	8 67%	6	50%
Distressed	2	0 0%	0 50%	1 50%	0 0%	0	0%
Total	109	53 49%	76 70%	76 70%	101 93%	73	67%

The QTC (2008: 9/11) made numerous recommendations for policy change, including:

- Councils should target a balanced or surplus operating result, and if this is not feasible, then operating deficits should not be continuous should be no greater than 4.0 per cent of annual operating revenue.

- Increases to net rates, utilities and charges should be determined as a function of service provision costs rather the Consumer Price Index.

- Annual depreciation expenses should be realistic.

- Tax equivalent amounts should be paid as a consequence of capital grants, subsidies and contributions and should be immediately reinvested in the business as equity contributions, and dividend payments should be made as a percentage of operating profits after tax, adjusted for capital grants, subsidies and contributions.

- Each council should develop and have in place approved policies and processes to manage and monitor liquidity.

- Councils should consider an optimal and prudent funding mix for capital investment and borrow where appropriate.

- Asset Management Plans should be completed and linked to a long-term financial forecasting model.

- Each council should develop, maintain and regularly review a ten-year financial forecasting model which incorporates an income statement, cash statement and a balance sheet to assist strategic planning and decision making.

- When developing long-term financial forecasts, councils should include estimates for asset revaluation.

3.3 CONCLUSIONS

3.3.1 Financial Sustainability in Local Government

Financial sustainability in local government is a thorny question since it inevitably involves developing methods of evaluating the financial performance of individual councils. Moreover, the conceptual and measurement difficulties revolving around financial performance evaluation are formidable. Despite a voluminous literature on this problem, there is no agreed definition of 'financial sustainability'. This lack of consensus should not be surprising given the complexities of defining financial sustainability in a democratic non-profit local public service environment. For example, should the financial circumstances of a council be judged exclusively on financial magnitudes, such as operating expenditure, operating revenue, indebtedness, and the like, or should the yardstick be standards of service provision, operational efficiency and community expectations?

3.3.2 Measuring Financial Stress in Local Government

A notable feature of the analysis of the inquiries into local government financial sustainability conducted in this paper is that 5 of the 7 reports (i.e. SA, NSW, WA, Tasmania and PWC) relied heavily on Access Economics. As we have seen, Access Economics defined financial sustainability in terms of accounting measures by employing financial KPIs and associated benchmark values to distinguish between financially sustainable and unsustainable councils. This is unfortunate since uncritical acceptance of the 'accounting' approach to financial sustainability has allowed 'ideology' to masquerade as objective 'analysis' in some instances. For example, if we use operating deficits to proxy financial capacity, then this will inevitably mark small rural councils as unsustainable due to their low rate base, an artifact of non-discretionary factors, such as demographic trends, and not council discretionary policy.

3.3.3 Common Findings on Financial Sustainability

A common theme runs through the findings of all the 7 reports considered in this paper: All Australian local government jurisdictions are afflicted by severe financial distress and that the primary symptom of ongoing financial unsustainability resides in a large and growing local infrastructure backlog. Moreover, the degree of financial distress differs by type of council, with the problem most acute in rural and remote councils. These results emerge from all of the inquiries which assessed financial sustainability and therefore are not dependent on the methodology employed.

CHAPTER 4: LAKE MACQUARIE CITY COUNCIL IN COMPARATIVE PERSPECTIVE

4.1 Introduction

The analysis conducted in Chapter 3 demonstrated that financial sustainability in Australian local government is not only difficult to define and measure with any degree of precision, due in part to the fact that local councils are simultaneously democratically-based service organisations as well as not-for-profit business entities, but also that its causes are complex, multi-faceted and largely derived from factors outside the control of the local government sector itself. Moreover, all the national and state public inquiries we examined in Chapter 3 unanimously found that a large number of local authorities in all state and territory jurisdictions were financially unsustainable, with the burden of fiscal distress falling mainly on local infrastructure maintenance and investment, resulting in a large and growing infrastructure backlog. Our analysis of the findings of these inquiries in Chapter 2 demonstrated that they were decidedly sceptical of amalgamation as a method of improving local government efficiency and enhancing local government financial viability.

In addition to the intrinsic imprecision surrounding the meaning of financial sustainability, performance assessment of individual local authorities, or even groups of councils, is fraught with both conceptual and empirical problems. At the conceptual level, an inescapable dichotomy exists between local government efficiency and local government democracy (see, for instance, Dollery and Robotti, 2008). Aulich (2005, p.198) has argued that local government has two basic functions: on the one hand, ‘it gives voice to local aspirations for decentralized governance’, whereas, on the other hand, ‘it provides a mechanism for efficient delivery of services to local communities’. This dichotomy has led to a bifurcated approach to public policies aimed at the reform of local government; ‘one which focuses on local democracy and stresses democratic and local values over efficiency values; the other primarily concerned with structural efficiency and emphasising the importance of efficient distribution of services to local communities’. Since both democratic process and efficient service outcomes are each valued in its own right, but may involve trade-offs, performance appraisal is made more difficult.

At the empirical level, the paucity of relevant data, as well as data deficiencies in the available information, necessarily implies that imperfect and intermediate proxy variables must frequently be used in performance appraisal instead of the actual behaviour under assessment. A consequence is that often performance evaluation measures elements of council service provision unrelated to its performance but which are rather artefacts of data availability. Various methods of ameliorating these problems exist. The most widely used approach is to place the local council under consideration in a comparative context by evaluating its performance relative to other local authorities in the same jurisdiction which therefore operate under the same legislative framework.

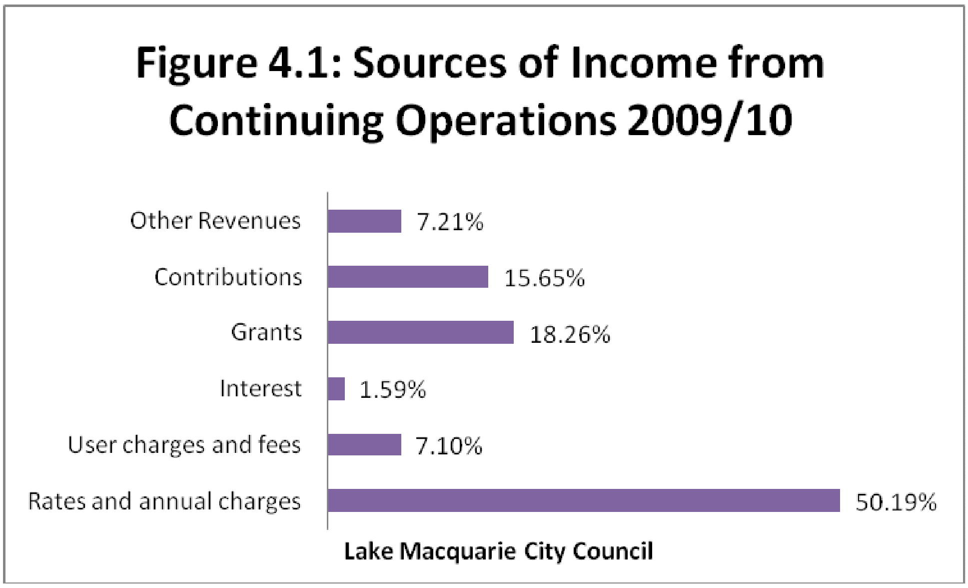
With these caveats in mind, Chapter 4 provides a comparative analysis of the Lake Macquarie City Council relative to NSW Division of Local Government Category 5 Councils (Coffs Harbour; Lake Macquarie; Newcastle; Shoalhaven; Tweed; and Wollongong) contained in the NSW Division of Local Government's *Comparative Information on NSW Local Government Councils*, the Wyong Shire Council which neighbours on Lake Macquarie City Council, and the average performance of all local councils in NSW as determined in *Comparative Information on NSW Local Government Councils 2008/09*.

The rational for this approach straight-forward. In the first place, the NSW Division of Local Government has situated Coffs Harbour, Lake Macquarie, Newcastle, Shoalhaven, Tweed and Wollongong in the same classification Category 5 since they meet the same criteria under Australian Local Government Classification (ALGC) 8/9URL/URV classification codes. These councils are thus the most similar to each other in NSW. Secondly, even though it has a separate NSW/ALGC classification, Wyong Shire Council is included in the analysis as a comparator council since its boundaries adjoin those of Lake Macquarie City Council. Finally, in those cases where it is apposite, the average performance of all NSW councils is employed as established by the NSW Division of Local Government in *Comparative Information on NSW Local Government Councils*.

Chapter 4 is divided into three main parts. Section 4.2 outlines recent trends in the performance of the Lake Macquarie City Council by way of background. Section 4.3 examines Lake Macquarie City Council relative to NSW Division of Local Government Category 5 Councils Coffs Harbour, Newcastle, Shoalhaven, Tweed and Wollongong, as well as the Wyong Shire Council, and the NSW state average. Chapter 4 ends with some brief concluding remarks in section 4.4.

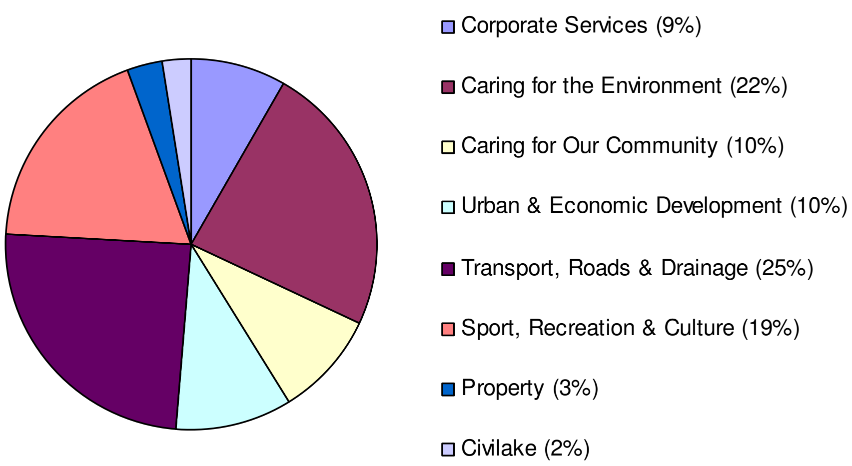
4.2 Lake Macquarie City Council

Figure 4.1 lists the various sources of revenue for Lake Macquarie City Council. It is evident from Figure 4.1 that rates and attendant annual charges comprised just over half of the total annual income of Lake Macquarie City Council for the financial year 2009/10. With grants set at only 18.24 per cent of total revenue, Lake Macquarie City Council is far from the stereotypical 'grant-dependent' local government entity so frequently attacked by state government politicians!



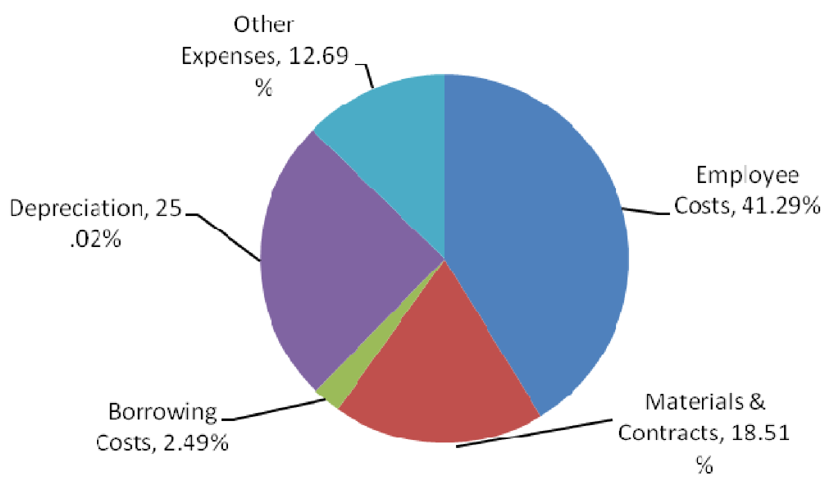
With respect to annual operating outlays, Figure 4.2 provides a useful 'snapshot' of the activities of Lake Macquarie City Council by expenditure category for 2009/10. Figure 4.2 illustrates several salient features of the cost structure of Lake Macquarie City Council by type of activity. For instance, environmental services (22 per cent), transport (including roads) (25 per cent), and areas of community engagement and participation (i.e. 'sport, recreation and culture') (19 per cent) absorb no less than two-thirds of all outlays by activity (i.e. 66 per cent).

Figure 4.2 Operating Costs by Focus Area - Budget 2009/10

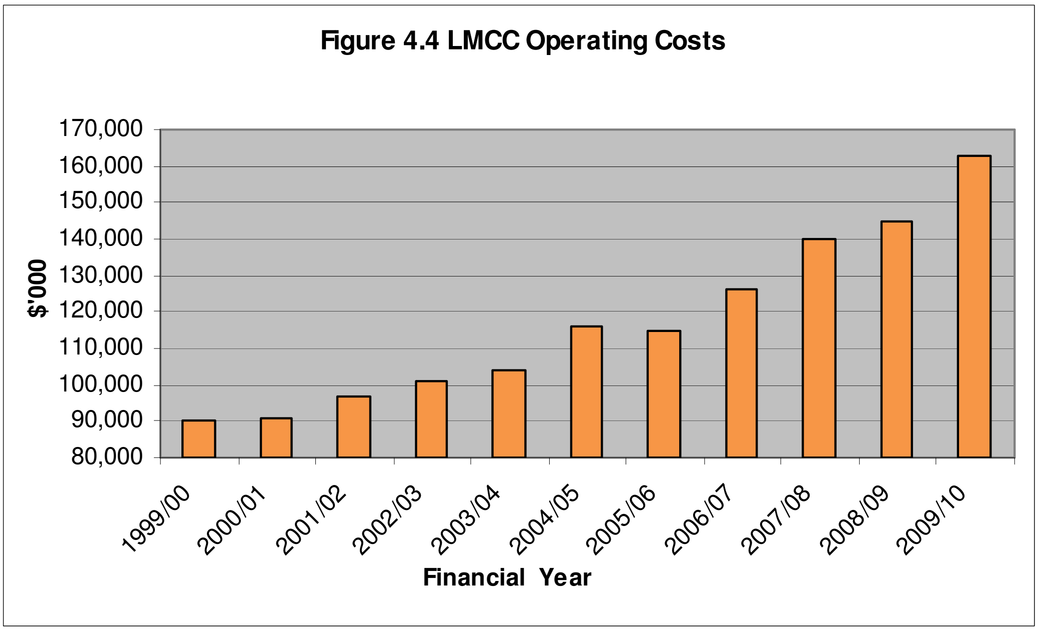


An alternative way of examining the mix of activities at Lake Macquarie City Council through the lens of expenditure on inputs is provided in Figure 4.3. It is obvious from Figure 4.3 that employment (41 per cent) represents the major object of expenditure in the financial year 2008/09, followed by capital costs in the form of depreciation (25 per cent). In a labour-intensive service industry, such as NSW local government, this is entirely to be expected.

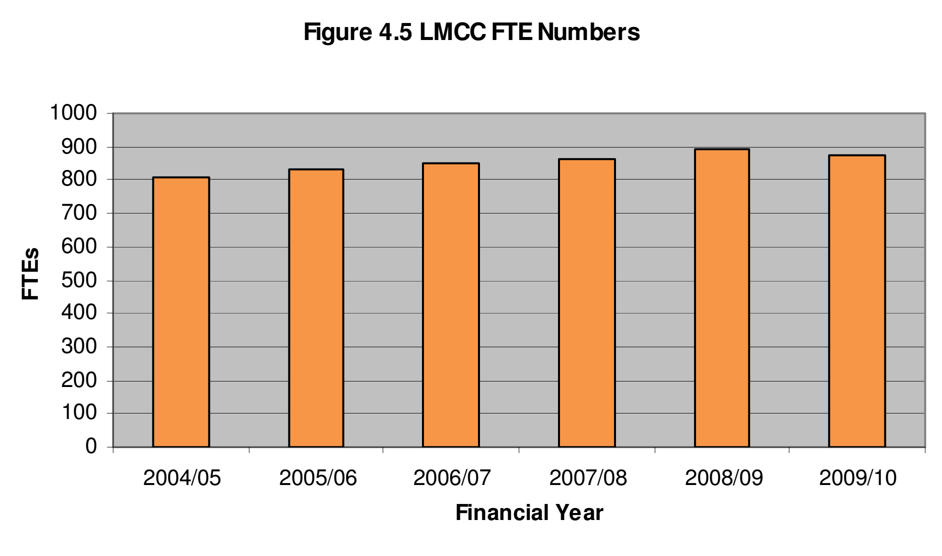
Figure 4.3: Lake Macquarie City Council Dissection of expenses from continuing operations 2008/9



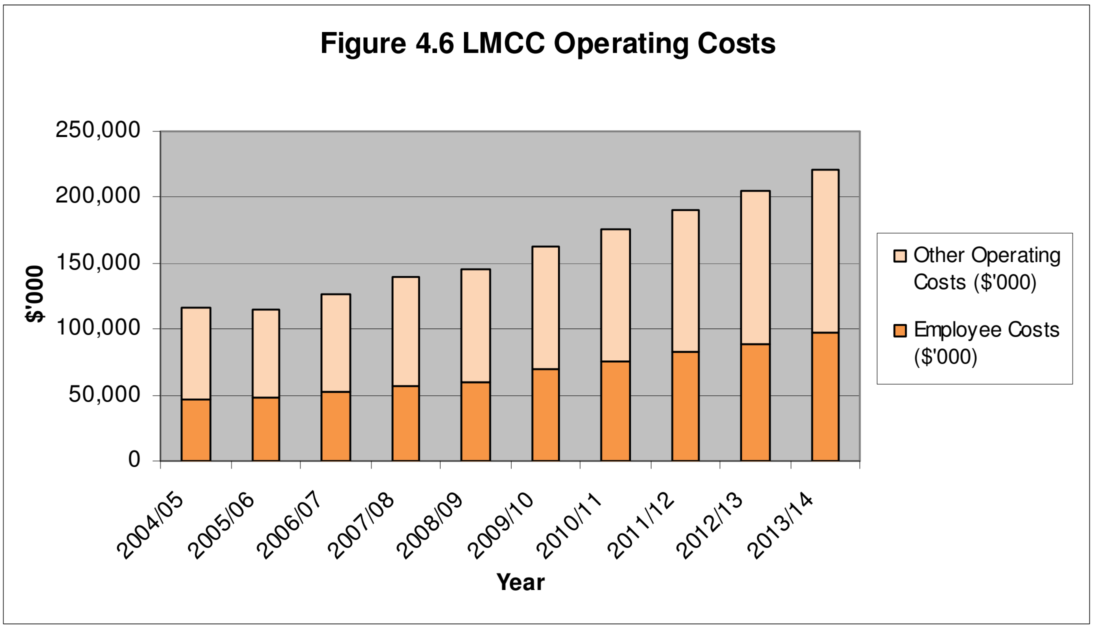
The cross-section data in Figure 4.2 are displayed through time in Figure 4.4 over the 11 year period 1999/00 to 2009/10 to provide some idea of the trends in operating costs. The steady rise in nominal (and not real) costs in Figure 4.4 follows industry-wide cost escalations experienced over the first decade of the twenty first century. It is worth noting that, in common with all other NSW local authorities, a significant proportion of operating costs derive from state government regulation of council activities, including prescriptive mandates setting the mix and quality of service provision.



An interesting measure of the size and effectiveness of a given local council lies in its employment. Figure 4.5 shows recent trends in Full-Time Equivalent (FTE) employment at Lake Macquarie City Council over the 6 year period 2004/05 to 2009/10. A notable feature of the data in Figure 4.5 resides in the constancy of FTE numbers of this period; an atypical outcome in Australian local government generally over the period in question, as we shall see in Figure 4.8 in section 4.3 of Chapter 4.



The data in Figure 4.4 and Figure 4.5 has been decomposed into operating costs associated with employment and all other operating costs in Figure 4.6 in order to examine the rate of growth of these two categories of expenditure. An interesting aspect of the information in Figure 4.6 resides in the 'lean and mean' falling ratio of employment costs relative to other costs Lake Macquarie City Council over this period, which serves to highlight the trends in employment in Figure 4.5:

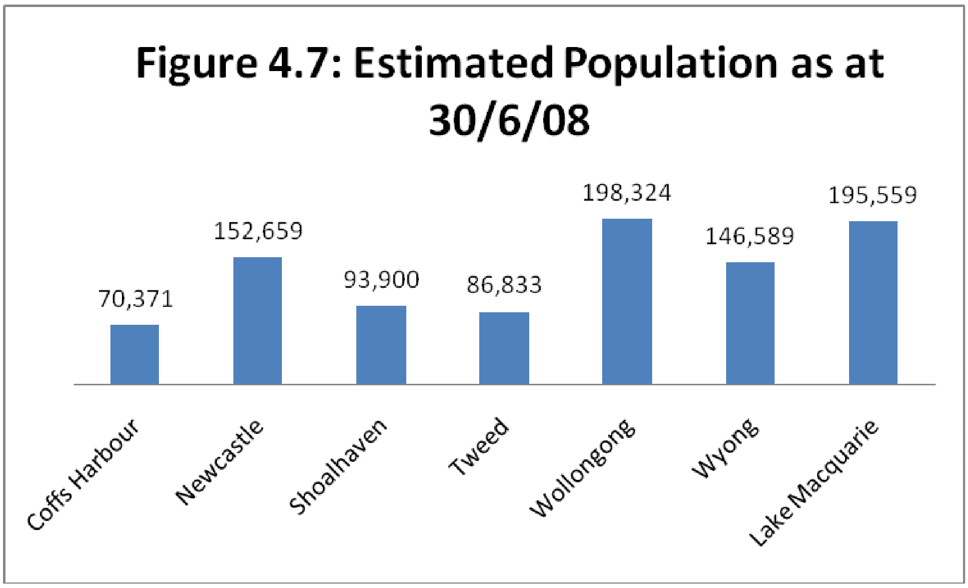


While the information contained in Figures 4.1 to 4.6 provide useful background information on the nature of the Lake Macquarie City Council, by itself this data tells us little about the performance of the Lake Macquarie City Council. Given the difficulties involved in performance appraisal of local government, outlined in section 4.1, we need to consider Lake Macquarie City Council in comparative context in order to get a more holistic perspective on its relative performance.

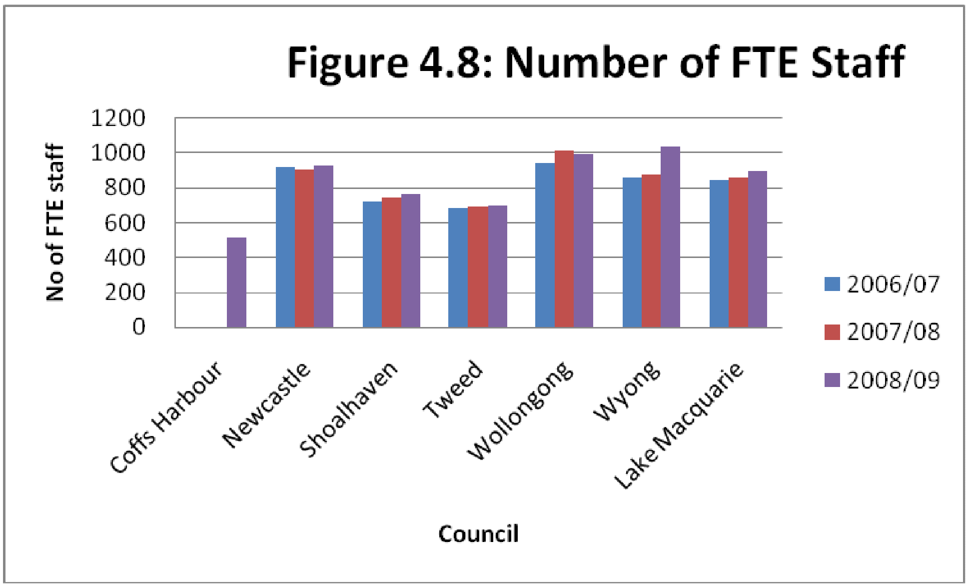
4.3 Lake Macquarie City Council in Comparative Perspective

In section 4.3, we provide a comparative analysis of the Lake Macquarie City Council relative to other NSW Division of Local Government Category 5 Councils (Coffs Harbour; Newcastle; Shoalhaven; Tweed; and Wollongong) contained in the NSW Division of Local Government's *Comparative Information on NSW Local Government Councils*, the Wyong Shire Council which neighbours on Lake Macquarie City Council, and the average performance of all local councils in NSW as determined in *Comparative Information on NSW Local Government Councils.*

It is useful to begin this assessment by determining the relative population size of the six comparator local council areas employed in the analysis. In the first place, Figure 4.7 provides a helpful picture of these local authorities in relation to Lake Macquarie City Council. With its population a little under 200,000 as at mid-2008, Lake Macquarie City Council is the second largest municipality in Figure 4.7, just below Wollongong, but substantially above Newcastle. In comparison with the population size of either all NSW councils or all Australian local authorities, Lake Macquarie City Council is a very large municipality.



With respect to determining the size of the actual local council organisations, one approach is to focus on FTE employment. It is clear from Figure 4.8 on the FTE measure Lake Macquarie City Council falls below Newcastle, Wollongong and Wyong, despite its proportionately greater population. While Figure 4.8 provides useful information on the relative dimensions of these councils, it simultaneously sheds indirect light on council performance, with Lake Macquarie City Council comparatively 'lean and mean' relative to the comparator councils.



The next step in our comparative analysis is to examine the financial aspects the seven councils under review relative to each other and relative to the NSW council average from both revenue and expenditure angles.

From an income perspective, available data permit a multi-faceted scrutiny. Firstly, in order to compare 'like with like', it is instructive to consider various measures of income per capita. Figure 4.9 provides a useful comparison for the councils under review compared with the NSW state average. It is evident that not does Lake Macquarie City Council falls below the NSW average, but it also falls below the other six councils with which it is being directly compared.

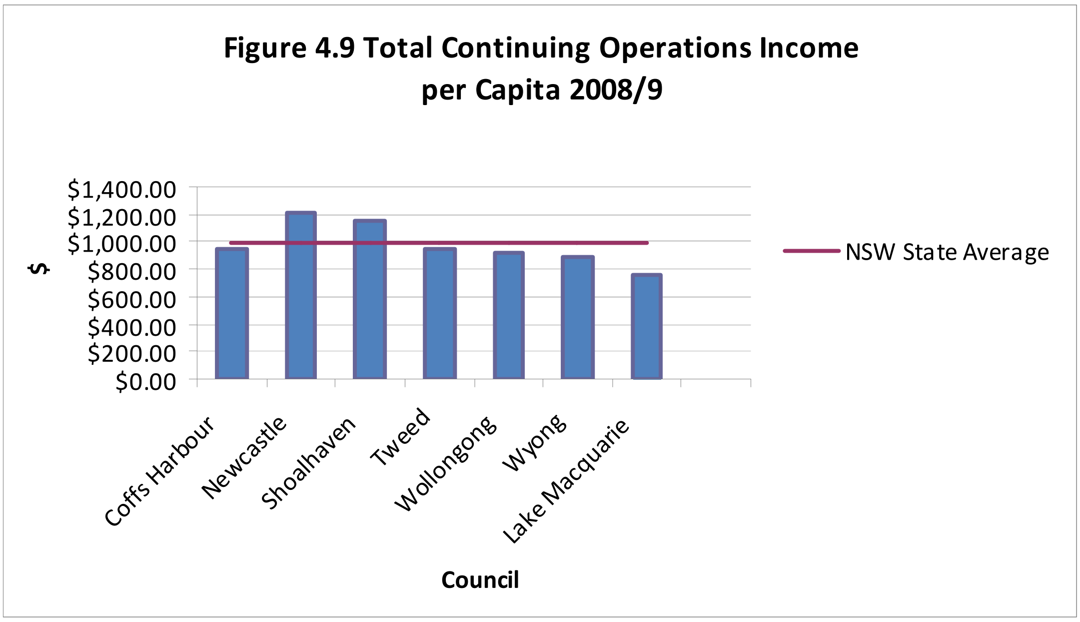


Figure 4.9 Total Continuing Operations Income per Capita 2008/9

A second mode of examining revenue characteristics is through income per capita, which is illustrated differently in Figure 4.10, and facilitates inter-council comparisons.

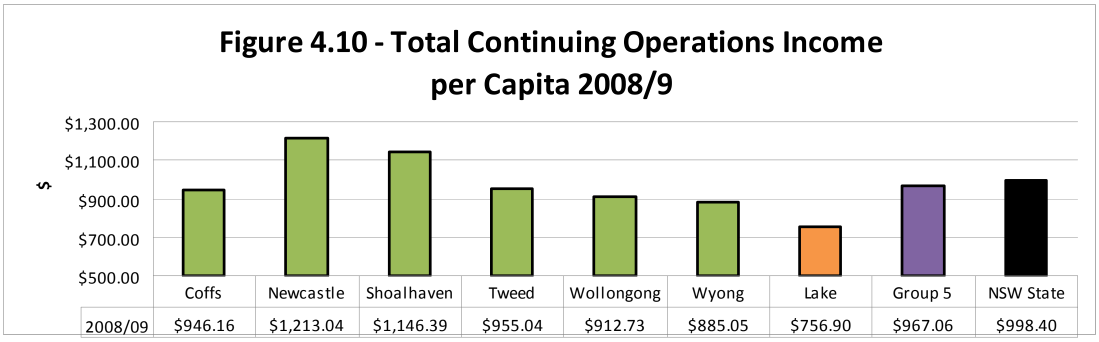


Figure 4.10 - Total Continuing Operations Income per Capita 2008/9

Figure 4.10 shows that Lake Macquarie City Council accrues less income per capita than both the NSW average and the other six councils under review. In some cases the difference is sharp, notably compared with Newcastle.

Both Figure 4.9 and 4.10 convey a strong impression that Lake Macquarie City Council operates on modest per capital income flows. Figure 4.11 reinforces this impression from a total revenue perspective.

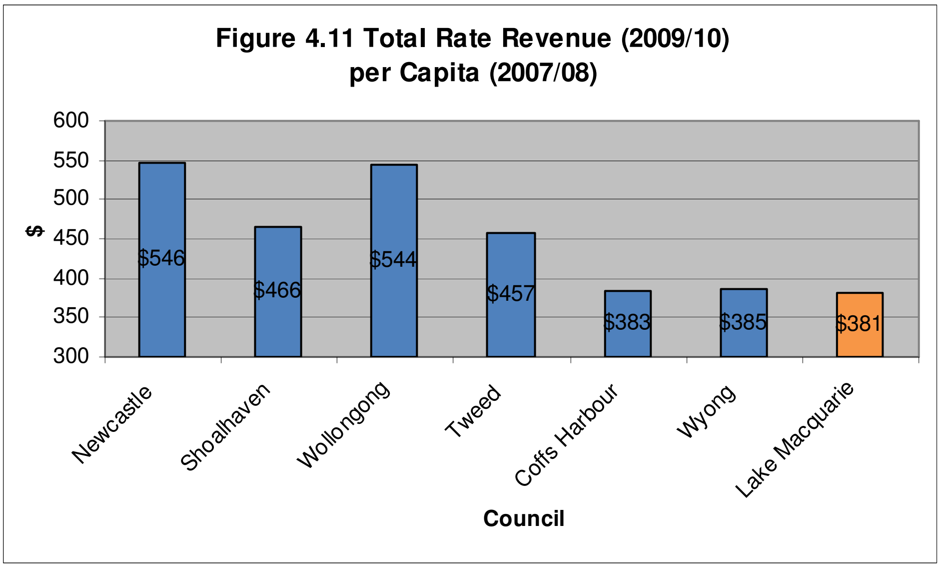


Figure 4.11 shows that Lake Macquarie City Council collects less total revenue per capita than any of the other six councils, particularly compared with Wollongong and Newcastle, where the difference is surprisingly large. A normative implication of this finding is that Lake Macquarie City Council imposes a corresponding lighter financial burden on its residents.

From a cost perspective, available data enable us to conduct an analogous exercise.

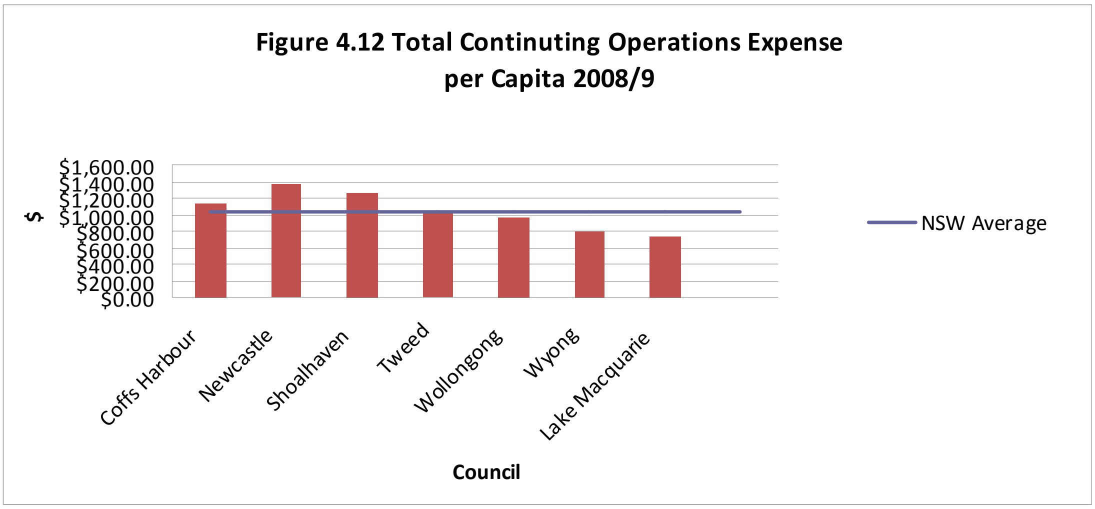


Figure 4.12 shows continuing costs per capita for the councils under review compared with the NSW state average. It is evident that Lake Macquarie City Council falls below the NSW average, as well as below the other six councils with which it is being

directly compared. In Figure 4.13, the same information is presented in a different manner, but nonetheless illustrates the same outcome.

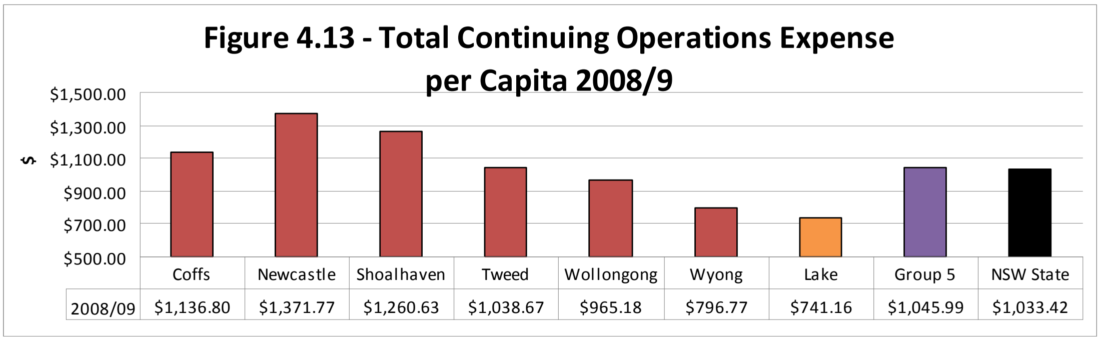


Figure 4.13 - Total Continuing Operations Expense per Capita 2008/9

	Coffs	Newcastle	Shoalhaven	Tweed	Wollongong	Wyong	Lake	Group 5	NSW State
2008/09	$1,136.80	$1,371.77	$1,260.63	$1,038.67	$965.18	$796.77	$741.16	$1,045.99	$1,033.42

In both Figure 4.12 and Figure 4.13, Lake Macquarie City Council falls below both comparator groups, and far below Newcastle and Shoalhaven. The import of this information is repeated if we examine costs per capita for FTE employment. This is shown in Figure 4.14.

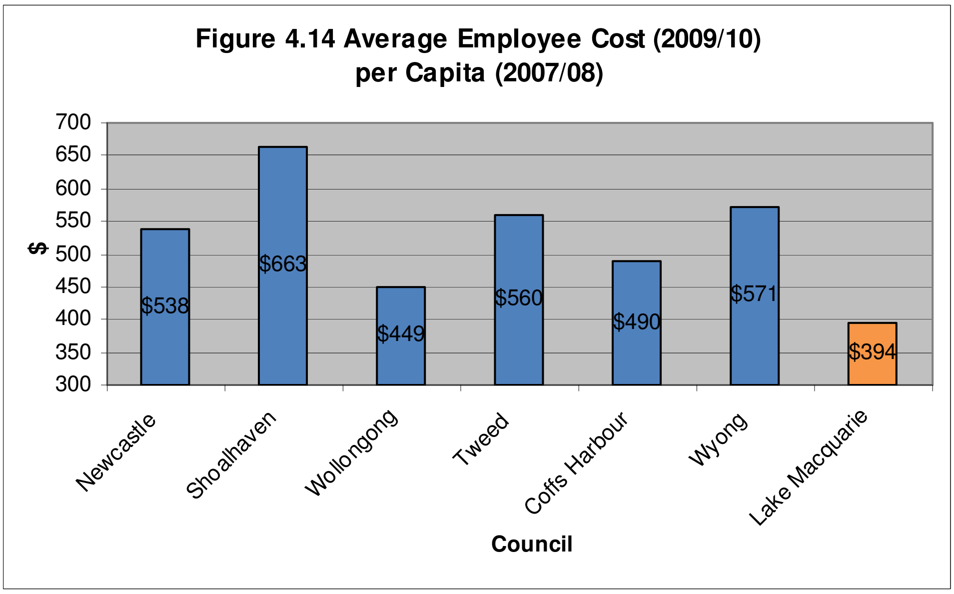
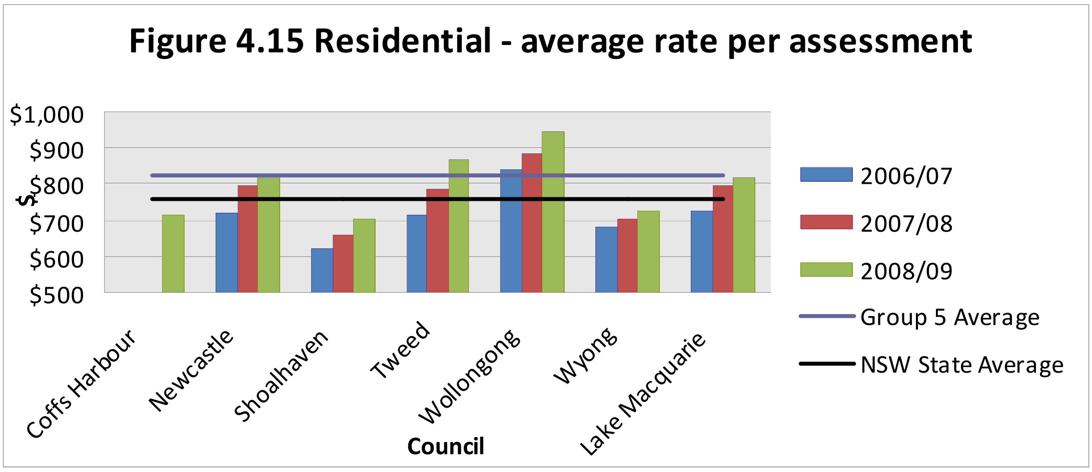


Figure 4.14 Average Employee Cost (2009/10) per Capita (2007/08)

Figure 4.14 confirms the results in Figure 4.12 and Figure 4.13, with Lake Macquarie City Council spending far less per FTE employee relative to the other six councils. A normative implication of this finding is that Lake Macquarie City Council is significantly more efficient than the comparator councils

Apart from examining income and costs, a further important dimension of local government finance resides in the pecuniary burden local authorities impose on local communities. Various methods can be used to approach this question. In the present context, available data allow us to consider residential rates, farmland rates and business rates per assessment. This is shown in Figure 4.15, Figure 4.16 and Figure 4.17 respectively.



From Figure 4.15, it is clear that, in general, Lake Macquarie City Council imposes lower residential rates than either of the two comparator groups.

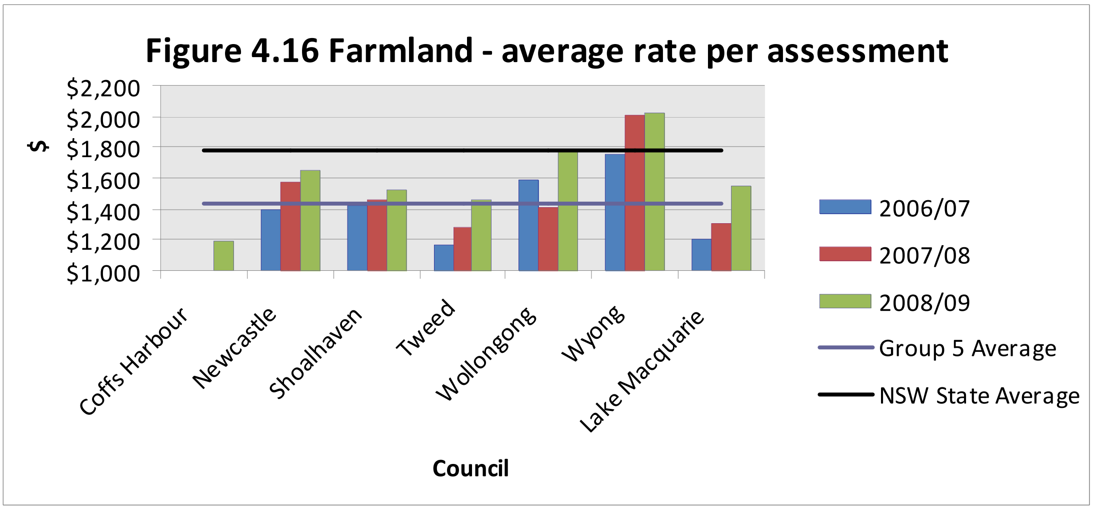


Figure 4.16 shows Lake Macquarie City Council is below both comparator groups for most years.

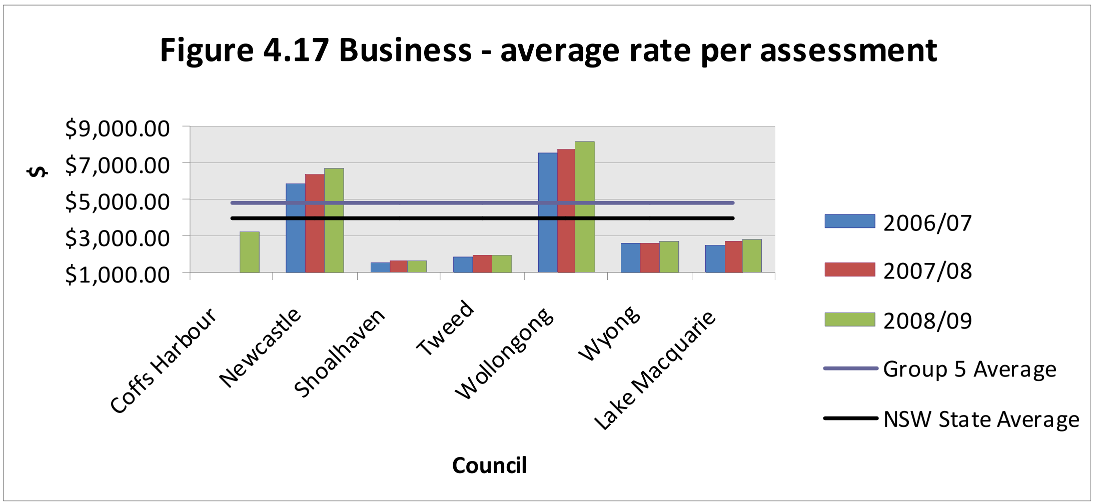
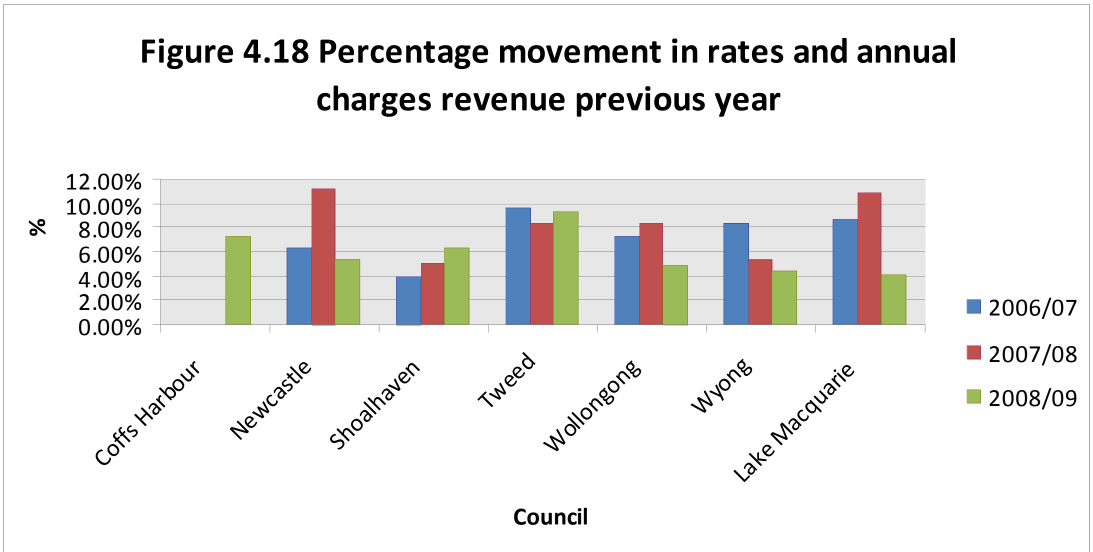
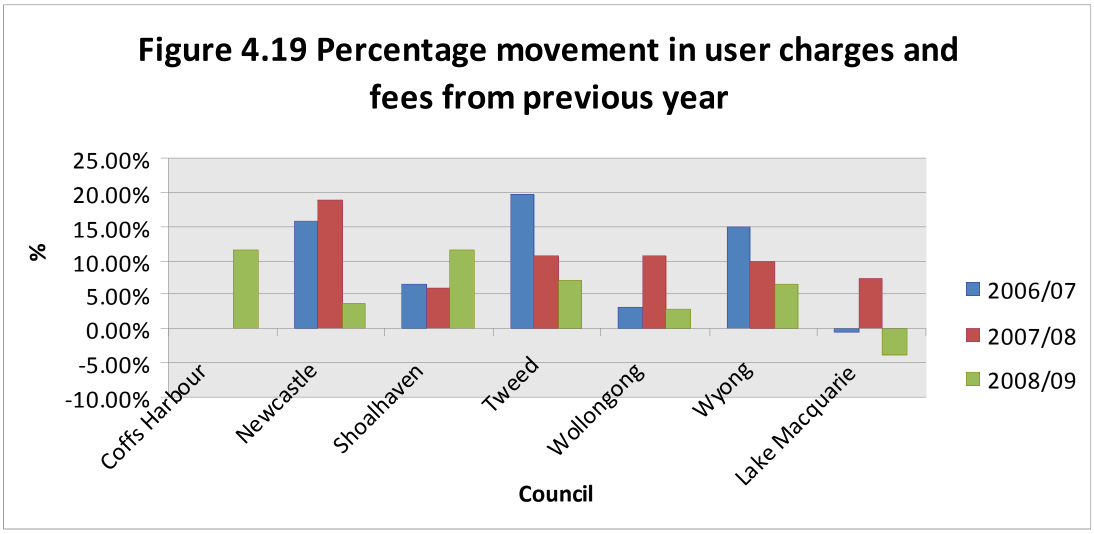


Figure 4.17 again demonstrates the comparatively light rates burden imposed by Lake Macquarie City Council.

Figure 4.18 illustrates trends in rates and attendant annual charges for the seven councils, with Lake Macquarie City Council at the lowest level in 2008/09.



With respect to trends in user charges and fees shown in Figure 4.19, the difference between Lake Macquarie City Council and the other six comparator councils is stark, with Lake Macquarie City Council far lower over the three financial periods under review.



4.4 Concluding Remarks

Set against background information on Lake Macquarie City Council, Chapter 4 has focused on a comparative analysis of the Lake Macquarie City Council relative to other NSW Division of Local Government Category 5 Councils (Coffs Harbour; Newcastle; Shoalhaven; Tweed; and Wollongong), the neighbouring Wyong Shire Council, and the average performance of NSW local councils.

From section 4.2 it was abundantly evident that Lake Macquarie City Council represented a very large council in terms of population size according to both NSW and broader Australian standards, although the Lake Macquarie City Council organisation itself was comparatively modest in terms of FTE employment, given the large population it had to serve.

Section 4.3 examined Lake Macquarie City Council in relative perspective in order draw at least some conclusions about its comparative performance. The analysis conducted in section 4.3 established five main findings:

- From the perspective of relative size, with its total population a little under 200,000 as at mid-2008, Lake Macquarie City Council is the second largest municipality among its six comparator councils, below Wollongong, but far above Newcastle. However, with respect to FTE employment Lake Macquarie City Council falls below

Newcastle, Wollongong and Wyong, despite its proportionately greater population. We can thus draw the general conclusion, other factors remaining constant, that Lake Macquarie City Council is comparatively more efficient in its use of labour relative to the comparator councils.

- From a revenue perspective, three different measures of income demonstrated that Lake Macquarie City Council collected less revenue per capita than any of the other six councils, particularly compared with Wollongong and Newcastle, where the difference was marked. It can thus be concluded that Lake Macquarie City Council imposes a proportionately lighter financial burden on its residents.

- From a cost perspective, the analysis demonstrated that Lake Macquarie City Council spending far less relative to the other six councils. It can thus be concluded that, other factors being equal, Lake Macquarie City Council is more efficient than the comparator councils
- From the perspective of rates imposed on local communities, it was demonstrated that residential rates, farmland rates and business rates per assessment were comparatively light in the Lake Macquarie City Council jurisdictional area. It can thus be concluded that Lake Macquarie City Council imposed a lower rates burden on its local community.

- Finally, from the perspective of trends in rates and attendant annual charges, as well as trends in user charges and fees, the rates of increase were lower in the Lake Macquarie City Council jurisdictional area. It can thus be concluded that Lake Macquarie City Council imposed a lower escalations in rates, attendant annual charges, user charges and fees, than its comparator councils on its local community.

CHAPTER 5: CONCLUSION

Chapter 5: Conclusion

This independent Report has pursued three main objectives:

1. To consider the conceptual and empirical literature on local government amalgamation, including the findings of a host of recent public inquiries into local government, in order to determine whether it offers promise to the Hunter councils.

Chapter 2 addressed this question was tackled in detail. Chapter 2 considered various conceptual and empirical dimensions of amalgamation in local government using both Australian and international academic literature, as well as the findings of 8 separate public inquiries into local government, which dealt with council mergers as an instrument to enhance the operation of local government.

The high degree of consensus in this material was striking. Almost all writers concluded that local government amalgamation not only seldom achieved cost savings and efficiency gains, but that it typically absorbed a much greater magnitude of resources than had been anticipated. Moreover, in social and political terms compulsory consolidation was invariably accompanied by bitter and divisive controversy. Moreover, amalgamation seldom addressed the root causes of local government inadequacy. However, although unanimity existed that 'bigger was not necessarily better or cheaper' for the vast majority of local authorities, some contributors to the literature on council amalgamation did conclude that for small regional and remote councils, consolidation served to increase the administrative and technical capacity of amalgamated entities.

Chapter 2 demonstrated that the eight Australian public inquiries into local government which did consider amalgamation found that alternative models of council cooperation should be pursued in preference to council mergers. For example, the national PriceWaterhouseCooper study (2006) established that efficiency, effectiveness and scale could best be improved through regional service provision, shared service arrangements, outsourcing, and state-wide purchasing initiatives, rather than by means of council mergers.

2. To consider the nature, causes and solutions to the problem of financial sustainability in Australian local government as established in the spate of a host of recent public inquiries into local government financial sustainability.

At the national level, Chapter 3 consulted the PriceWaterhouseCooper (PWC) (2006) *National Financial Sustainability Study of Local Government*, as well as Productivity Commission (PC) (2008) *Assessing Local Government Revenue Raising Capacity.* At the state level, Chapter 3 considered the South Australian Financial Sustainability Review Board's (FSRB) (2005) *Rising to the Challenge* Report, the Financial Sustainability of NSW Local Government ('Allan Report') (2006) *Are Councils Sustainable*, the Western Australian Local Government Association (WALGA) (2006) *Systemic Sustainability Study*, the Local Government Association of Tasmania (LGAT) (2007) *Review of the Financial Sustainability of Local Government in Tasmania*, and the Queensland Treasury Corporation (QTC) (2008) *Financial Sustainability in Queensland Local Government.*

A common theme ran through all the public inquiries reports considered in Chapter 3: All state and territory local government systems have experienced fiscal distress and this has resulted in ongoing financial unsustainability, together with a large and growing local infrastructure backlog. In addition, financial stress differed by type of council, with the problem most acute in rural and remote councils.

All of the reports examined in Chapter 3 advanced recommendations for improving financial sustainability in local government, ranging from changes to Commonwealth government financial relations with local government to enhanced financial governance by council management. However, all inquiries agreed on the need for improved asset and financial management, common approaches to asset depreciation, and uniform financial practice and record-keeping across state jurisdictions.

Chapter 3 drew four lessons from the public inquiries on financial sustainability in local government:

- Financial sustainability cannot be defined with precision and thus cannot be captured adequately through using financial KPIs. This means that other measures are needed to augment accounting measures, including public opinion surveys of the local communities. For example, a council may be sustainable if its local community is content with its performance.

- Data deficiencies meant that financial KPIs ratios are only at best broadly indicative of the actual financial situation facing individual councils.
- Due care should be taken to determine the predictive capacity of KPIs. Thus, to what extent do a particular set of KPIs have predicted past good, bad, or indifferent financial performance?

- Immense diversity between councils in any given local government jurisdiction precludes either a 'one-size-fits-all' method of assessing local authorities or a ''one-size-fits-all' approach to ameliorating financial unsustainability, such as forced amalgamation.

3. To consider how Lake Macquarie City Council compares with other NSW councils in its ACLG/NSW category, the neighbouring Wyong Shire Council, and the NSW council average performance.

Chapter 4 provided a comparative analysis of the Lake Macquarie City Council relative to NSW Division of Local Government Category 5 Councils (Coffs Harbour; Lake Macquarie; Newcastle; Shoalhaven; Tweed; and Wollongong) contained in the NSW Division of Local Government's *Comparative Information on NSW Local Government Councils*, the Wyong Shire Council which adjoins Lake Macquarie City Council, and the average performance of all local councils in NSW.
The analysis drew five main conclusions:

- From the perspective of relative population size, Lake Macquarie City Council was the second largest municipality among its six comparator councils, below Wollongong, but far above Newcastle. However, with respect to relative council size - as measured by FTE employment - Lake Macquarie City Council fell below Newcastle, Wollongong and Wyong, despite its proportionately greater population. Other factors remaining constant, Lake Macquarie City Council is comparatively more efficient in its use of labour relative to its comparator councils.

- From a revenue perspective, three different measures of income demonstrated that Lake Macquarie City Council collected less revenue per capita than any of the other six councils, particularly compared with Wollongong and Newcastle, where the difference was marked. Lake Macquarie City Council thus imposed a proportionately lighter financial burden on its residents.

- From a cost perspective, the analysis demonstrated that Lake Macquarie City Council spent far less per capita relative to the other six councils. Other factors being equal, Lake Macquarie City Council is thus more efficient than its comparator councils

- From the perspective of rates imposed on local communities, it was demonstrated that residential rates, farmland rates and business rates per assessment were comparatively lower in the Lake Macquarie City Council jurisdictional area. Lake Macquarie City Council thus imposed a lower rates burden on its community.

- From the perspective of trends in rates and attendant annual charges, user charges and fees, rates of increase were lower in the Lake Macquarie City Council jurisdictional area. Lake Macquarie City

> Council thus imposed lower escalations in rates, attendant annual charges, user charges and fees, than its comparator councils.

In addition to these three major aims of this Report, it is also obliged to briefly consider the implications its findings for any possible proposals to merge Lake Macquarie City Council with neighbouring councils in its broader region. In this respect, this Report has made it clear that structural change programs which simply rely on the blunt instrument of council amalgamation have not only been ineffective in Australian local government, but have also imposed significant economic, political and social costs on the targeted local communities. In the realm of structural change, alternative methods of local government reform involving collaborative voluntary partnerships between councils are much more likely to be effective in securing any scale or scope economies that may be available. This Report is thus unequivocal in recommending against Lake Macquarie City Council participating in any amalgamation plan with other councils, apart from possible minor boundary changes. Rather than involving itself in an amalgamation exercise with adjoining councils in its immediate region, this Report strongly recommends that the Lake Macquarie City Council focus on implementing its Service Review, especially those elements of the Service Review dealing with additional revenue-raising activities.

While financial sustainability is the biggest threat facing Australian local government, especially in NSW local government hampered by rate-pegging, and is most obviously manifest in a large and growing local infrastructure, all evidence points to the fact that amalgamation is not a 'silver bullet' in this regard. Indeed, all eight public inquiries which considered the desirability of amalgamation from the perspective its potential to improve financial sustainability and unanimously found that it had not achieved its intended aims. There is thus no case for amalgamation which can be derived from considerations of financial sustainability.

Finally, the comparative analysis of the Lake Macquarie City Council relative to NSW Category 5 Councils (Coffs Harbour; Lake Macquarie; Newcastle; Shoalhaven; Tweed; and Wollongong), the Wyong Shire Council, and the average performance of all NSW local councils unequivocally demonstrated that Lake Macquarie City Council performed better than its comparator councils on all measures, and in some cases, such as the efficient use of FTE labour, markedly better. There is thus no case based on comparative performance for Lake Macquarie City Council to merge with neighbouring councils. Not only is Lake Macquarie City Council already a very large local government entity, but it has also demonstrated superior performance.

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