

Deloitte Access Economics

Local government structural reform in Tasmania

Property Council of
Australia - Tasmania

August 2011

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Glossary

ACELG	Australian Centre of Excellence for Local Government
FSRB	Financial Sustainability Review Board
LGB	Local Government Board
LGAS	Local Government Areas

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Key findings

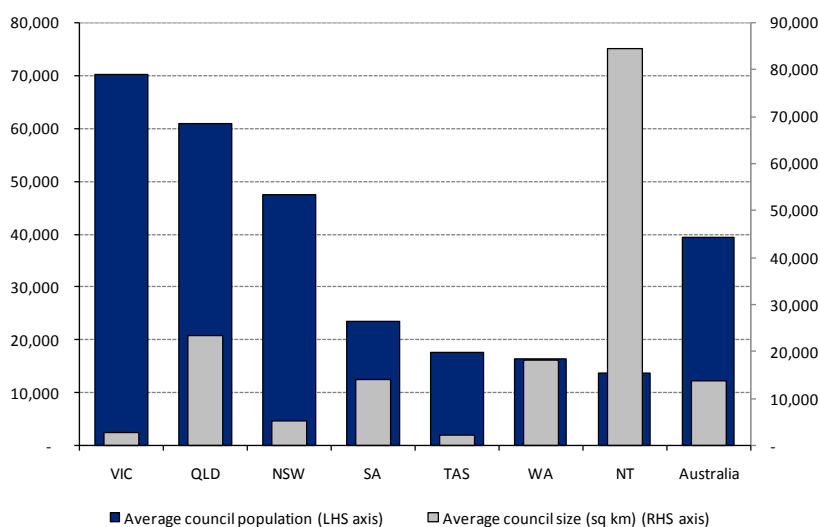
- Structural reform of councils in Tasmania could allow for efficiency gains of up to 35% if appropriately conceived and effectively managed. Past experience in Tasmania and elsewhere in Australia suggests gains of at least 10 and 20%.
- Benefits will be achieved through economies of scale, a broadened scope of operations and improved specialisation, creating potential for enhanced financial sustainability, more efficient governance and greater competency within councils.
- Community benefits will be achieved through a greater capacity to deliver improved and potentially increased service levels to a broader section of the community, while either reducing or slowing the rate of increase of council rates.

Executive Summary

Despite reforms in 1993 which saw the number of councils reduced from 46 to 29, Tasmania has one of the highest rates of local government representation in Australia.

In terms of average council population, Tasmania ranks as the nation's third lowest – only Western Australia (which has committed to structural reform) and the Northern Territory have smaller average populations (Chart i). Tasmania is also the only state or territory where no council has a population greater than 75,000 and this is despite the state's six largest councils accounting for over half (53%) of the State's population. In terms of average geographic size, Tasmania's councils are the nation's smallest (and this is without taking account of the vast mass of land which is state or national park).

Chart i: Average council size by State, June 2010



Source: Australian Bureau of Statistics 2011 and Deloitte Access Economics GIS calculations.

Reflecting these characteristics, and in light of the observed benefits of previous local government structural reform in Tasmania, there is growing interest among business and the community in exploring the merits of further council consolidation. This impetus is further amplified by the challenging economic conditions in the state and the pressing need – both in Tasmania and more broadly – to pursue reform initiatives that enhance productivity.

Why reform local government?

The overarching rationale for local government structural reform lies in the efficiencies that accompany the provision of local government services on a wider scale. These include economies of scale, scope and specialisation. Related to these efficiencies are a range of broader social and economic benefits that derive predominantly from greater competency within councils (i.e. resources can be pooled and shared, leading to more effective local governance and service delivery).

However, efficiencies in, and of themselves, do not provide a robust justification for local government structural reform. Rather, it is the economic and social benefits facilitated by these efficiencies that underwrite the merit of council consolidation. In particular: the capacity to deliver improved service levels or broader service ranges to the community; the ability to reduce council rates (or at least slow the pace of rate inflation); and/or bolster the financial sustainability of councils.

Since the gains of local government structural reform can manifest in a variety of ways, they can consequently be difficult to directly observe, and even more difficult to directly measure. Nevertheless, past reforms demonstrate that there are potentially significant benefits to be achieved from local government structural reform, but – crucially – that the conditions must be appropriate. Ill-conceived or poorly managed structural reform has historically been less likely to deliver identifiable gains.

In this regard, two broad considerations are pertinent:

- Reform design – the configuration of any consolidation proposal must have regard to the nature of local government service delivery; the characteristics of the councils involved; and community concerns.
- Reform implementation – structural reform must be implemented in a way that community support is garnered and maintained, and the appropriate resources, guidance and – where appropriate – governance are provided to councils involved.

Potential impacts of local government structural reform in Tasmania

The characteristics of Tasmania's councils coupled with the experiences of past reforms suggest that, **if well conceived and effectively managed, efficiency gains in the order of 10% to 20% of operating expenses are achievable from local government structural reform in Tasmania.**

However, econometric analysis suggests that the gains could potentially exceed this. Indeed, under a stylised reform scenario modelled in this report, whereby 12 councils in the state's south are consolidated into a single council, the analysis finds that:

- **Efficiency gains of up to 35% could be achieved.**
- **Based on the operating expenses of these councils in 2009-10, a \$110 million annual saving in the aggregate cost of administering local government across these regions could be realised.**

While these figures should be regarded as a hypothetical optimum, they nonetheless illustrate the magnitude of the potential gains which are achievable if the experiences of local government elsewhere in Australia can be effectively translated to the Tasmanian context.

Again, there are a variety of ways in which such gains may materialise and it is not feasible to speculate which of these are more or less likely. Irrespective, the primary beneficiaries are likely to be ratepayers – rate reductions, service quality improvements and enhanced fiscal sustainability all offer long term benefits for the community. When these benefits are overlaid with the potential for enhanced council capability, the opportunities for community gain are heightened. In the event that productivity gains do translate to rates reductions, there is likely to be a positive flow-on to property values and therefore wealth.

Of course these potential benefits are not without their risks. Past experience demonstrates that, if poorly managed, representativeness and responsiveness can be diminished. However, this only serves to underscore the importance of ensuring the design and implementation process is effective.

Concluding remarks

The significant level of local government in Tasmania, coupled with the imperative of continuing to pursue productivity-enhancing microeconomic reform, provides a strong basis for considering further council structural reform in the state.

The preliminary modelling undertaken to inform this report demonstrates that efficiency gains of between 10% and 35% are achievable, depending on the design and management of any reforms. When these gains are overlayed with the potential broader economic and social benefits, a strong case for local government structural reform in Tasmania emerges.

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1 Introduction

The potential economic merit of local council structural reform has been a topic of policy interest for all Australian states at one point or another over the last few decades. In Tasmania, the issue of local government structure has been investigated several times over the last century, with a substantial round of council structural reform in 1993. The 1993 structural reform was found to achieve benefits (Local Government Board 1997) and it has been asserted that there is scope for further benefits to be achieved from another round of council structural reform in Tasmania.

Subsequent to the structural reform conducted in 1993, a review of local government in Tasmania conducted by the Local Government Board (LGB) in 1998, gave a Principal Recommendation for structural reform to reduce the number of councils in Tasmania from 29 to 11, on the basis that this would provide ‘the greatest scope for gains in the efficiency and effectiveness of local government’ (LGB 1998). However, for a variety of reasons, this recommendation was not acted upon.

Relative to other states, Tasmania has a large number of councils for its population, especially when also taking into account its small geographic size. Based on economic theory, there are reasonable grounds to assert that larger councils are able to achieve efficiency gains through economies of scale and/or scope. As most Tasmanian councils have a small population size when compared with the Australian average, there would appear to be significant potential for such economic benefits to arise from a move towards a structure of local government with fewer, larger councils. In addition, broader economic benefits may also result from improved capacity of councils and a simpler administrative interface with the Federal and Tasmanian Governments.

Despite the prospect of further benefits from council structural reform, the structural reform agenda has failed to re-gain momentum in Tasmania over the last decade. While there are a number of factors at play, the lack of traction is at least partly due to the fact that a compelling case for change has not been demonstrated. That is, the benefits of further structural reform and, the conditions under which this will be achieved, have not been clearly articulated.

In light of this, Deloitte Access Economics has been engaged by Property Council of Australia (Tasmanian Division) to examine the case for, and potential benefits from, further local government structural reform in Tasmania.

Scope and approach

The analysis contained in this report forms the first step in articulating the economic merits of further local government structural reform in Tasmania. As such, it is a relatively high level analysis that draws on the findings of a stylised case study of potential efficiency gains that may be achieved through the formation of a ‘Southern’ council, as well as canvassing potential wider social and economic impacts.

The analysis of potential efficiency gains examines, first of all, the evidence for efficiency dividends of councils operating at a larger scale, as well as the potential magnitude of these efficiency dividends. It then extrapolates these findings to a stylistic quantification of potential benefits from the formation of a 'Southern' council. The potential broader economic benefits which may arise through the improved capacity and effectiveness of councils are discussed at a qualitative level.

It is important to note that the potential economic benefits canvassed in this analysis cannot be assumed to be decisive outcomes, as many factors are at play that may influence their realisation. Factors that are found to facilitate the success of a reform process, and hence, the achievement of desired economic benefits, are also examined in this analysis.

Our analysis has been conducted purely through desktop research by examining the existing literature and by analysing publicly available data pertaining to local government in Tasmania and in other states. A more detailed study might also draw on consultations with councils and other stakeholders, as well as seeking additional data directly from councils.

Report overview

This report is structured as follows:

- Chapter 2 provides an overview of Tasmania's economy, Tasmania's local councils and how they compare with other States, plus a brief history of local government structural reform.
- Chapter 3 provides an overview of the theoretical rationale for structural reform, as well as empirical evidence relating to the impacts of reform.
- Chapter 4 describes our methodological approach to modelling potential benefits and the findings of that empirical modelling.
- Chapter 5 outlines the broader economic benefits of structural reform, including the potential for improved capacity and effectiveness.
- Chapter 6 canvasses factors critical to the success of local council structural reform.

2 Background

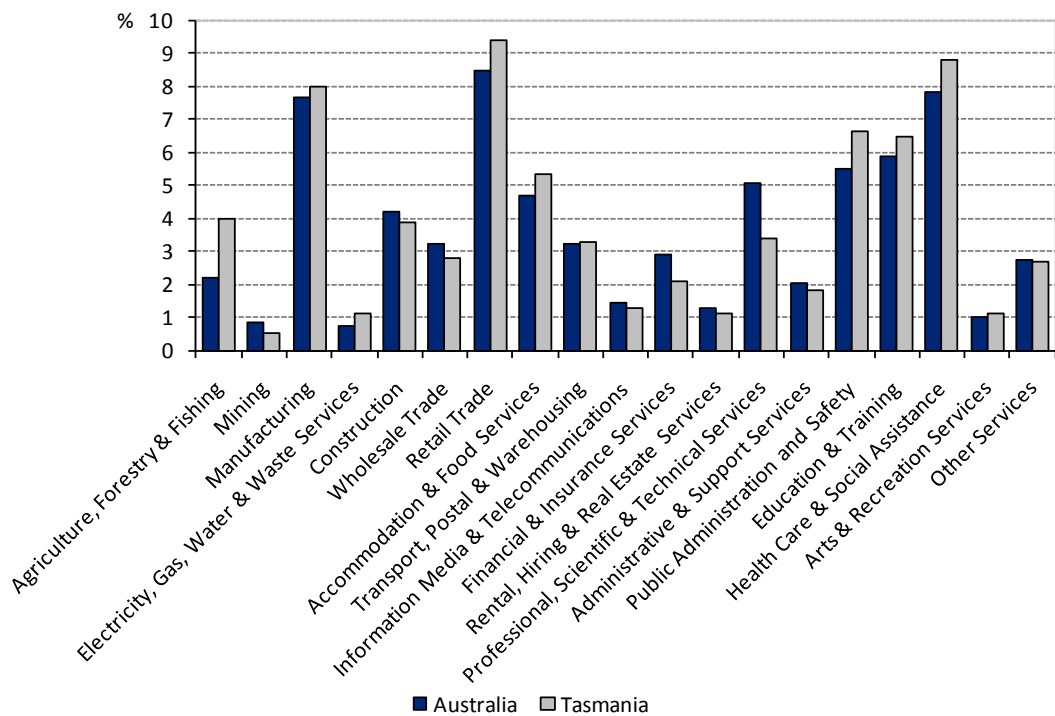
As a precursor to the analysis presented in latter sections of this report, this chapter describes the characteristics of Tasmania’s councils, compared with local government in other parts of Australia, and overviews the relevant historical context – both in Tasmania and nationally.

2.1 The economic context

In broad terms, the profile of employment by industry in Tasmania is similar to that of the nation (refer to Chart 2.1). However, there are also some notable differences. In particular:

- The proportion of workers employed in the Agriculture, Forestry and Fishing sector is nearly twice the national average;
- Employment is also above average in Retail Trade; Accommodation and Food Services (both of which indicate a strong tourism sector); Public Administration; Education and Training; and Health Care and Social Assistance;
- Conversely, employment in Professional, Scientific and Technical Services; Mining and Financial Services is significantly below the national average.

Chart 2.1: Employment by industry (% total); Tasmania and Australia



Source: Deloitte Access Economics based on Australian Bureau of Statistics labour force data

Economic performance

As Deloitte Access Economics' recently released *Business Outlook* reports, the Tasmanian economy has performed relatively well over the past decade, maintaining a steady share of Australia's economy, despite the strength of the resource-rich states.

Yet the short term outlook is a challenging one. With the Australian dollar at a post-float high, Tasmania's manufacturers and exporters are struggling, and some of them are shedding jobs as a result. With interest rates also high – and likely to go higher still – private consumption has slowed markedly. Indeed, trend retail sales have been falling for more than 12 months.

Tasmania's challenges reflect, among other things, the lack of any significant minerals sector – which will be the chief driver of investment and Australia's continuing economic recovery over the next year or so. The appetite for new investment in Tasmania is at present low, and this is reflected in the data.

Compounding these challenges are the state's demographic trends. Population growth in Tasmania is slowing and is projected to average a mere 0.5% over the next decade (compared to the national average of 1.5% – Table 2.1). At the same time, workforce participation remains considerably below the national average (around 5 percentage points lower) and the state's workforce is ageing (with many on the cusp of retirement). Reflecting these trends, the state's age dependency ratio (population aged 65 and over as a proportion of those aged 15-64) is also considerably below the national average. Collectively, these factors suggest a growth outlook which is modest, at best.

Table 2.1: Key economic indicators, 2009-10

	Tasmania	Australia
GSP	\$22.3b	-
<i>GSP as a share of Australian output</i>	1.7%	-
<i>GSP growth (forecast 5 yr ave)</i>	2.1%	3.2%
Population	506,000	-
<i>State population as a share of Australia</i>	2.3%	-
<i>Population growth (forecast 5 yr ave)</i>	0.5%	1.5%
Labour force participation	60.7%	65.3%
Unemployment	5.7%	5.5%
Average weekly earnings	\$795	\$961
Age dependency ratio	24%	19.8%
(65+ as a % of 15 to 64)		

Source: Deloitte Access Economics

Like Victoria and South Australia, Tasmania has outperformed the national average in housing over the past decade. However, this too is now slowing, amid falling population growth, higher interest rates and constrained household finances. Yet the drops in leading indicators, while continuing, are very modest, leaving them at around the average level seen over the past decade and well ahead of the results of the 1990s. With less under

building over recent years, there may be little increase in local construction, even as the national pace picks up.

Engineering work is not typically a big driver of activity in Tasmania and commencements have dipped of late, suggesting that may be even more true in the short term. Indeed, the modest pipeline of construction is a key reason why overall economic growth is weak. A \$190 million Brighton/Pontville bypass is underway in the state's south. A new \$79 million Brighton transport hub (incorporating both road and rail elements) is due to be completed in early 2012, while Metals X is planning to spend \$53 million developing the Retails tin mine south of Burnie. However, there are signs that business confidence is unstable. For example, it is expected that the joint venture between Hydro Tasmania and China Light and Power to build a \$425 million, 56-turbine wind farm in Little Musselroe Bay, which was a significant component of Tasmania's construction pipeline, will be dissolved.

The level of Tasmania's commercial approvals bounced back in late 2010, but still fell overall for the year compared to the levels seen in 2009. Projects under construction are led by the \$565 million redevelopment of the Royal Hobart Hospital, which will remain underway until 2016, while smaller projects are also underway, including the \$76 million construction of 30 child and family centres around the state. Work on a new \$30 million high school at Kingston has been completed.

2.1.2 Public policy implications

Much of the strength and resilience of the Australian economy over the last two decades can be attributed to the microeconomic reform of the latter part of the 20th century; in particular, the 1980s. However, throughout the period since 2000, the rate of microeconomic reform has slowed markedly – despite calls for its acceleration from a range of policy and political leaders.

Looking forward, the Australian economy faces significant challenges over the coming decades, challenges which are particularly pronounced in Tasmania. Successive inter-generational reports released by the Australian Treasury have highlighted the economic pressures that the demographic ageing of Australia's population will create for the Australian economy, as the proportion of Australians outside the workforce grows. As the discussion above notes, the age dependency ratio in Tasmania is already significantly above the national average and the projected population growth rate significantly below.

These challenges are likely to be compounded by pressure – and potentially policy intervention – to reduce greenhouse gas emissions and the increasingly competitive nature of the global environment in which Australia operates.

If Australia is to continue to enjoy increasing levels of economic prosperity, in the face of the significant economic challenges that the future holds, identifying and initiating productivity-enhancing microeconomic reform will be paramount. Well conceived and effectively executed local government structural reform has a modest, but important contribution to make to this reform agenda.

2.2 Local government in Tasmania

There are currently 29 councils in Tasmania, 27 of which are located on mainland Tasmania and the remaining two being King Island and Flinders Island. According to Australian Standard Geographic Classification, six Tasmanian councils are classified as city councils, while the remainder are municipalities (see Table 2.2).

Further, the six largest councils represent over half (53%) of the State's population, while the remaining 23 councils encompass 47% of the State's population. Along with the municipalities of Brighton and Kingborough, the six city councils have the highest population densities of all councils in Tasmania and are centred around Hobart in the South and Burnie, Devonport and Launceston in the North, as shown in Table 2.2 and Figure 2.1.

Table 2.2: Overview of Tasmanian council characteristics, 2010

Council	City / Municipality	Population	Land area (sq-km)	Pop. density (pers./sq-km)	Total roads (km)
Break O'Day	Municipality	6,410	3,521	1.8	547
Brighton	Municipality	15,807	171	92.4	171
Burnie	City	19,877	610	32.6	346
Central Coast	Municipality	21,732	931	23.3	663
Central Highlands	Municipality	2,324	7,976	0.3	752
Circular Head	Municipality	8,300	4,891	1.7	769
Clarence	City	52,140	377	138.3	456
Derwent Valley	Municipality	10,036	4,104	2.4	330
Devonport	City	25,518	111	229.9	249
Dorset	Municipality	7,377	3,223	2.3	739
Flinders	Municipality	897	1,994	0.4	385
George Town	Municipality	6,830	653	10.5	273
Glamorgan Spring Bay	Municipality	4,500	2,522	1.8	354
Glenorchy	City	44,628	120	371.9	311
Hobart	City	49,887	78	641.2	312
Huon Valley	Municipality	15,134	5,498	2.8	775
Kentish	Municipality	6,281	1,155	5.4	443
King Island	Municipality	1,700	1,094	1.6	436
Kingborough	Municipality	33,464	719	46.5	534
Latrobe	Municipality	9,616	600	16.0	286
Launceston	City	65,548	1,411	46.5	732
Meander Valley	Municipality	19,547	3,320	5.9	846
Northern Midlands	Municipality	12,602	5,126	2.5	982
Sorell	Municipality	13,127	583	22.5	396
Southern Midlands	Municipality	6,054	2,611	2.3	803
Tasman	Municipality	2,374	659	3.6	257
Waratah-Wynyard	Municipality	14,117	3,526	4.0	529
West Coast	Municipality	5,242	9,575	0.5	195
West Tamar	Municipality	22,223	690	32.2	454

Source: Australian Bureau of Statistics 2011 and State Grants Commission 2010.

Councils in Tasmania range in population size from 897 in the municipality of Flinders, to 65,548 in the city of Launceston. In geographic size, they vary from 78 km² in the city of Hobart and 9,575 km² in the municipality of West Coast. In spite of its large geographic

size, the West Coast municipality has the second smallest total kilometres of roads (195 kms) of any council in Tasmania, due to its very low population density, relative geographic isolation and significant mass of National Park.

In comparison, the Northern Midlands municipality has the highest total road kilometres in the state, which at 982 kms is nearly six times the total length of roads in West Coast municipality.

Figure 2.1: Tasmania’s local government areas



Source: State Grants Commission (2010)

Compared with other states and territories, Tasmania has a relatively small population and a relatively small number of local government areas (LGAs)¹ - only the Northern Territory ranks lower against these two metrics (see Table 2.3). While other states have LGAs with a smaller population than Tasmania's smallest council, these are typically in remote areas with low population densities. Moreover, Tasmania's largest council is smaller than the largest councils of all other states and the Northern Territory.

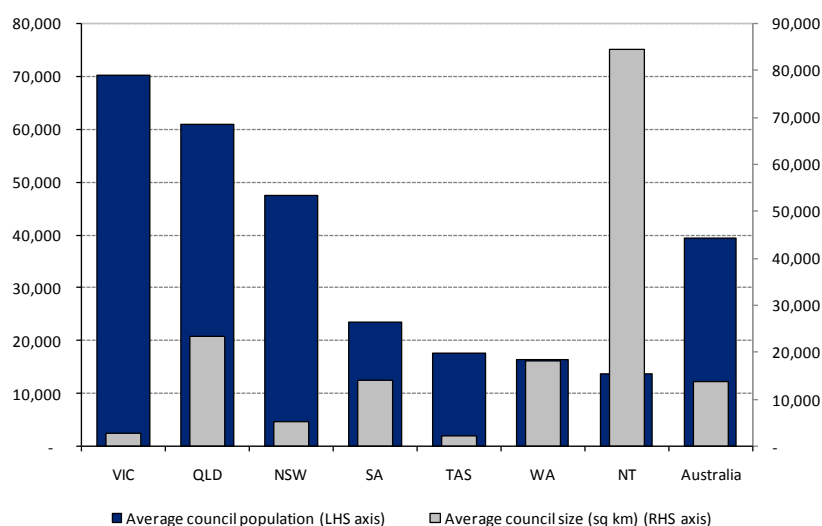
Table 2.3: Council size statistics by state, June 2010

State	Total number of councils	State/Territory population	Smallest council population	Largest council population
NSW	152	7,232,589	1,261	307,816
VIC	79	5,545,932	3,314	255,659
QLD	74	4,513,850	267	1,067,279
WA	139	2,293,510	112	202,014
SA	70	1,644,582	110	162,925
TAS	29	507,643	900	65,826
NT	16	229,711	209	77,290

Source: Australian Bureau of Statistics 2011

Furthermore, as Chart 2.2 shows, only Western Australia and the Northern Territory have a smaller average council size than Tasmania. In light of this, it is worth noting that Western Australia is currently in the process of reviewing its local government structure with a view to achieving significant reform. After this is complete, the average population of Western Australian councils is likely to increase.

Chart 2.2: Average council size by state, June 2010



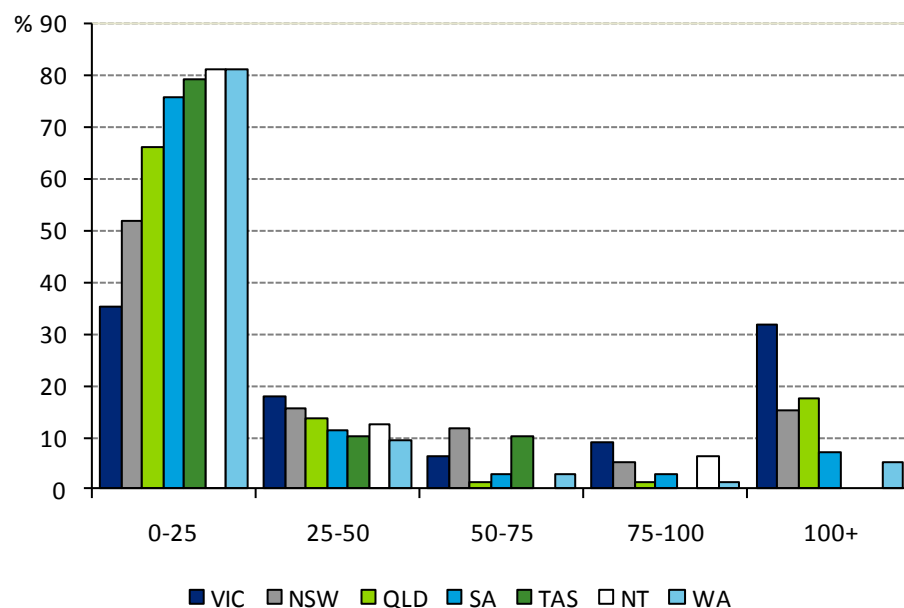
Source: Australian Bureau of Statistics 2011 and Deloitte Access Economics GIS calculations.

¹ The term LGA reflects the Australian Standard Geographical Classification level relating to local councils, which may also be referred to as local governments.

The Northern Territory completed significant reforms in 1998, moving from a system comprised of 61 community and municipal councils to 16 municipal and shire councils. Nevertheless, the average population of councils in the Northern Territory is still the lowest in Australia, which reflects the fact that it has a small population overall spread over a large geographic area, making it difficult to achieve a high average population size. Hence, it also has by far the largest average council size in geographic terms (see Chart 2.2).

Similar trends are reflected in the size profile of councils across the different states and the Northern Territory, as shown in Chart 2.3. The majority of councils in all states (except Victoria) have a population of less than 25,000. This majority is particularly significant for Tasmania which, at 79%, is broadly on par with the Northern Territory and Western Australia. However, Tasmania differs from the other states in that it has no councils that might be considered ‘large’. Indeed, **Tasmania is the only state which has no council with a population of 75,000 or more.**

Chart 2.3: Council population size profile by state, June 2010



Source: Australian Bureau of Statistics 2011, Deloitte Access Economics calculations.

Note: X-axis values refer to council population size (thousand persons).

2.2.2 The impetus for further reform

In 1997, the Tasmanian Local Government Board conducted a review of local government structure in the state. The Review found that considerable benefits were achieved by the 1993 council reforms, but that additional reforms would achieve further benefits, especially given that the 1993 reforms focused on small rural councils. The restructuring of urban centres was expected to deliver major improvements.

The Board’s primary recommendation was that the number of councils in Tasmania should be reduced from 29 to 11, with nine mainland Tasmanian councils while keeping the King and Flinders Island councils in their current form. The proposed restructure included

significant structural reform in the Greater Hobart region, including the division of existing council boundaries.

The Board's analysis was based on public submissions, public hearings and specially-commissioned research projects. Further rounds of public submissions in response to the exposure draft report were subsequently incorporated into the final report. The Board found that (Local Government Board 1997: 3):

the financial benefits from the proposed reduction in the number of councils will be widespread and will directly benefit the vast majority of residents and businesses.

Under the Board's proposed restructure, the smallest council in mainland Tasmania would have a population of 17,500 and the largest would have a population of 152,000. Furthermore, the average population for mainland Tasmanian councils would be 50,000. To put this in perspective, the population of the smallest mainland council (Central Highlands) is currently 2,300; the population of the largest council (Launceston) is currently 65,800 and the average population is 18,700.

The particular model proposed by the Board for the restructure of the Greater Hobart councils, which included dividing some existing councils between the proposed new councils, generated significant response from the councils in question. The Board was asked by the Minister for Local Government to reconsider the proposed structure in light of submissions she had received from councils, including the results of elector polls and resident surveys conducted by those councils. In a Reconsideration of the Final Draft, the Board put forward two further options for the structuring of a Greater Hobart council, but noted that the original option was still the preferred.

The Reconsideration of the Final Draft was adopted by the Government and Elections Regulations were introduced to regulate the conduct of elections in order to implement the structural reforms. The Minister for Local Government issued an Order for elections to proceed. However, the validity of the Regulations and the Order was challenged, at the instigation of several councils, in the Supreme Court of Tasmania. The Court held that the Order was not authorised by the Local Government Act and that the elections could not proceed.²

Implementation of the reform proposals did not proceed.

² *Devonport City Council, Central Highlands Council and Southern Midlands Council v Farrell, David (Chief Electoral Officer) [1998] TASSC 92 (3 August 1998)*

3 Local government structural reform: rationale and experience

There is a body of research which examines the economics of local government structural reform – both at a theoretical and empirical level. In addition, the experiences of other jurisdictions provide insights – at a practical level – to the impacts (positive and negative) of structural reform. This section summarises these streams of research.

3.1 The theoretical rationale

Theoretical arguments for local government amalgamation are generally mounted on the basis of economies of scale; scope; and specialisation.

Economies of scale refer to conditions under which an increase in output (the quantity of goods and services produced) results in a reduction in per unit costs. These conditions arise where the production of goods or services includes large fixed costs, so that as output increases, the unit costs decline, as the fixed costs of production are spread over a larger base.

In the case of local government, the level of production can generally be proxied by resident population. However, it must be noted that this is not always a perfect proxy for the level of council services provided. In particular, for those councils covering the CBD area of capital cities, the mix of services delivered may differ markedly from other councils. In a similar vein, Dollery et al (2008) argue that councils' level of production will also be affected by their 'non-discretionary' environment, their service quality and inter-council variation in service provision. Nevertheless, in most cases, the size of the population serviced by a council will be the most important determinant of their level of services provided, making it a meaningful proxy in an analysis of this nature.

Local councils provide a basket of services, ranging from direct services such as roads, stormwater drainage and waste collection to more abstract services, such as local democracy. In the case of the direct services, the degree to which they are characterised by economies of scale varies. The primary source of this variation is the extent to which costs of provision are fixed. Services which are characterised by significant fixed costs offer greater opportunities for economies of scale.

Examples of local government services that are likely to be subject to scale efficiencies include governance, general administration and to a lesser degree recreation and culture. In principle, as local government gets larger, the fixed costs of providing these services are spread over a large population, lowering the average unit cost of production. Conversely, activities where economies of scale are unlikely are those where the quantity of service to be provided increases broadly in line with the population being serviced – areas such as provision and maintenance of the local road and footpath network.

However, even where the propensity for economies of scale is high, it is likely that such efficiency gains will only be achieved up to a certain threshold. Beyond this point, the returns to increasing scale are likely to be constant; or even diminishing (that is, unit cost may actually increase as scale expands). The current literature casts only limited light on this issue. Certainly, the concept of ‘optimal council size’ (i.e. the size at which unit costs are minimised) is widely canvassed however, there are relatively few robust estimates (refer to Section 4.3.2 for a more extensive discussion).

As suggested by the Local Government Board (1997), when considering council structure, a balance must be achieved between efficiency (which tends to be done better in larger councils) and effectiveness (which tends to be done better in smaller councils). As such, it is important to consider both the size threshold for efficiency gains as well as how council size and structure impacts upon those services in councils’ baskets of goods that may not be subject to economies of scale.

Economies of scope are achieved where the delivery of more than one type of good or service by a single organisation delivers a lower average cost of production than if those services were provided by separate organisations. This generally results where complementary production processes are combined into a single entity.

As applied to the concept of council structural reform, this may be achieved through an expansion of service delivery when two councils amalgamate. Gains of this nature are likely to be particularly pronounced in the case of small councils with low levels of resources, where the breadth of services provided is constrained by capacity. In this instance, not only does the volume of activity increase under an amalgamation, but the mix of services provided expands, providing further opportunities for efficiency gains.

The final source of potential efficiency gains is **economies of specialisation**. As the size of organisations grow, so too does their capacity to employ specialised resources and utilise them in undertaking specialised activities. For example, a larger organisation can employ a professional accountant and justify this on commercial grounds; whereas account-keeping responsibilities in a smaller organisation might fall to someone less qualified, who undertakes a variety of tasks. The capacity for specialisation in larger organisations is a further source of potential efficiency gains.

3.1.1 Identifying and gauging the benefits

While the scope for efficiency gains to be achieved can be readily articulated in a theoretical fashion, they are often difficult to identify and measure in practice. The efficiencies gained through scale, scope or specialisation have the capacity to reduce unit costs however, *how* these unit costs savings are utilised, largely determines the extent to which they are observable and measureable.

Ultimately, councils may use these efficiencies for a variety of purposes, including³:

- real reductions in levels of rates and charges;
- improved asset management;
- reduction of debt; or

³ Department of Treasury and Finance, as cited in *Local Government Board Report 1997*

- improvement of services.

Where efficiency gains are utilised to reduce council rates (or at least slow the pace of rate increases), the impacts of reform tend to be considerably more conspicuous than when, for example, they are utilised to improve service quality. In any case, the myriad of factors which impact on council revenues, expenses, service levels and performance mean that disentangling and measuring the impacts of reform can often be challenging.

3.2 Evidence from past structural reforms

There is a growing literature reviewing previous experiences of structural reform or other empirical evidence relating council size to economies of scale. This literature presents mixed evidence as to the extent of these efficiencies. Many sources support the argument for efficiencies associated with council size, while other sources cast considerable doubt over their existence. Much of the literature is based on reviews of other work or, at best, on largely qualitative evidence obtained through consultations with councils and other stakeholders.

3.2.1 The general academic literature

The most prolific source of Australian academic work in the area of council structural reform is the Centre for Local Government at the University of New England and particularly work by Dollery (and colleagues). This sub-set of the literature focuses on reviewing the arguments for council structural reform in Australia - particularly in the context of New South Wales – generally basing their findings on previous studies and analyses. For example, Tiley and Dollery (2010a, 2010b and 2010c) have published a series of papers on the history of Australian council structural reform.

On the issue of economies of scale, Byrnes and Dollery (2002) find that the evidence from Australia is ‘mixed’. Furthermore, Sancton (2000) argues that, from an international perspective, there is no optimal size for local government at all. In contrast to this proposition, a report by Dr Bruce Felmingham for Clarence City Council (cited in Local Government Board 1997: 19) reviewed the existing literature at the time and found that constant returns to scale may be expected for urban councils with a population between 50,000 and 90,000. He also notes that these efficiencies may be difficult to detect as cost savings, as they may be absorbed by spending on additional services.

A recent report by the Australian Centre of Excellence for Local Government (ACELG) undertakes a rigorous review of the literature, finding that the consensus supports the view that benefits will arise from council consolidation or collaboration. A few of the major findings of this report include (Aulich et al 2011):

- Benefits of some sort generally accrue when councils adopt mechanisms to collaborate or consolidate with other local authorities.
- There is little evidence that structural reform will automatically yield economies of scale, although the capacity to achieve economies of scope is more obvious.
- Efficiency gains typically transpire as enhanced strategic capacity or in new services and approaches to service delivery, than through headline cost savings or reduced property

rates. Enhanced strategic capacity is most likely as the result of consolidation of councils into relatively large units.

- Concerns for any diminution of local democracy were muted.

This literature more strongly supports the argument that there may be *economies of scope* as a result of council structural reform. As Dollery and Fleming (2006) note, economies of scale and economies of scope exist independently; so even if economies of scale do not exist, economies of scope may still exist. Dollery and Crase (2004) argue that ‘where economic benefits do stem from amalgamation, these are probably due to scope economies and enhanced local government capacity’ (Dollery and Crase 2004: 22) but the authors also note that there is a paucity of research in this area.

Dollery (1997) also surveys the extensive council structural reform that has previously taken place in Canada, New Zealand, the United Kingdom and the United States. He finds that the evidence on structural reform in Canada, New Zealand and the United Kingdom provides very little indication as to whether small or large local governments are more efficient in service delivery. Indeed, he finds that extensive evidence on the United States indicates that small councils are in fact more efficient than large councils in service delivery, signifying the existence of diseconomies of scale. However, care needs to be taken when considering the findings of research based on international examples, as local governments abroad often have broader responsibilities than those in Australia. Hence, comparability of outcomes and the transferability of conclusions is often limited.

Dollery and Grant (2009) explore an alternative arrangement to council structural reform that may also deliver desired efficiencies. They argue that improved service provision and cost savings can result from shared service arrangements between local governments. Furthermore, Dollery and Johnson (2005) contend that local government efficiency may be enhanced using such arrangements. However, previous analysis by the Tasmanian Local Government Board (1997) found that resource sharing arrangements have delivered mixed results in a Tasmanian context - that is, they have only sometimes been successful in reducing costs. The Board concluded that resource sharing arrangements do not represent a robust alternative to the restructuring of boundaries. Similarly, the Western Australian Local Government Steering Committee (Department of Local Government 2010) finds that the increase of regional groups in that State has resulted in ‘increased system complexity, added costs and created duplication with limited outcomes’.

3.2.2 State-specific research and reviews

Several rounds of council structural reform have occurred in most states over the last two decades, with the most recent reforms being in Queensland and the Northern Territory, both of which took place in 2008. A process of reform is also underway in Western Australia at present, where no wide-scale reforms have occurred for at least a century.

Table 3.1 gives an overview of recent council structural reform in all states (except Western Australia) and the Northern Territory. Most of these reform processes have published research regarding the impacts of structural reform; however in most instances, this has occurred prior to the structural reform taking place. The remainder of this chapter summarises the findings of this research, highlighting the major impacts which have been identified and relevant lessons and learnings.

Table 3.1: Overview of most recent council structural reform

State	Year	Description
New South Wales	2003	The number of councils was reduced from 172 to 152 under voluntary boundary reforms.
Victoria	1994	The number of councils was reduced from 210 to 78 under compulsory boundary reforms.
Queensland	2008	The number of councils was reduced from 157 to 73 under compulsory structural reform.
South Australia	1998	The number of councils was reduced from 118 to 68 under voluntary structural reform.
Tasmania	1993	The number of councils was reduced from 46 to 29 under compulsory structural reform.
Northern Territory	2008	The number of councils was reduced from 61 to 16 under compulsory structural reform.

Source: Department of Regional Development (2008) and State Government of South Australia (2008)

3.2.2.2 The South Australian experience

South Australia undertook significant council structural reform in 1998. Subsequently, the *Local Government Boundary Reform Board January 1996 – September 1998 Report* (State Government of South Australia 1998) was published, outlining the extent to which objectives had been achieved as well as further opportunities for reform. Based on estimates provided by the councils involved, this report found that cost savings had been achieved. These were estimated to be:

- recurrent savings, conservatively estimated at \$19.4 million each year, and
- one-off savings of \$3.9 million.

In addition to these cost savings, it was also found that the capacity of councils had been improved, chiefly through:

- Additional capacity for improved and consistent planning decisions;
- Greater resource bases for amalgamated councils; and
- Additional capacity for local government to improve the range and quality of its services and to participate in the development of SA's economy (particularly regional areas).

Dollery (2009) has subsequently called these savings estimates into question, citing analysis undertaken by the Financial Sustainability Review Board (FSRB), specifically the FSRB's point that 'whether the on-going savings have in fact continued is a moot point' (FSRB 2005, cited in Dollery 2009: 6). In the lack of any further empirical research that specifically focuses on the outcomes of council structural reform in South Australia, it is difficult to reach a conclusion either way.

On the question of further opportunities for reform, an independent report was commissioned by the Local Government Boundary Reform Board which estimated possible savings of \$22.1 million in annual operational costs from further reforms. However, there is a strong caveat that these are speculative, rather than definitive, and would depend upon precise reform options and how councils opt to use efficiency benefits.

3.2.2.3 Research from Western Australia

In recent years, the Western Australian government has been building the case for structural reform of its local councils, with specific reference to reducing the number of Western Australian councils to fewer than 100 (from the current number of 139). The most recent report on the matter (Department of Local Government 2010a), noted that the reform process is expected to deliver community benefits of better services, reduced bureaucracy and cost savings. Furthermore, reform is intended to address the following critical capacity issues (Department of Local Government 2010a):

- a lack of strategic and community planning;
- a lack of adequate financial planning and asset management; and
- a fragmented and inconsistent approach to planning and business procedures.

A previous report by the Local Government Advisory Board (2006) and another report by the Department of Local Government (2010b) look specifically at previous examples of council structural reform in Western Australia. They put forward a number of case studies that represent examples of successful council consolidation in a Western Australian context. These case studies and their headline achievements are summarised below (Local Government Advisory Board 2006 and Department of Local Government 2010b):

- Kalgoorlie-Boulder: resulted in uniformity of treatment of the whole city and better enabled major infrastructure to be developed for the community (i.e. increased capacity).
- City of Albany: able to reduce its 'inside' workforce by 20% and also to employ further in specialist roles (i.e. cost savings and efficiencies of specialisation).
- Geraldton-Greenough: achieved capacity expansion through the incorporation of key functions lacking in previous entities and additional resources to areas previously under-resourced (i.e. economies of scope).
- The Town and Shire of Northam: achieved more efficient processes, increased capacity and rationalisation of administrative buildings. An ongoing annual saving of \$422,256 was achieved through increased efficiencies in organisational processes and councillor related expenses (i.e. economies of scale).

However, it should also be noted that there is a concern that when small regional councils are consolidated, the resulting larger council will centralise services in its main town, at the expense of smaller towns (Local Government Advisory Board 2006). This is an example of the trade-off or balance that must be considered between achieving efficiency in the delivery of certain services provided in a council's basket of goods, with effectiveness in other aspects of a council's service delivery.

3.2.2.4 Recent reform in Queensland

Queensland underwent significant council reform in 2008. The case for this reform process was made on the grounds that echo many of the previous arguments for council structural reform in relation to efficiency and capacity. The Local Government Reform Commission (2007) put forward that councils must be of a sufficient size and scale to:

- 'remove inefficiencies resulting from duplication and sub-optimal use of assets'
- enable growth of knowledge, development of capacity and fostering of innovation; and

- to provide effective political leadership to, and advocacy for, communities facing fast-paced change.’

While significant consolidation was recommended, from 157 councils to 73 overall, there were notable exceptions to the structural reform process. These included:

- large western councils, as structural reform was not expected to deliver efficiency benefits; and
- the amalgamation of Aboriginal council with mainstream councils, due to the unique features of the former.

Following the reform process in Queensland, a review into the costs of structural reform for 24 councils involved in the reform process was conducted by Queensland Treasury Corporation (2009). This report concluded that there is an expected short-term net cost for each of the amalgamated councils that generally ranges between \$0.15 million and \$4.27 million over the years 2007-08 to 2011-12. One exception was Cairns Regional Council, which reported an expected net benefit of \$2.5 million over the same period.

Without follow-up empirical analysis, it is difficult to predict the actual short-term financial impact of the reform process in Queensland, let alone whether reform has improved (or generated capacity to progressively improve) the long-term financial position of the councils involved. However, this report does point to the importance of addressing issues such as the management of the costs of structural reform as well as the importance of supporting councils through the management of the reform process.

3.2.2.5 The Northern Territory’s grounds for structural reform

The recent council reform process in the Northern Territory resulted in significant structural reform. It moved the Northern Territory from a system based on a mixture of 61 local government and community councils and where some communities had no local government or services, to a system of 16 local governments covering all communities. While this reform process was somewhat different from council reform processes in other states, due to the Northern Territory’s unique local government system in place prior to the restructure, the arguments for reform were similar to those we are familiar with from economic theory and from other states.

Primarily, the agenda for reform was based on the fact that most councils in the Northern Territory were too small to meet their communities’ needs. For example, (Department of Local Government, Housing and Sport 2007):

- half of the councils were too small to pay for services that communities should expect to receive;
- many councils were too small to attract experienced senior staff and staff turnover was the highest in the country with a significant cost for ongoing recruitment; and
- about half of councils were financially unstable or at high risk.

The Department of Local Government, Housing and Sport (2007) noted that all new councils would be expected to achieve the following:

- the delivery of a set of services; including roads, waste and management, and parks and reserves;

- the scale to negotiate with the Territory or Federal Governments on behalf of their communities; and
- the ability to apply for grant money where previously this was not possible.

In the case of the Northern Territory council reforms, it appears as though improved efficiency was a key factor in the decision for consolidation, as many previous councils were too small to provide even a basic level of service. While the same efficiency argument is unlikely to be applicable to the same extent in other states, it does support the view that scale efficiencies are important in local government. Other familiar arguments are also touched upon in this example, such as the ability of scale to deliver increased capacity; in this case through either the ability to hire experienced senior staff or to negotiate with higher levels of government.

3.2.2.6 The Tasmanian case for reform

The 1997 Local Government Board report presents the most recent piece of research relating to council structural reform in a Tasmanian context. It touches upon issues of efficiency and benefits of structural reform through both its own research, as well as independent research commissioned by the Board.

For example, one of the independent pieces of research, by the Australian Centre for Quality Management & Organisational Research (1997), conducted its own interview, focus group and survey-based research into the outcomes of council structural reform in Victoria, South Australia and Tasmania. This paper finds that there are significant improvements in terms of efficiency and effectiveness as a result of structural reforms and canvasses some of the resulting quantifiable outcomes (see Table 3.2 for an overview).

These findings are based on interviews with key individuals; they cannot be taken to be statistically significant or even a representative of the general experience resulting from council structural reform. However, they do provide examples of the kinds of measurable benefits that may be achieved.

Table 3.2: Example benefits achieved through prior council structural reform

Examples of savings	Examples of rate cuts	Examples of staff redundancies	Examples of regional development
\$400,000 savings on garbage contract from \$1 million contract, with improved services	20% rate cut, equivalent to \$6 million/year	440 down to 250 (FTE)	Secured \$16 million grant funding in 18 months
30% reduction in Parks and Gardens and road contract costs	17% rate cut, plus 3% increase in capital works expenditure	100 down to 32 (sectional)	\$10 million works program creating 950 jobs
\$400,000 savings on a Parks and Gardens contract	16% rate cut	240 down to 120	\$60 million food factory creating 130 jobs
\$1.6 million in recurrent savings	20% rate cut	30% reduction in staff	7% to 8% increase in small business participation in former 'in house' jobs

Savings between 8% and 12% on total non recurrent expenditure		235 down to 22 (Community Development)	
Reduced operating expenses of \$1.2 million		21 down to 6 garbage staff	

Source: Australian Centre for Quality Management and Organisational Research 1997.

As part of the Local Government Board's broader report, research was conducted by the Department of Treasury and Finance into the financial implications of proposed structural reforms. Upon reflection of the evidence, the Department's modelling includes the assumption that cost savings will be achieved in general administration costs and capital expenditure (as certain assets are reduced).

However, the report notes specifically that expenditure on roads and bridges is an area of council spending that will not achieve savings under a larger council structure due to the close relationship between population and such expenditure. Hence, expenditure on roads and bridges was not included in the modelling. The report also notes that the modelling does not include potential savings in expenditure on public order and safety, nor does it include savings as a result of efficiency and productivity improvements. However, on the other side of the ledger, neither does the modelling include the short-term costs of structural reform, that may result from relocation of staff and changes to databases and computer systems.

More recently, Waratah Wynyard Council and Burnie City Council commissioned KPMG to undertake financial modelling of a potential consolidation of the two councils. It was found that consolidation would save approximately \$1.6 million per annum in operating costs, relative to the business as usual case (KPMG 2002).

3.2.1 Summary of estimated savings

A limited number of studies provide a quantitative estimate of the scale or degree of savings associated with council structural reform. As shown in Table 3.3, these estimates are sometimes provided as part of an evaluation post-structural reform among councils, or they are estimates based on scenarios of potential council reform. Each metric listed in Table 3.3 has its own specific context and caveats, making its applicability to a broader context difficult. Nevertheless, the range of values canvassed does provide an understanding of the range of potential savings. On this basis, past reforms indicate efficiency gains in the order of 5-15%.

Table 3.3: Estimates of savings associated with council structural reform

Source	Description of structural reform/analysis	Area of saving	Quantification of saving
Local Government Boundary Reform Board (1998)	Voluntary structural reform of 118 councils to 68 councils in South Australia	Recurrent savings	\$19.4 million (1998 dollars)
		Estimated one-off savings	\$3.9 million (1998 dollars)
Local Government Boundary Reform Board (1998)	Estimation of possible savings from further structural reform in South Australia. Looked only at councils with a population of less than 80,000 in metro areas.	Metro councils – total costs in waste, management, sport & recreation, road maintenance, footway maintenance, stormwater drainage maintenance and road & footpath construction	9%
		Metro councils – per capita development management costs	44%
		Non-metro councils - per capita administration costs	2.5%
		Non-metro councils - per capita development management costs	10%
		Non-metro councils (with population of more than 10,000 prior to structural reform) - total costs in waste, management, sport & recreation, road maintenance, footway maintenance, stormwater drainage maintenance and road & footpath construction	4.5%
		Non-metro councils (with population of less than 10,000 prior to structural reform) - total costs in waste, management, sport & recreation, road maintenance, footway maintenance, stormwater drainage maintenance and road & footpath construction	9%

Department of Local Government (2010)	Voluntary consolidation of Cities of Geraldton and Greenough (new council created 1 July 2007) and voluntary consolidation of the Town and Shire of Northam (new council created 1 July 2007) in Western Australia.	Northam - recurrent saving	\$422,256
KPMG (2002)	Estimation of savings that would result from consolidation of Waratah Wynyard Council and Burnie City Council, both in Tasmania, based on consultation with councils.	Saving on operating expenditure	5%
KPMG analysis, reported in Local Government Board Report (1997)	Estimation of savings achieved from different structural reform options in Tasmania (Southern Tasmania and Greater Hobart reported here)	Southern Tasmania scenario - Works, & Maintenance	9%
		Southern Tasmania scenario - Community & Development	4%
		Southern Tasmania scenario – Administration	45%
		Southern Tasmania scenario – Governance	35%
		Greater Hobart scenario - Works, & Maintenance	8%
		Greater Hobart scenario - Community & Development	5%
		Greater Hobart scenario - Administration	30%
		Greater Hobart scenario - Governance	40%

3.3 Summary of rationale and experiences

There is a strong justification for well conceived local government structural reform on the basis of economic efficiency grounds via the economies of scale, scope and specialisation that are generated from providing local government services at a broader level.

However, the academic research - much of which draws on past experience - is mixed regarding whether tangible gains are achievable. While in many cases the focus of this research is narrow (i.e. a particular region or set of circumstances), it is also hampered by the fact that identifying the gains of reform – given the variety of ways in which the benefits materialise and plethora of factors at play – can be challenging.

Nevertheless, analyses of past structural reform – including reforms of a similar ilk to those previously proposed in Tasmania – suggest that material efficiency gains have been achieved and that in many cases other benefits have been evident.

However, a clear message from this research is that the conditions under which structural reform is conducted (the characteristics of the councils (particularly size and population density) and the structural reform process) are critical to the success of reforms. Poorly conceived or poorly managed structural reforms have been considerably less likely to deliver identifiable economic benefits.

4 Analysing the potential benefits

As Section 2 outlines, compared with Australia more generally, Tasmania's councils are relatively small – both in their population and geographic size. However, while these characteristics highlight significant scope for structural reform, they do not alone demonstrate that benefits would be realised from further structural reform.

In this section, a range of data is drawn on to analyse whether the provision of 'local government services' exhibits economies of scale – both in Tasmania and nationally – and, on the basis of this evidence and the findings presented in Section 3, the likely magnitude of benefits would be potentially be achieved from further structural reform in the State.

4.1 The relationship between size and cost

4.1.1 Tasmania's current councils

On average, per-capita local government expenses in Tasmania were \$1,218 in 2009-10. However, around this average was considerable variation, with per-capita expenses ranging from \$686 in Brighton to \$4,511 in Flinders. While these data clearly demonstrate *some* relationship between council size and per-capita expenses, it is not clear how consistent this relationship is.

Table 4.1: Tasmanian council operating expenses, 2009-10

Council	Operating expenses (\$)	Population	Operating expenses/capita
Break O'Day	11,582,075	6,410	1,807
Brighton	10,846,767	15,807	686
Burnie	33,075,000	19,877	1,664
Central Coast	21,631,140	21,732	995
Central Highlands	9,230,000	2,324	3,972
Circular Head	11,680,077	8,300	1,407
Clarence	50,244,000	52,140	964
Derwent Valley	9,421,000	10,036	939
Devonport	31,771,000	25,518	1,245
Dorset	10,502,000	7,377	1,424
Flinders	4,046,284	897	4,511
George Town	8,723,293	6,830	1,277
Glamorgan Spring Bay	8,490,000	4,500	1,887
Glenorchy	53,949,000	44,628	1,209
Hobart	94,368,000	49,887	1,892
Huon Valley	19,047,156	15,134	1,259
Kentish	7,412,000	6,281	1,180

King Island	5,616,138	1,700	3,304
Kingborough	31,806,000	33,464	950
Latrobe	8,993,906	9,616	935
Launceston	76,759,706	65,548	1,171
Meander Valley	15,204,864	19,547	778
Northern Midlands	14,948,404	12,602	1,186
Sorell	12,858,102	13,127	980
Southern Midlands	8,131,000	6,054	1,343
Tasman	4,701,000	2,374	1,980
Waratah-Wynyard	11,770,024	14,117	834
West Coast	9,112,726	5,242	1,738
West Tamar	17,286,000	22,223	778

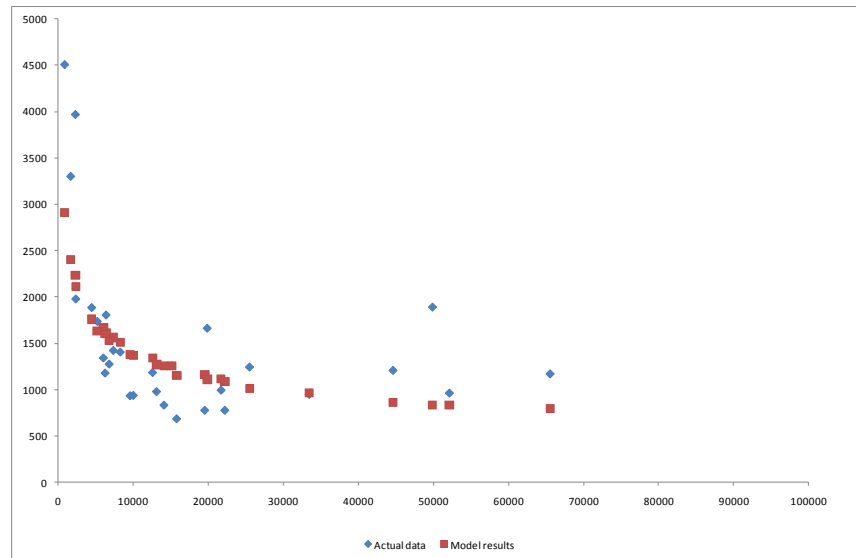
Source: Compiled from Tasmanian council Financial Statements, Australian Bureau of Statistics 2011

In order to examine the nature of the correlation between council size and per-capita expenses, a range of econometric analyses were conducted. Taking the data presented in Table 4.1, and combining it with the (i) total road kilometres in each LGA; (ii) rural/metropolitan; and (iii) the proportion of expenses which are roads/non-roads, a series of econometric regressions were undertaken. Details in relation to the techniques which were employed can be found at Appendix B.

The findings of the analysis suggest that the provision of local government services in Tasmania exhibits economies of scale. That is, **per-capita operating expenses are lower in larger councils**. The magnitude of this relationship is expressed via the elasticity of per-capita operating expenses with respect to population size. The results from the modelling indicate that **as the population of a local government area increases by 1%, per-capita operating expenses fall by 0.31%**.

While this provides insight into the potential gains from further structural reform, the relatively small maximum existing council size, and limited number of relatively large councils, limits insights that can be drawn from this analysis (and confidence limits associated with them). For example, it does not reveal whether further economies of scale would continue to be generated for council sizes much larger than those of existing 'large' Tasmanian councils.

Chart 4.1: The relationship between operating expenses and council population; Tasmania



Source: Deloitte Access Economics

Naturally, an exercise of this nature is not without its limitations. While the econometric models are deemed a relatively good fit and the results indicate relatively high explanatory power (refer to Appendix B), there are, nonetheless, some significant areas of uncertainty. In particular, the quantity of output (services per capita) and the quality of council services cannot be directly controlled for. While the variables included in this analysis (metro/rural; road expenditure; road kilometres) go some way in this regard, there is nevertheless some variation which is not accounted for. As such, this evidence should be considered robust, but not definitive – there may be some factors that have not been accounted for.

4.1.2 National overview

Across Australia, the average operating expenses of local governments ranges from \$15.6m in the Northern Territory to \$118m in Queensland. Tasmania sits at the lower end of this spectrum, with an average of \$21m.

Perhaps more instructively, average operating expenses per capita vary from \$1,360 (Victoria) to \$7,561 (Queensland). Again, Tasmania – at \$1,527 per capita – is at the lower end. Despite the small average size, average per-capita expenses by councils in Tasmania are relatively low. While an in-depth analysis of the factors underlying this finding has not been conducted, it likely reflects a variety of factors that impact on operating costs – perhaps most significantly, differences in wage and salary costs (which account for a significant proportion (in the order of 30-40%) of council budgets),.

Table 4.2: Council operating expenses summary statistics, 2008-09⁴

State	Average operating expenses (\$)	Average operating expenses/capita (\$)	Minimum operating expenses/capita (\$)	Maximum operating expenses/capita (\$)
NSW	47,728,420	1,614	553	6,797
VIC	69,242,330	1,360	626	3,423
QLD	117,578,329	7,561	816	71,535
WA	18,464,379	3,163	525	23,632
SA	22,808,845	1,628	576	7,181
TAS	21,145,057	1,527	686	4,511
NT	15,597,686	1,978	330	4,387

Source: Australian Bureau of Statistics (2011), Department of Premier & Cabinet (2009), Department of Premier & Cabinet (2010), Department of Planning and Community Development (2009), Department of Local Government and Planning (2009), Department of Local Government and Planning (2009), Western Australia Local Government Association (2011), Western Australia Local Government Association (2010), South Australia Grants Commission (2009), compiled from Tasmanian council financial statements, Northern Territory Grants Commission (2010), Northern Territory Grants Commission (2009).⁵

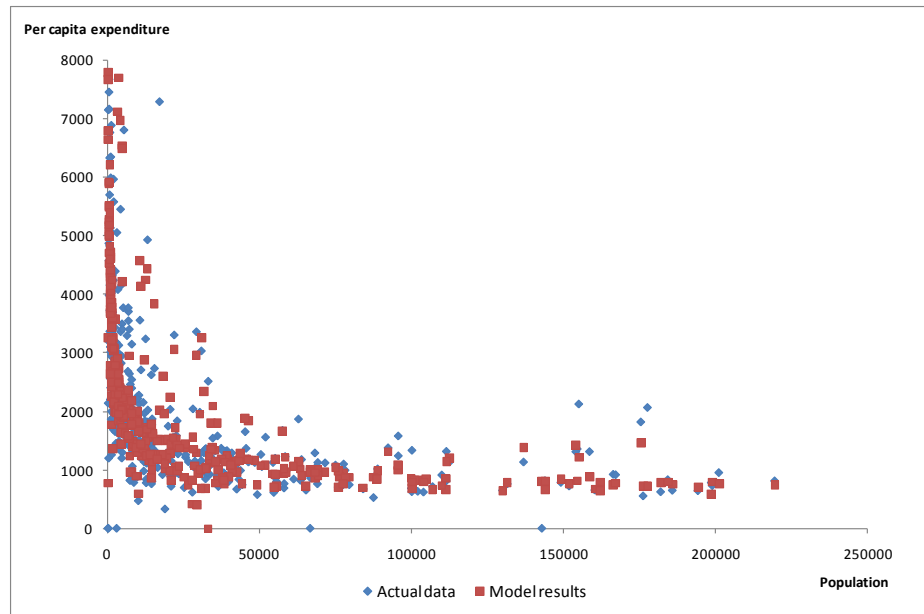
Average operating expenses/capita are broadly consistent across all states and the Northern Territory, with the exception of Queensland and Western Australia. In these two states, the relatively high average operating expenses/capita reflect a number of outliers in each state. These outliers are typically regional councils with very small populations and relatively high operating expenses. For example, when five councils with per-capita operating expenses of \$30,000 and above are excluded from the analysis, the average per capita expenditure is \$4,281. It may be that these high operating expenses reflect State or Commonwealth grants used by those councils to provide additional services that are typically provided elsewhere by other spheres of government, such as works on 'main roads'.

When the same econometric techniques which were applied to the Tasmanian data are applied to a national data set, the results are highly instructive. Indeed, the modelling suggests that when all of Australia's local governments are taken into account, there is clear evidence of economies of scale. The Australia-wide analysis suggests that **a 1% increase in LGA size (measured in terms of resident population) is associated with a 0.34% decrease in per-capita operating expenses**. It finds that this relationship is broadly constant across councils up to the size of around 100,000 people (refer to Chart 4.2, below).

Beyond this size, returns to scale are broadly constant. That is, per-capita expenditure remains largely unchanged. Notably, it does not increase; therefore, there is no evidence that, beyond a certain size, the provision of council services exhibit diseconomies of scale.

⁴ All data for the financial year 2008-09, except for Tasmania operating expenses data which is taken from 2009-10

⁵ Due to a lack of consistent reporting standards across the States, care should be taken when comparing these figure across States. In an effort to improve consistency, costs relating to water and sewerage have not been included in operating expenses for councils in NSW and Queensland, in order to ensure comparability with the other States where these services are not provided by councils. It should also be noted that data was not available for all councils in Queensland, so the figures presented here represent only 57 of Queensland's 74 councils.

Chart 4.2: The relationship between operating expenses and council population; Australia

Source: Deloitte Access Economics

4.2 Where are the benefits of structural reform likely to lie?

The analysis presented above highlights that per-capita operating expenses are, on average, lower in larger councils. However, as the discussion in Section 2 underscores, local governments provide a basket of services and functions and the extent to which these functions exhibit economies of scale (and hence, potential for benefits from structural reform) will vary. To reiterate, the more significant fixed costs are (as a proportion of total cost), the greater the economies of scale.

In a high-level analysis of this nature, identifying the extent of economies of scale with precision is limited by the detail in the available data. Greater rigour could be achieved with more granular information. Nevertheless, the data disaggregation which is currently available based on public data sources provides a sound basis for exploring how economies of scale are likely to vary across council functions.

Table 4.3 shows a breakdown of operating expenditure, by council function, for all Tasmanian councils. It also outlines Deloitte Access Economics' broad assessment of the potential for economies of scale in each major function. Naturally, an exercise of this nature is imprecise. It is not intended as a definitive assessment, but rather an illustration, based on professional expertise and the experiences relayed in Section 3.

A detailed overview of the areas of expected savings, as canvassed in the literature is provided in Appendix A.

Evidently, on the basis of this assessment, **more than half of council expenditure is likely to be subject to economies of scale of reasonable magnitude (i.e. at least low to moderate)**. Indeed, only roads expenditure is nominated as an area where the scope for economies of scale will be modest. Consistent with past studies (and indeed the econometrics conducted in this report) roads expenditure is deemed predominantly related to the length of the roads network and only weakly associated with council size.

The area of council expenditure where the potential savings are likely to be greatest is general administration. While this expenditure category is broad ranging, part of this will encompass reduced salary costs of elected members and senior administrators. As it stands, Tasmania has 29 Councils and 281 elected members. It is estimated that in 2009-10 \$5.3 million was paid in allowances to Mayors, Deputy Mayors and Councillors. In addition, a further \$780,000 was estimated to have been paid in expenses to elected members. Based on current arrangements, this figure is likely to rise in 2010-11 commensurate with increases in allowances that came into effect in November 2010.

Table 4.3: Tasmanian council expenditure by purpose⁶

Purpose of expenditure	Proportion of total expenditure (%)	Potential for economies	Approximate scale of saving (%)
General Administration	18	High	30 to 45
Education Health Housing and Welfare	5	Low	5 to 10
Law Order and Public Safety	1	Low - Moderate	5 to 30
Planning and Community Amenities	9	Low – Moderate	5 to 30
Waste Management and the Environment	13	Low – Moderate	5 to 30
Recreation and Culture	16	Low – Moderate	5 to 30
Other non-roads	7	Unknown	n/a
Roads	31	Low	5 to 10

Source: State Grants Commission (2010), Deloitte Access Economics calculations

The findings outlined in the literature, as summarised in Table 3.3, estimate savings of between 5 and 45% in certain areas of council expenditure. However, these occur under a variety of different circumstances and estimates are derived under a range of qualifications. Furthermore, estimates of savings based on total expenditure are rare.

Nevertheless, the findings of these reviews, together with the current structure and characteristics of councils in Tasmania, suggest that the gains from local government structural reform in the state are likely to be at the upper end of those observed in previous studies. With these considerations in mind, it is concluded based on past experiences that **efficiency gains in the order of 10% to 20% are potentially achievable from effective local government structural reform in Tasmania.**

⁶ Based on State Grants Commission state average expenditure per person.

4.3 Modelling a reform scenario

In light of the analysis presented in Section 4.1 above, this section draws on econometric analysis to provide an alternative assessment of the benefits that could potentially be achieved from further structural reform in Tasmania. More specifically, it draws on a stylised example whereby 12 adjoining councils are amalgamated into a single ‘Southern Council’ to illustrate the magnitude of the potential efficiency gains.

4.3.1 ‘Southern Council’

As the data in Table 4.4 demonstrates, a hypothetical ‘Southern Council’ would see the consolidation of 12 councils into a single council with a population of 250,000, aggregate operating expenditure (excluding efficiency gains) of \$313 million and operating expenditure per capita (excluding efficiency gains) of \$1,255.

Table 4.4: Characteristics of ‘Southern’ councils

Current council name	Population	Operating expenditure	Operating expenditure/capita
Brighton	15,807	10,846,767	686.2
Central Highlands	2,324	9,230,000	3,971.6
Clarence	52,140	50,244,000	963.6
Derwent Valley	10,036	9,421,000	938.7
Glamorgan-Spring Bay	4,500	8,490,000	1,886.7
Glenorchy	44,628	53,949,000	1,208.9
Hobart	49,887	94,368,000	1,891.6
Huon Valley	15,134	19,047,156	1,258.6
Kingborough	33,464	31,806,000	950.5
Sorell	13,127	12,858,102	979.5
Southern Midlands	6,054	8,131,000	1,343.1
Tasman	2,374	4,701,000	1,980.2
Total	249,475	313,192,025	1,255.0

Source: State Grants Commission (2010), Deloitte Access Economics calculations

4.3.2 Modelling results

To estimate the efficiency gains that would potentially be achieved under a ‘Southern Council’ reform scenario, the econometric parameters presented in Section 4.1.2 are applied to the 12 councils outlined in Table 4.4.

On this basis, **it is estimated that combining these 12 councils into a single local government would yield an efficiency gain of up to 35% - or, based on current figures, a saving of up to \$110 million.** Significantly, the modelling suggests that these gains would be primarily achieved up to a population size of 120,000; beyond this, the returns to scale a minimal (but equally, there is no evidence of ‘diseconomies of scale’).

To the extent that these savings translate into rates reductions – and noting that they are likely to manifest in a variety of forms – there may be flow-on benefits to the broader economy. While local government rates are among the most efficient forms of taxation, like virtually all taxes they nevertheless undermine economic efficiency to some degree. Hence, rates reductions would yield broader macroeconomic efficiency gains – albeit modest ones. To the extent that a reduction in local government rates increases the expected net return on investment in property, there may be upward movement in land prices (see Box 2, below).

Box 2: Potential impacts on property prices

In simple terms, the value of a property asset reflects the present value of its future net earnings. Hence, a reduction in costs (through a reduction in rates) would lead to a higher present value of net earnings and, all else equal, an increase in the capital value of the property. Accordingly, property values and therefore wealth would increase in council areas that pass on productivity gains to a reduction in rates.

Take, for example, a commercial office building with council rates of \$200,000 per annum and a capitalisation rate of 10. In the case that efficiency savings of 10% are achieved and *fully passed on to rates*, a saving of \$20,000 per annum would be generated. This would increase the capital value of the property in question by \$200,000 (a 1% increase in the underlying value; assuming an underlying value of \$20m). If efficiency gains of 20% were achieved and *fully passed on to rates*, this would generate a saving of \$40,000 per annum, increasing capital value of the property by \$400,000 or 2%.

However, certain factors may moderate this potential impact. For example, there may be market rigidities that limit the extent to which changes to future earnings streams are reflected in prices. Furthermore, particularly in the case of the residential market, it is not clear that investors always act rationally – that is, prices in residential property markets are not driven solely by expected future earnings.

As noted above, these results – by their stylised nature – should be considered an initial assessment of the potential benefits of structural reform in Tasmania. While the econometric analysis underpinning the findings is considered robust, there are, nevertheless, a range of simplifying assumptions that have been made (refer to Appendix B for greater detail in this regard). Moreover, the economic benefits of structural reform hinge heavily on the precise design specifications; hence a more detailed modelling exercise should be conducted should reform deliberations be further advanced.

5 Broader economic and social impacts

As well as providing evidence into the efficiency gains generated by local government structural reform, past experiences, and the reports that have documented these, provide insights into some of the broader economic and social impacts of structural reform. On this basis, the discussion in this section outlines a range of broader impacts – beyond merely operating cost savings – which can potentially materialise from local government structural reform. These impacts are described below under five broad headings: (i) capacity and capability; (ii) fiscal management; (iii) coordination benefits; (iv) impacts on representation and responsiveness.

5.1 Capacity and capability

Many of the roles and responsibilities of local government – both those involving direct service provision to residents and ratepayers, such as town planning and regulatory and community services, and internal support services such as infrastructure asset management and local governance – are highly specialised. However, many local governments, particularly in rural areas, face significant challenges in sourcing skilled, qualified resources to administer these functions. Without this in-house expertise, the effectiveness with which councils perform these functions is often diminished.

With increasing rates of retirement stemming from the demographic ageing of Australia's population, and further expected growth in employment opportunities for skilled persons in other areas of the economy, it is likely that smaller and more remote councils, in particular, will face ever increasing challenges in attracting and retaining suitable staff.

The consolidation of local government provides a broader base of expertise upon which to draw. Hence, **one of the benefits consistently identified in reviews of previous structural reform is an improvement in council capacity and capability leading to increased effectiveness in operation.** While in many instances improvements of this nature will manifest in efficiency gains (and thus be captured in the quantitative benefits described above), they may also materialise in improved responsiveness and increased quality of services.

The main beneficiaries of improved capacity and capability within local government are likely to be ratepayers, who benefit from more effective decision making and efficient service provision. However, other groups who transact or otherwise interact with councils are also likely to benefit and the outcomes of previous structural reform support this contention.

For example, investors seeking to undertake a new development potentially benefit from more competent councils who can deal with, and respond to, enquiries and applications in a more effective fashion. Similarly, other spheres of government potentially benefit from interacting with more competent local government, particularly given the interplay in areas

such as planning and land use management. Councils which struggle in these areas place additional demands on other levels of government and government agencies such as dispute resolution bodies.

Box 3: Capability case study – strategic planning

Among the most complex areas of local government administration is strategic planning. Good strategic planning enables an organisation to identify and focus its energies and capabilities on opportunities and activities that best satisfy long-term community welfare.

Strategic planning is particularly important in local government, especially given that, relative to revenue levels, councils are responsible for provision and maintenance of far more long-lived infrastructure than other spheres of government. Decisions in regard to the level and types of infrastructure and related services need to have regard to long-term demographic trends. Larger councils are more likely to be able to generate the capability to undertake more effective strategic planning and therefore be better placed to make proactive rather than reactive decisions, eg regarding asset management.

5.2 Equity and consistency

Present council boundaries may give rise to inequities between ratepayers residing in neighbouring councils with otherwise similar characteristics. Councils based in major centres of population like Hobart, Launceston, Burnie and Devonport, tend to provide a range of services and finance activities from which councils and ratepayers across the wider region may benefit.

Some spillover of services between councils may be inevitable. However, boundaries based on historical structural arrangements that are no longer appropriate can exacerbate these issues. For example, larger councils often tend to provide a broader range and higher level of sporting, recreational and cultural facilities and services than neighbouring smaller councils. They have greater financial capacity and economies of scale to do so but often these facilities and services are also used by ratepayers of other councils, where similar services are not provided.

5.3 Fiscal sustainability

The fiscal sustainability of local government is a policy issue that was examined in the mid-2000s in some detail by local government associations in most states, signifying general concern with the financial position of councils. In Tasmania, a review of the financial sustainability of Tasmanian councils conducted by Access Economics in 2007 found that one in five councils may be financially unsustainable.⁷

⁷ Access Economics (2007) "A review of local government financial sustainability in Tasmania" Report for the Local Government Association of Tasmania

To the extent that council structural reform generates efficiencies and cost savings, they create opportunities for improvements in both balance sheets and long term financial sustainability. However, analyses in relation to these issues provide mixed findings as to the success of previous structural reform in improving financial sustainability.

Where these reports address the issue of council structural reform, they often reach different conclusions regarding its role and significance.

- For example, the Western Australian Local Government Association (2006) noted in their *Systemic Sustainability Study* that financial unsustainability is a structural problem within Western Australia, prevalent among smaller councils and regional councils with declining populations. In the case of regional councils, it was asserted that only limited gains are able to be made through structural reform due to the difficulty of achieving adequate population scale in areas with low population densities, as discussed earlier in the report.
- The *Rising to the Challenge* report (Financial Sustainability Review Board 2005) in South Australia found examples of high financial risk amongst both large and small councils and suggested that structural reform does not, of itself, address the problems impacting on council finances. Instead, strengthened policy frameworks and improved financial governance are essential for bettering the financial sustainability of local government.
- In response to the *Size, Shape, Sustainability* report, the Local Government Association of Queensland (LGAQ 2005) suggested four options for change, including resource sharing arrangements, voluntary boundary change or voluntary structural reform.
- The *National Financial Sustainability Study* (PWC 2006), which canvassed a range of findings from the state reports as well as data obtained from various State Grants Commission, concurs that the picture of what drives financial sustainability is mixed. It notes that the South Australian *Rising to the Challenge* report indicates that policy and skills are important, while other states' evidence indicates scale, and implicitly size, assist in improving sustainability.

Local factors may explain these mixed findings regarding the relationship between local government financial sustainability and structural reform. In states other than South Australia at the time of the financial sustainability inquiries, the needs for, and merits of, structural reform were topical. It is understandable that structural reform was identified as a factor worthy of consideration. South Australia had been through significant structural reform with little interest in further structural reform at the time. The way to improve financial sustainability therefore focussed on improving financial governance and expertise. Structural reform can help bring these things about.

5.4 Strategic coordination

Larger councils also provide greater opportunities for strategic coordination and for the realisation of the wider economic gains that potentially stem from this. This could include activity to promote local economic development by encouraging new businesses and development and better supporting existing businesses.

In relation to tourism marketing, for example, coordination across regions allows for a more consistent and more integrated campaign to be executed. Resources can be pooled, and

the strengths of the broader region can be promoted in a complementary fashion. While these benefits are realisable without structural reform (i.e. there are regional tourism marketing authorities), they are likely to be greater or more readily realised when the coordination occurs within a single entity (or involves fewer entities).

The benefits of coordination may also manifest in relation to investment attraction and facilitation. As indicated by the discussion in Section 2.1, Tasmania struggles to attract business development and investment. Again, the capacity to put forward a compelling case regarding the opportunities of the region is enhanced when there is a single authority of responsibility. Investors and businesses operating across multiple regions may also benefit from structural reform as a result of harmonised regulation and a single point of contact.

Box 4: The COAG reform agenda

The need for strategic planning of Australia's capital cities has been recently acknowledged by the Council of Australian Governments (COAG)'s Reform Council and the Major Cities Unit of Infrastructure Australia, with the development of nine criteria for the future strategic planning of capital cities.

In light of this approach of high level strategic planning, structural reform of councils in the Greater Hobart area may help to drive an innovative strategy for Hobart's development, through increased coordination and capacity.

5.5 Impacts on representation and responsiveness

Past structural reform has raised concerns regarding reduced responsiveness to local needs. However, this is largely a design issue – it must be kept particularly mindful of in rural areas – and an operating issue (one which can be managed).

Structural reform can dilute local representation and opposition to structural reform can arise because of community concerns that they may result in elected representation outcomes that is not balanced and reflective of the diverse localities and community character that may exist within an area proposed for structural reform.

There are mechanisms that can be utilised to mitigate these concerns. For example ward electoral boundaries could be established that ensure balanced representation from different parts of the new council's area. Effective community engagement is not though just dependent on elected representation. Other strategies tailored to local circumstances need also to be considered (local forums and surveys, area meetings, community newsletters, website content and features etc) to ensure a strong degree of connectedness between disparate localities and communities and a new, larger amalgamated council.

This is not to say that risks in these areas are not real; but rather that they can be effectively mitigated through utilisation of appropriate strategies and mechanisms.

6 Ensuring successful implementation

The potential benefits from structural reform canvassed in the preceding sections of this report are just that: *potential*. As the experiences outlined in Section 3 demonstrate, the success of previous structural reform processes has been mixed. Evidently, the design of any structural reform and the management of the implementation process are critical to success.

Drawing on the findings of past structural reform as well as the data and analysis collated to inform other sections of this report, this chapter outlines some of the factors most critical to successful local government structural reform – that is, critical to translating potential gains into actual benefits.

6.1 Factors critical to successful design

6.1.1 Justifying the case for change

The case for structural reform of councils must be put to councils and the public in a manner that clearly articulates its objectives and expected outcomes. In turn, the objectives must be well researched and must justify structural reform, in light of a balanced view of the expected outcomes. The analysis contained in this report is a valuable first step in this regard. The objectives should also reflect factors important to the users of council services (that is, ratepayers) and should be cognisant of local considerations. For example, many ratepayers may find arguments in favour of better services more appealing than reductions in council rates. As such, the design of objectives might consider the polling of community opinion on these issues.

6.1.2 Optimising the reform parameters

The design of structural reform must optimise configuration of council boundaries, based on an understanding of the conditions under which efficiency and other desired gains will be maximised. Some of the conditions influencing such outcomes, have been highlighted by previous discussions in this report. Broadly these include:

- population size;
- geographic area;
- remoteness;
- existing council boundaries;
- communities of interest; and
- economic characteristics.

This design process should be conducted by an independent body, at arm's length from the relevant State Government. The process should be consultative with local government. The trade-offs between different desired outcomes must be recognised and balanced with accommodating community concerns; as no reform process will be successful without at least moderate community support.

6.1.3 Compulsory or voluntary?

A major issue for consideration in the successful design of structural reform is whether consolidation is compulsory or voluntary. Some Australian states have embarked on voluntary programs of local government consolidation and others have implemented compulsory arrangements. (In practice there have been ‘shades of gray’ within these alternative approaches. For example, compulsory amalgamations have often had regard to suggestions and considerations raised by councils and their communities. Similarly the comprehensive level of amalgamations in South Australia occurred within a framework that threatened compulsory amalgamations if desired objectives were not met voluntarily).

Both alternatives have their advantages and disadvantages, but, ultimately, large scale reform is difficult to achieve on a purely voluntary basis. Whatever the preferred approach, the process requires extensive engagement with and between councils.

As found by ACELG in their review of the literature on this issue, potential benefits are reduced or lost when the process is flawed due to inadequate planning and consultation or a failure to consider all the options available. (Aulich et al 2001: 7) Hence, resources need to be provided to investigate various boundary change options and their implications and to facilitate local community engagement and support. Conditions may need to be imposed with a degree of oversight to ensure that any specified objectives from structural reform (e.g. regarding service levels or efficiency gains) are, to the fullest extent possible, realised in practice.

6.2 Factors critical to successful implementation

While the motivation for, and design of, local government structural reform is a prerequisite to its success, effective management of the implementation process is equally imperative. Sufficient resources must be invested to underwrite the reform process, both during the initial stages and over the longer term. This includes resources for supporting councils as well strategies for continuing to maintain community support.

6.2.1 Council support

As noted elsewhere in this report, local governments face significant challenges in attracting and retaining a high calibre workforce, with the broad range of skills and capabilities required to administer local government. While structural reform is likely to, at least, partially overcome these issues (refer to the discussion in Section 5), it is nonetheless likely that amalgamated councils will in many cases lack the knowledge and expertise to manage the implementation process in the most effective fashion.

Therefore, there is an important role for state government – or an appropriate independent authority – to provide advice and resources to councils throughout the early stages of the reform. Ensuring councils are adequately equipped to reconfigure their asset management strategies; staffing profiles; maintenance contracts and fiscal strategies will be imperative to realisation of the potential benefits and to minimisation of the transition costs. As such, it may be prudent for the relevant state agency responsible for

implementing council restructuring to provide guidelines and support for managing this process.

6.2.2 Community engagement

In order to ensure that the objectives and rationale of the reforms are understood, effective communication and engagement with the public is imperative. As well as demonstrating progress toward the objectives as implementation of the reforms progresses, community communication should also highlight tangible benefits (as they emerge) and be responsive to community concerns and mitigate their likelihood and consequences.

A successful communication strategy should comprise clear and consistent messages, early direct contact with people, use of media, a wide variety of feedback mechanisms and the publication of a series of guidelines and newsletters (Local Government Boundary Reform Board 1998).

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Appendix A: Areas of expected saving – literature review

Study	Area
Local Government Boundary Reform Board (1998)	<ul style="list-style-type: none"> • Wages and salaries (reduction in staff numbers) • Contract services & purchasing • General admin and elected member cost • Lease of administration centre • Sale of surplus plant and equipment • 'Collapsing' of CEO positions
Local Government Boundary Reform Board (1998)	<ul style="list-style-type: none"> • Administration • Environmental health • Development management • Waste management • Parks and other recreational areas • Road, drainage and footway maintenance
KPMG (2002)	<ul style="list-style-type: none"> • Engineering and works • Community and development services • Administration and corporate services • Governance
KPMG analysis, reported in Local Government Board Report (1997)	<ul style="list-style-type: none"> • Works & Maintenance • Community & Development • Administration • Governance
ACQMOR(1997)	<ul style="list-style-type: none"> • Waste • Parks & Gardens • Services
Easton & Thompson (1987)	<ul style="list-style-type: none"> • Administration • Overhead • Roads

Appendix B: Technical appendix

The basic model employed in the econometric analysis is expressed below:

$$\log(\text{opex}) = \beta_1 + \beta_2 \log(\text{pop}) + \beta_3 \log(\text{roads}) + \text{error}$$

where log means natural logarithm, opex is operating expenditure, pop is population and roads is kilometres of roads. The parameters β_2 and β_3 are the elasticities of operating expenditure with respect to population and kilometres of roads, respectively. They represent the percentage changes in operating expenditure for small percentage changes in population and roads, respectively.

The ordinary least squares estimates for Tasmania are shown in the following table. The regression gave an R^2 of 0.82.

Variable	Estimate	t value
Intercept	9.80	9.8
Log(pop)	0.69	11.1
Log(roads)	0.04	0.3

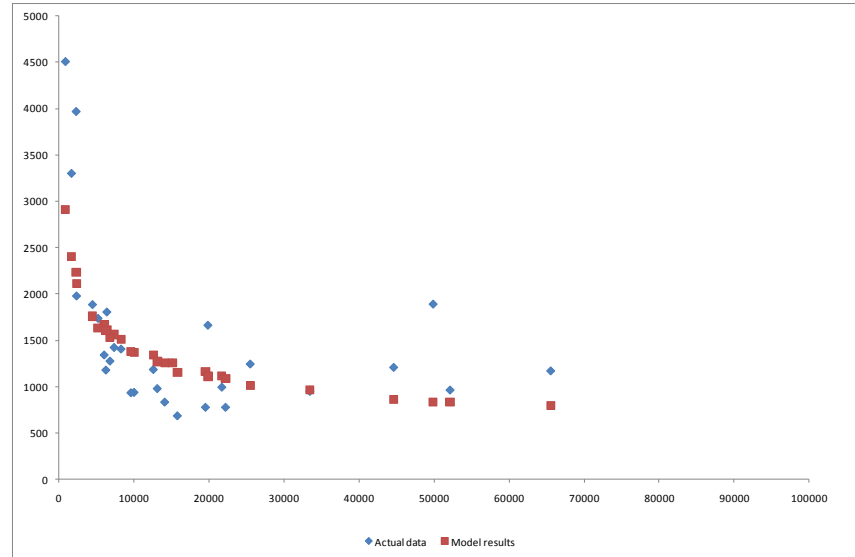
The estimate of the parameter on log(pop) means that a 1% change in the population is associated with 0.69% higher operating expenditure, or a 0.31% fall in operating expenditure per capita.

The estimate of the parameter on log(roads) means that, for given population, a 1% change in the number of kilometres of roads is associated with only a small increase in operating expenditures.⁸

The fitted values from the model are shown in Chart B.1 below, together with the actual data. Overall, and reflecting the high R^2 statistics, the fit is adequate. There is some suggestion that a quadratic term should be included, but the resulting estimates are influenced by the few large councils.

⁸ A separate analysis shows that, ignoring population, road expenditure per kilometre does decrease with kilometres of roads; but that relationship is not explored further.

**Chart B.1: The relationship between operating expenses and council population;
Tasmania**



Source: Deloitte Access Economics

Several additional models were estimated, but the results were similar to those in the basic model above. For example, replacing roads with the area of the council gave similar results. The results from estimating separate models on metropolitan and rural councils (with or without spiting operating expenditure into roads and non-roads) were limited by the blurred boundaries between metropolitan and rural councils (*i.e.*, many councils cover both metropolitan and rural areas), which made definitive conclusions difficult to reach. A model with per capita operating expenditure on the left hand side gave similar results (and had the undesirable feature of producing the occasional negative fitted value).

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