

# A new golden rule - The three C's of local government

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There are some ideas, particularly in the realm of public policy, that never seem to die. They return again and again like Jason in the Friday the 13th movies. Only, like Jason, each time they appear, they deliver less value and cost us more money. One of those ideas is municipal amalgamation. One large government, covering a certain natural geographic area seems quite logical. It can use the collective resources of that region to effectively and efficiently deliver needed public services.

In fact, it is almost so obvious that we want to kick ourselves for not seeing it sooner. But before we bow to the logical and clearly obvious, we need to consider the evidence. Local government is not merely a device for supplying municipal services, but also for finding out what services people want and how much they are prepared to pay for them. The smaller the government unit, the better they are at discovering this, because the empirical evidence is very strong that local government is closest to the people.

Amalgamation tends to undermine this relationship. It can only be justified if there are pretty remarkable efficiencies to compensate for the dilution of responsiveness and democratic accountability. The evidence is also quite strong that creating a single-tier local government monopoly doesn't reduce costs

- it increases them. It levels costs up to the highest common denominator in the pre-existing units of government, and results in higher trends of cost growth over time. The Halifax Regional Municipality (HRM) is just one of the most recent examples of this phenomenon.

This is especially true where amalgamation has eliminated competition between pre-existing municipalities both in terms of attracting residents and industry; and in terms of tax and service levels. Again, just have a look at HRM or the Cape Breton Regional Municipality. The most dynamic force helping to keep costs down is not a highly centralized and bureaucratic monopoly provider of public services, but a decentralization of authority and decision making. For example, organized minorities and pressure groups benefit from centralized political power because they can concentrate their lobbying power on a central point of authority. Amalgamation gives undue influence to organized minorities in local government affairs.

In contrast, when power is widely dispersed to many small units of government, their lobbying power is reduced because it is spread so thinly. It is better to have several municipalities within an area so residents cannot vote themselves benefits at the expense of other taxpayers in other parts of the region. This ensures that people only demand services that they're prepared

to pay for, and municipalities have powerful incentives to keep costs low and satisfaction high, or risk the erosion of their tax base as people and businesses vote with their feet. Moreover, despite what most people believe, only a small portion of local public services can achieve any real return to scale. In other words, the idea that the bigger you are, the cheaper it is to produce a unit of a given service does not apply to most local services.

The evidence says pretty clearly that very small municipal units (on the order of 5,000-10,000 residents) are compatible with the lowest observable level of per unit costs for most services. Moreover, there are significant diseconomies of scale beyond relatively small population numbers - on the order of 250,000 residents. So, small units do quite fine, thank you very much. Finally, the supposed savings from smaller councils and elimination of several city halls and other trappings of multiple local governments is so paltry as to be not even worth mentioning.

### **So, where should local government be headed?**

Research since the 1960s has revealed that a well-organized region should include:

- competition
- cooperation
- accountability

We can call these the three C's of good municipal management. You can test whether your region is applying the three C's by looking for a few, very basic things.

First, a large number of local municipalities offering distinct residential, business, and industrial environments thereby allowing users with different preferences to find an appropriate location within the region. Second, local governments should engage in rivalry to provide better locations for their residents, and cooperation to produce services more efficiently when there are benefits for residents from doing so. Third,

there should be some kind of structure for regional cooperation on major activities where governance and production are best done regionally.

While it is certainly possible that municipalities can negotiate each agreement separately, there will be higher levels of mutually beneficial cooperation if there is some forum in which to do so. Now, this is no small challenge, given the difficulty of persuading elected officials, who are used to winning with majority votes, to switch to a focus on a system in which everyone wins.

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Fourth, there should be competitive tendering for many activities to obtain the benefits of being able to choose among alternative suppliers. The role of local government is to provide residents the services they want and are willing to pay for in the most efficient way possible. Local governments may also benefit their residents by becoming efficient enough to sell services to other governments.

Fifth, each decision making unit within the region should operate under rules that encourage “fiscal equivalence” - that is, residents who benefit from a local government's services should elect the officials and pay the costs. Finally, and most importantly, with a large number of municipalities and relationships, the knowledge of decision makers - and by decision makers I mean not only politicians and administrators but business and taxpayers as well - the knowledge of decision makers within the system becomes paramount. There should be open, regular and comprehensive public reporting of performance, not just consumption of resources. Citizens should know what they get for their tax dollars, not just in terms of total dollars spent, number of employees and average salaries.

So, to repeat, municipalities should collaborate, not amalgamate. Professor Bob Bish, one of Canada's leading experts in this field did a study for my Institute looking at the Greater Saint John Area (Saint John, Rothesay, Quispamsis and Grand Bay-Westfield in New Brunswick). This region represents a healthy mix of large and small local governments. Its

small population of 100,000 constrains economies of scale and limits the specialized organizations to produce local government services that can exist in larger urban areas. The municipalities in the Saint John region have made considerable progress toward increasing the level of competitive local government services delivery. Rothesay and Quispamsis, in particular, outsource many of their activities, and Quispamsis has moved far toward activity-based costing in its general budget. Because of the market for municipal services in the area, local governments can compare options and choose the most efficient way to provide needed services. Alongside this competition there is also considerable cooperation among the four municipalities - to the point where they actually use a common letterhead, with each unit taking its turn on the masthead.

Several regional institutions have been created to facilitate cooperation - most, like the Regional Health Authority, for a single purpose. Others, like the “True Growth” economic development initiative, meant to pool resources to compete in a larger marketplace. This selective cooperation allows for the maintenance of cost controls on service delivery - because there are consequences if your service mix is too rich or too costly - people move. At the same time it helps avoid the mistakes of the past where, for example, bidding wars for economic opportunities often saw municipal units making bad deals that actually hurt them economically. Or infrastructure that could have been built to service a larger region at a lower cost, is over built by multiple neighbouring units. And the approach is remarkably flexible and fluid - Rothesay and Quispamsis, for example, as a sub group of the four units have bilateral commissions for policing and fire protection. This is a key point. Amalgamation would not allow for this creativity and experimentation, cooperation and continued independence does.

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## **Competition encourages experimentation**

At the local level, competition takes place on two dimensions. First, there is competition within municipalities. By this I mean that the most successful municipalities, places like Charlotte, North Carolina; Phoenix, Arizona; and Indianapolis, Indiana, are more and more getting out of the game of directly supplying traditional local government services. Instead, the model that is emerging is of a much smaller local government that acts as a kind of buyer's co-op on behalf of the residents of the locality. Service standards are set, and contracts are let on the basis of those standards, to competitive bidders - generally both internal and external. The winning bidder is then held accountable for his success or failure in reaching the agreed standards. Jim McDavid at the University of Victoria has been instrumental in documenting the significant benefits of competitive tendering in relation to a multitude of local services, including for example, garbage collection.

The other kind of competition that is vital to preserve is that between municipalities on the local level. Again, one of the things that drives local government toward reform is the ease with which people vote with their feet. One strategy for frustrating this crucial means of disciplining and controlling the quality of local policy and holding local officials accountable, is to expand the boundaries of local government to such an extent that the costs of exit become prohibitive. This movement toward what we call municipal amalgamation is driven, ironically, in many cases by the business community, who believe that we have “too many governments”, resulting in “overlap and duplication”.

Surely, it stands to reason that having only one mayor, one council, one city hall, and one public works department would save money and promote efficiency. But as Gordon Tullock, a prominent economist, argued in a recent book, “there do not seem to be any very obvious economies of scale outside a few special areas like the military and, possibly, diplomacy.” Tullock is properly drawing our attention to the fact that in both government and the economy, small and large organiza-

tions exist, and both can be efficient in those things where they enjoy advantages. But being large in itself is no guarantee of anything.

In fact, there are good reasons for thinking that bigger government will be less efficient and responsive, not more. Certainly in the private sector thinking is running the other way, as the break up of corporate giants releases hidden value in their assets.

The other danger, of course, is that of cartelization. This is what happens when local governments refuse to compete, but simply agree that they will all aim for the lowest common denominator. It is not unusual, in practice, for cartels of local governments to complain about outliers who do engage in vigorous competition, accusing them of “raiding”, “unfair practices”, “social dumping”, provoking a “race to the bottom” and so forth.

### **No model works without open performance reporting**

This is where senior governments can usefully play the role of stimulator of competition, through actions such as those taken in New Zealand and Australia. Here there are laws obliging local governments to use compulsory competitive tendering for all services. Local governments undergo regular audits, where service levels and taxation levels are compared. This permits the publication of league tables and other instruments of accountability that grant to local voters much greater insight into the performance of their local government and hence more means to hold them accountable. Research indicates that people and businesses that move from one municipality to another are actually quite knowledgeable about the conditions in both their old and new municipalities.

Cities set goals or outcome measures that are important; they might say that they will turn a building permit around in a week or fix a pothole in 24 hours. With sophisticated measurement systems, the services actually provided are bench-

marked against such standards. Achieving performance goals, or continuous improvement against ever rising benchmarks results in pay bonuses for management and employees. It is no longer about spending budgets or losing them, or prolonging and complicating service to minimize effort or maximize overtime. High performing entrepreneurial communities measure their services in the form of outputs, not inputs (or what they will spend). With outputs we can measure, and reward, performance.

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The employees, management, present and future citizens and taxpayers all find their interests looked to and positive behaviour rewarded. What more could we ask for?

No one, however, likes to have their work assessed or their performance reported publicly. You need only consider the annual reaction to AIMS' High School Report Card to see the truth in that statement.

In New Zealand, they have gotten around that natural reluctance by requiring municipal units to act in a certain way. For instance; councils must complete ‘Triennial Reviews’ and talk to their Council neighbours to assess opportunities for ‘combined’ - corporate or joint - service provision; asset management plans are in place and are vital for funding of depreciation; long term plans are actually audited prospective 10-year financial and community plans.

These requirements have allowed for the creation of annual reports that:

- are based on published financial plans and reports but include economic, geographic and demographic data
- use reliable, even audited and or otherwise attested (credible) data
- are clear and understandable. Matters of finance are reported in layman’s terms for all including engineers to study. By the same token, reporting of engineering details are in plain language

- are based on current year and five year formats (over 200 measures per unit), in an easy to understand standard graphical presentation.
- are produced for peer/cohort groups of Councils (either standard or customized groups). These groups are set by criteria including population, nature (e.g. rural-urban etc) and area.
- can be updated annually, reporting every Council's vital signs (financial, demographic, economic and geographical) even while the cost of the comprehensive report set is kept low.

It is this broad based, easily understood, comprehensive and readily available data that is the backbone of the local government reform movement in New

*“...comprehensive and readily available data ... the backbone of ... government reform...”*



Zealand. No longer is it possible for solutions to be based on the apparent logic or reasonableness of an idea. Reformers have to prove that an experiment has worked and that a new idea is worthy of broader application.

Managers have to prove that a specific mix of competition and cooperation has improved the services offered to local citizens, or grown the economy, or saved money.

I can't report that New Zealanders have found a way to finally slay Jason. He still comes back from time to time to haunt the inhabitants with yet another round of debate on right-sizing or rebalancing. I can report, however, that the sequels are shorter and the reviews are based not so much on what is obvious but on what is demonstrably true.



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