AIMS Commentary

Atlantic Institute for Market Studies

HRM: Shaping our government
A talk to Citizens for Halifax

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I am sure that Citizens for Halifax would want me to make clear that while I am here at their invitation, I am not here in any way representing them, and the opinions you are about to hear expressed by me are ***not*** opinions that I have shared with them in advance nor that they in any way endorsed or agreed to. They are my opinions alone. Naturally I hope that some of you will find them persuasive, but then it will be me who has persuaded you, and not Citizens for Halifax!

I was asked to speak to what we might learn from HRM's experience of amalgamation and then what we might learn from that experience about ways we might more successfully reshape our government.

The first section of my talk, which deals with amalgamation, is therefore called "The Chief Cause of Problems is Solutions!"

So if amalgamation was the "solution" what was it supposed to solve and what problems has it created instead?

In my view, to understand the HRM experience, you have to understand three particular circumstances.

1. One might easily make the case that the amalgamation of metropolitan Halifax was caused by the Price Club big box retailer now known as Costco. This is only a slight exaggeration. The old municipalities of Halifax and Dartmouth got in a destructive bidding war with each other to attract the Price Club store that had been announced for the metropolitan area. This was silly, since the benefits of the Price Club went well beyond the boundaries of each municipality. In the end, Halifax won the right to have the store built within its boundaries at a cost of about $1-million. That amount was a direct gift from the taxpayers of Halifax to the shareholders of Price Club for zero public benefit, other than sticking it to the municipality of Dartmouth across the harbour. Ironically, of course, there will shortly be a Costco in Dartmouth Crossing!

It was events like this that raised great suspicion of the rivalry between these municipalities and convinced many, including in the provincial government, that a single municipality would be cheaper and more efficient because it would abolish such wasteful behaviour.

2. The discovery of natural gas off the shores of Nova Scotia triggered a huge flurry of public spending on the assumption that the revenue to pay for it was just around the corner, except the corner turned out to be 2 decades away. By the early 90s, as the federal government cut back transfers in an effort to fix its own fiscal problems, and the province's debt had reach truly monstrous proportions, the province was in desperate fiscal shape — more so than virtually any other province — and they were desperate to cut costs.

3. The third circumstance is that we have in Nova Scotia a culture of what I call executive personalism in government (otherwise known as pigheadedness uninformed by any real information) — the policy formulation process is excessively weak, and fashionable ideas that get into the heads of premiers and powerful cabinet ministers are not subjected to searching analysis. If an idea sounds good to the right people, things happen — heavy water plants, steel mills, container ports in the bush, and municipal amalgamation being only a few examples.

The Premier, John Savage, and his minister of finance, Bernie Boudreau, got it into their heads that there were major efficiencies to be had in amalgamating the municipalities. Now if they had actually wanted to test these ideas properly, if they had wanted to engage in that dangerously radical practice known as evidence-based policymaking, they could easily have consulted the literature on local government and amalgamation, a literature which is now quite vast. Had they done so, they would have discovered the following:

First, they would have discovered that 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 evidence is very strong that local government is *closest* to the people, and the smaller it is, the closer it gets. Amalgamation tends to undermine this relationship and therefore can only really be justified if there are pretty remarkable efficiencies to compensate for dilution of responsiveness and democratic accountability.

But, second, they would have discovered that the evidence is quite strong that creating single-tier local government monopolies doesn't reduce costs — it increases them. It levels costs *up* to the highest common denominator in the pre-existing units, and seems to result in higher *trends* of cost growth over time.

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. It seems that the most dynamic force helping to keep costs down is not a highly centralised and bureaucratic monopoly provider of public services, but a decentralisation of authority and decision-making within several municipalities within an urban area where residents cannot vote themselves benefits at the expense of other taxpayers in other parts of the city. 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.

In most amalgamated municipalities, spendthrift city centres vote for big spending and pass the bill along to suburban and rural voters who don't want them. I am not aware of a single serious scholar studying municipal amalgamation on a broad scale who has concluded that they save money or improve efficiency. In fact one of our leading thinkers on this issue, the former head of the government department at Harvard, is now arguing that de-amalgamation is the way to go....

Third, they would have discovered that it is a fairly small part of public services where there are significant "returns to scale" — in other words where

the bigger you are, the cheaper it is to produce a unit of a given service. Researchers seem to agree that roughly 80% of municipal services enjoy no economies of scale. The evidence says pretty unambiguously that the lowest observable levels of per unit costs for most services are compatible with *very* small municipal units (on the order of 5,000-10,000 residents). Moreover, there are significant *dis*economies of scale beyond relatively small population numbers — on the order of 250,000 residents. And, finally, that 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.

But of course, given the culture of executive personalism (remember this means pigheadedness of the "don't confuse me with facts, my mind is made up" variety) that I mentioned, they didn't consult the literature or the research. Had they done so, they, like California under Ronald Reagan, would likely quickly have abandoned their amalgamation policy.

Instead they committed a nearly always fatal mistake — they hired a consultant. And instead of asking this consultant to review what was known about the dynamics of local government, they asked him to write an abstract report about all the ways one could, theoretically, save money if one were an omniscient manager and if there were economies of scale in the provision of most municipal services.

The consultant duly told them that there were significant savings to be had at very low cost. This is not hard to do since any outsider can look at any organisation and identify ways that things could be done "better". In 1996, HRM was duly created.

Now what is interesting to note is that the HRM is an extremely valuable test case, because it is the only large scale amalgamation North America to have been studied from the outset by a team of academics, a team, moreover, that received high levels of co-operation from the authorities of the new municipality. Bob Bish, of the University of Victoria was a key member of the team, which was headed by Dale Poel of the Dalhousie School of Public Administration. Their study, which covered 1996-2000, was financed largely by the Donner Canadian Foundation, a private foundation which supports important public policy work in this country. A very great deal of what Bob Bish learned from his years of studying municipal government, and from the HRM study in particular, became the key material for his extremely illuminating paper for the CD Howe Institute a few years ago under the revealing title of "Local Government Amalgamations: Discredited Nineteenth-Century Ideals Alive in the Twenty-First."

Now before I report on their findings, let me emphasise that these results were preliminary, and the research team themselves recognised that the 5 years they gave themselves to study the new entity was not enough for it, and its procedures, to be fully formed.

Still, certain things are clear and I have not seen anything in the subsequent years of HRM's operation to persuade me that these early results were atypical or unrepresentative. In our work on our municipal report card I see no evidence that the trends I have identified have changed for the better.

So what can we see with hindsight? Well, for example, the consultant's implementation study underestimated the cost of amalgamation by a very significant margin. The final tally, including a new financial management system and labour agreements, reached something on the order of a minimum of $40-million, whereas the estimate was under $10-million. No cost savings or economies of scale are observable yet, and it is not obvious that they ever will be, or where they might come from. Both taxes and other charges, as well as debt increased significantly. User charges rose and average residential property taxes went up about 10% in urban areas and by as much as 30% in suburban and rural areas. Polling data show low levels of satisfaction with post-amalgamation services, although again it may be premature to make a strong judgment here.

Recalling the Price Club fiasco, it was clear that the business community thought that amalgamation would produce a more disciplined and efficient municipality and that this would improve the business climate. Other than the innovative public-private partnership that now looks after HRM's economic

development, I haven't seen the evidence that this has occurred and it is worth noting, as an aside, that those US cities with the highest rates of economic growth count many with the most fragmented local government structure.

There is no observable correlation between amalgamation and economic growth.

There is still a very high degree of monopolistic in-house provision of services, although there are exceptions, in areas like solid waste collection. An innovative public-private partnership process for the construction of a waste water treatment system collapsed, in large part in my view because the powers that be in HRM favoured in-house monopoly provision for political reasons, ignoring the efficiency losses and loss of innovation and accountability it almost always entails.

Part II: Where should local government be headed?

I've already remarked on some of the advantages of local government, and in particular the fact that it is the level of government most able to be relatively aware of the real concrete circumstances of their populations, and most able to see and correct the damaging and undesirable consequences of their policies. But the small scale of local governments and having several of them, has other advantages.

For example, organised minorities and pressure groups benefit from centralised political power because that means that they can concentrate their lobbying power on a central point of authority when power is widely dispersed to many small units of government. However, that reduces their lobbying power because it is spread so thinly. Amalgamation in a large urban area, however, exaggerates the bargaining power of organised minorities in local government affairs.

In the same vein, decentralisation reduces significantly the ability of voters to pass the costs of local decisions along to larger communities, which forces voters to be more fiscally responsible. When governments cover relatively small geographical areas, it reduces significantly the cost of "voting with your feet". It is much cheaper to move from one town or suburb to the one next door than it is to move to another province or country.

The third consequence of the existence of a large number of local government units is that it allows the benefits of successful experiments to be copied by other local and even more senior governments. Decentralisation, when linked to a high degree of competition between localities, increases the likelihood of spreading local policies and practices when these are successful, and getting rid of them when they are not. Imitation is a powerful force.

But none of these positive effects can or will be realised without a vital element of competition. Because municipal officials really don't know that much about what their local population wants, about the true costs of various services, and about the potential of new methods to deliver efficiencies and improved service levels, we need a framework for local government that spurs competition, and ends rigid monopolies in the supply of local government services. Competition is how we find out what works.

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 where local government employees under a rigid contract supply individual services, such as garbage collection or sewer and water services, to the residents of an entire city as a typical public sector monopoly. There is now an association of so-called "contract cities" in the United States where municipalities provide almost no services in-house, and act instead as a purchaser of services from many competing suppliers on behalf of their population.

So 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. The winning

bidder is then held accountable for his success or failure in reaching the agreed standards. The question of whether the service is provided by public sector or private sector workers and managers is actually becoming irrelevant.

Naturally the monopolists are the ones who resist the most, and especially large centralised service provision bureaucracies and their associated public sector unions, but the benefits are so great from contracting out and privatisation – as Jim McDavid at the University of Victoria Local Government Institute has been instrumental in documenting with respect, for example, to garbage collection — that the momentum is clearly with the reformers.

The other kind of competition that it is vital to preserve is that *between* municipalities on the local level. 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 getting away from bad government 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 the evidence I've outlined here this evening clearly shows, being large in itself is no guarantee of anything and, as I have already remarked, research in local government leads us to think that at least 80% of municipal activities offer little prospect of economies of scale (i.e. saving money because you are bigger).

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 business giants releases hidden value in their assets. We have seen this, for example, in the decision of companies like Telus to sell many of its large office buildings, because they argue that they are in the telecommunications business, not the property management business. Almost all conglomerates trade at a discount to the value of their component parts, which has driven many of them to break themselves up in one way or another. And of course, in the municipal world we know now that the experience of amalgamation has been to drive costs up to the highest level, rather than down to the lowest.

So amalgamation isn't the answer. What is?

The province can usefully play the role of stimulator of competition between local governments, as we see in New Zealand and Australia. There, for example, 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, permitting 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 held 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. My institute is working hard to create a municipal report card like our high school report card, to introduce and stimulate exactly this kind of competition between municipalities by increasing the knowledge of voters and taxpayers about what they are getting for their money.

We must create a customer-service oriented culture in our municipal governments, something I have not seen much of anywhere in Nova Scotia. We must align the incentives of our elected officials so that they are rewarded for providing efficient, high quality services. This means we need them to focus on defining service levels, measuring them and rewarding superior performance by service providers.

Consider, again, New Zealand's cities, where performance pay is a significant portion of the management's compensation. 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 benchmarked 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.

In Indianapolis, unionized in-house providers actually proposed and benefited from an internal system called gain sharing where 25% of all savings beyond the bid price went to employees. With their eye on the ball of efficiency and good service, they out competed the private sector and became the most successful municipal employee union in the U.S., winning the highest pay increases in that country.

High performing entrepreneurial communities measure their services in terms of what they get for their money, not on what they spend or how many employees they have. That way we can measure and reward performance. 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?

Public sector competition, like private sector competition, is not "wasteful", but is a healthy discipline that promotes efficiency, accountability and good service. Such competition, where it has been introduced into local government, has transformed it for the better. That's a lot more than the evidence suggests we can say about amalgamation.

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