Empirical Evidence on the Impact of the 2016 NSW Forced Amalgamation Program

To date, three papers have been published or accepted in the peer-reviewed scholarly literature that have undertaken rigorous econometric examinations of the impact of forced mergers on the performance of compulsorily consolidated councils (McQuestin *et al.* (2021); Drew *et al.* (2021); Drew *et al.* (2022)). These papers shed light on the efficacy of the Boundaries Commission's recommendations regarding the forced amalgamations.

1. McQuestin, D., Drew, J. and Miyazaki, M. (2021). Do Amalgamations Make a Difference? What We Can Learn from Evaluating the Policy Success of a Large Scale. *Public Administration Quarterly*, 45(3): 278-298.

McQuestin *et al.* (2021) employed a difference-in-difference regression analysis of data three full years after the execution of the May 2016 forced mergers. Their basic model established that compulsory council consolidation had resulted in an increase in unit costs of 11.2 percent (statistically significant at the one percent level). When an urban interaction term was added, forced mergers increased unit costs by 16.7 percent (also significant at the one percent level). In addition, nearest neighbour and propensity score models were also run with results suggesting an increase to unit costs of 8.6 and 9.7 percent respectively.

To understand the underlying causes of this unexpected result, McQuestin *et al.* (2021) then ran disaggregated difference-in-difference models for the accounting items of 'staff expenditure', 'materials and contracts expenditure' and 'other expenditure'. Compulsory council consolidation was associated with a 15.2 percent increase in staff expenditure significant at the one percent level. This result was troubling because commercial consultants KPMG – which the Boundaries Commission accepted unreservedly – had projected the bulk of savings from municipal mergers would derive from staff expenditure. Materials and contacts costs increased by 5.9 percent and other expenditure by 13.3 percent as a result of the forced mergers. However, these latter two results were not statistically significant. Given these results, it is clear that the decision by the Boundaries Commission to recommend the forced mergers proceed had been misplaced.

2. Drew, J., McQuestin, D., and Dollery, B. E. (2021). Did Amalgamation Make Local Government More *Fit for the Future*? *Australian Journal of Public Administration,* 81(2): 383-398.

Secondly, in their paper Drew *et al.* (2021) stress the inadvisability of placing too much emphasis on local government size by population when considering forced mergers. To empirically demonstrate the problems created by such a myopic focus on council size by population, Drew *et al.* (2021) undertook a series of difference-in-difference analyses employing four full years of post-merger data.

The difference-in-difference analyses of unit costs indicated that forced amalgamation was associated with an increase in unit costs of 11.2 percent (statistically significant at the one percent level). Difference-in-difference regressions were then undertaken on six of the seven financial sustainability ratios (with the efficiency ratio deemed unsuitable given its flaws) used to determine which councils would be compulsorily consolidated in 2016. All but one of the ratios deteriorated as a result of the forced mergers. The only result that improved was the debt service ratio and Drew *et al.* (2021) demonstrated that significantly increased flows of intergovernmental grants largely explained this particular outcome.

Drew *et al.* (2021) then considered how best to address a failed municipal merger program through (a) de-amalgamation, (b) increased local government taxation and (c) higher ongoing operating grants. They noted that de-amalgamation hearings by the Boundaries Commission were already in train in NSW and that several substantial increases to municipal rates had already been implemented by amalgamated councils. Drew *et al.* (2021) argued that it might be advisable for the NSW Government to provide additional ongoing untied grants to the value of the average increases to unit costs demonstrated in their empirical findings. They contended that this would represent a 'just outcome' in view of the fact that the commercial consultants KPMG, the Boundaries Commission and the Minister had assured communities that amalgamation would result in savings and were thereby negligent. Given these findings, it is again apparent that the decision by the Boundaries Commission to recommend the forced mergers had been mistaken.

3. Drew, J., McQuestin, D., and Dollery, B. E. (2022). Fiscal Outcomes Arising from Amalgamation: More Complex than Merely Economies of Scale. *Public Management Review* (in print).

Finally, Drew *et al.* (2022) outlined the theoretical and practical reasons for why net fiscal outcomes arising from municipal mergers are far more complex than simply scale economies of scale. Indeed, they noted that constant returns to scale and diseconomies of scale are also probable outcomes in merged municipalities. Furthermore, they underlined the importance of the human factor by emphasising the tough decisions, such as forced redundancies, that must be made for efficiencies to be realised. Moreover, Drew *et al.* (2022) detailed how costs are generally under-estimated or ignored by commercial consultants, like KPMG, as well as the Boundaries Commission, such as the one-off costs of amalgamation, service harmonisation, and wage harmonisation, all of which can entirely offset any savings actually realised.

Drew *et al.* (2022) employed a difference-in-difference regression analysis based on five full years of post-merger data and employing a unique control group. Specifically, they took as their control the group the councils that had originally been considered for compulsory consolidation, but had escaped due to legal action and NSW Government policy reversals. Comparing these two groups of councils, Drew *et al.* (2022) demonstrated that mergers were associated with an 11.1 percent increase to unit costs at a one percent level of statistical significance.

Drew *et al.* (2022) concluded by showing the important effect that human nature, harmonisation (both service and wages) as well as fiscal illusion had on the outcome. They argued that in future decision-makers should better appreciate the complexity of amalgamation with respect to fiscal outcomes. Given their empirical results, it is again clear that the decision by the Boundaries Commission to recommend the compulsory council consolidations had been erroneous.

In sum, the empirical evidence presented in all three of these papers decisively establishes that the Boundaries Commission erred badly in its decision–making on municipal mergers in the 2016 NSW compulsory council consolidation program. As we shall argue, although several factors account for this flawed pattern of decision-making, an absence of technical sophistication in evaluating commercial consultant econometric modelling played a vital role.

4. Additional Evidence

In addition to the empirical evidence presented by McQuestin *et al.* (2020), Drew *et al.* (2021) and Drew *et al.* (2022) on the comparative performance of forcibly merged councils, specific evidence has also emerged on the veracity of the advice offered by the NSW Boundaries Commission on specific aspects of the municipal mergers it endorsed. The NSW Boundaries Commission was engaged to provide advice to the Minister on specific proposals to created 35 new compulsorily consolidated councils in 2016. Each proposal endorsed by the Boundaries Commission and its Delegates promised *inter alia*: (a) a '3 year payback period when merger benefits will exceed merger costs', (b) 'stronger balance sheets', (c) 'improved scale and capacity', (d) 'effective representation', (e) 'better infrastructure' and 'services', as well as (f) 'reduced local council reliance on rate increases' (New South Wales Government, 2015, p. ii).

In the aftermath of the 19 forced mergers that actually occurred, it is now possible to compare the specific claims made by the Boundaries Commission and its Delegates with the documented outcomes achieved in practice. In contrast to the positive predictions made by the Boundaries Commission, compulsorily consolidated councils have delivered (a) reduced efficiency in the order of 11.0 to 11.2 percent depending on the precise econometric method and panel size employed (McQuestin *et al.*, 2021; Drew *et al.*, 2021; Drew *et al.*, 2022), (b) forty percent of amalgamated councils failed to generate a General Fund surplus in any of the past four financial years, (c) rapidly declining unrestricted cash balances that are now dangerously low in some of the amalgamated local government areas, (d) diseconomies rather than economies of scale (Drew *et al.*, 2022), (e) small local communities declaring that they have been effectively disenfranchised (Local Government Boundaries Commission (LGBC), 2022), (f) limited anecdotal evidence of improved local infrastructure funded by grants as well as some evidence of upward harmonisation of local service levels (Drew, 2022) and (g) significant increases to property rates considerably in excess of what has been sought by non-amalgamated councils over the same period (Independent Pricing and Regulatory Authority (IPART), 2022)

In addition to these material costs, recent evidence presented to the Boundaries Commission has pointed to the severe psychological distress experienced by both affected local communities and municipal employees as a consequence of the outcomes of the Boundaries Commissions forced amalgamation advice. For example, evidence from affected council staff encompassed condemnation of the outcomes of the 2016 compulsory consolidation of Cootamundra-Gundagai endorsed by the Boundaries Commission, including 'every time I know I have to go to the Cootamundra office to work, I just feel like driving into a tree' (LGBC, 2022: 5).

Brian Dollery PhD
Emeritus Professor of Economics
New England Education and Research P/L
Armidale NSW 2350
Email: bdollery@une.edu.au
10 February 2023