

FOSTERING SHARED SERVICES IN LOCAL GOVERNMENT: A COMMON SERVICE MODEL

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ABSTRACT: Structural reform of local government through forced municipal mergers has occurred in a number of countries, including Australia, with mixed success. We argue that shared services arrangements by groups of voluntarily participating councils represent a superior means of securing the advantages of scale and scope in local government, without the heavy costs of the blunt instrument of compulsory council consolidation. However, in practice, the success of shared services has been inhibited in small regional, rural and remote local authorities by the costs of establishing and running shared service entities, which can swamp any savings from shared services. Taking into account the special characteristics of small non-metropolitan councils, we present a Common Service Model tailored to minimise establishment and transactions costs, maximise flexibility, and generate transparency.

KEY WORDS: local government; municipal mergers; scale and scope economies; shared services.

1. INTRODUCTION

Local government systems worldwide have experienced ongoing reform, including all Australian state and territory local government systems. In their pioneering *Municipal Reform in Canada*, Garcea and LeSage (2005) developed an insightful typology with five distinctive kinds of local government reform: (i) jurisdictional reform, (ii) functional

reform, (iii) financial reform, (iv) internal governance reform, and (v) structural reform. Contemporary reform programs in many countries have sought to address different aspects of local government activity in all or some of these categories.

Various policy instruments have been deployed (see, for instance, Dollery *et al.*, 2012, for a survey of the literature). Policy-makers, for example, have used performance monitoring, like the Comprehensive Performance Assessment (CPA) in the United Kingdom (Game, 2006); financial management and reporting (Kelly and Rivenbark, 2014); fiscal equalisation measures, such as intergovernmental grants in Sweden (Johansson, 2003); the co-production of municipal services (Andrews and Brewer, 2012), shared service provision and resource-sharing (Tomkinson, 2007); and municipal mergers (Lago-Penas and Martinez-Vazquez, 2013).

In common with some other countries, such as Japan (Shimizu, 2012) and Belgium (De Ceuninck *et al.*, 2010), Australian public policy-makers have frequently employed involuntary mergers as their main approach to reform. Proponents of municipal mergers have long claimed that numerous advantages derive from the consolidation of small local authorities into fewer and bigger local councils (Dollery *et al.*, 2013). However, Sancton (2011) has shown that these claimed benefits have changed through time. For instance, while advocates of mergers often emphasise cost savings and other dividends from council amalgamation (see, for example, Lago-Penas and Martinez-Vazquez, 2013), the failure of merged municipalities to achieve cost savings targets, has seen the emphasis of more recent council amalgamations shift to consolidation's ability to improve the administrative and technical capacity of municipalities (Dollery *et al.*, 2012). In addition, some contemporary campaigns aimed at securing council consolidation, like the recent attempt to compulsorily merge the five councils in the Hawke's Bay Region of New Zealand into a single entity, have contended that large merged regional local authorities will produce much more effective regional leadership, that will stimulate more rapid regional growth and economic development (McGredy Winder and Co., 2013).

In contrast, opponents of forced mergers stress the contentious character of council consolidation, inadequate supportive empirical evidence, disappointing outcomes of past amalgamation episodes, and an attenuation in local democracy (Faulk and Hicks, 2011). In general, the scholarly literature has been sceptical of compulsory consolidation as a policy instrument, and the weight of empirical work has raised doubt over

the effectiveness of amalgamation (see, for example, Lago-Penas and Martinez-Vazquez, 2013).

In Australia, an embryonic empirical literature has sought to compute the effects of structural reform through forced amalgamation (see Dollery *et al.*, 2012 for a recent survey of the academic and public inquiry literature). By way of example, Drew *et al.* (2014) empirically evaluated the economic consequences of the 2008 Queensland compulsory council consolidation program on the optimal size of local authorities and found that numerous merged local authorities exceeded the optimal council scale. In a similar vein, empirical scholars have examined the impact of proposed mergers on scale economies in local government in Tasmania (Drew *et al.*, 2013; Marques *et al.*, 2015), the greater Perth metropolitan region (Drew and Dollery, 2014a), and New South Wales (Drew and Dollery, 2014b; Drew, Kortt and Dollery, 2015), and all found that, in general, claimed scale economies would not have eventuated.

In terms of the impact of council size on the perceived effectiveness of council performance, Drew, Dollery and Kortt (2015) found limited evidence of a relationship between council size (by population) and council effectiveness (as measured by annual resident satisfaction surveys). Using a range of financial indicators to compare performance among a sample of large councils, Sinnewe *et al.*, (2015) found that Brisbane City Council – by far the biggest council by population in Australia – performed comparatively poorly. This literature broadly echoes international empirical work on size and performance in local government (see, for example, Faulk and Hicks, 2011; Lago-Penas and Martinez-Vazquez, 2013, for surveys of the international literature).

Given the empirical evidence on both the impact of municipal mergers and the relationship between size and performance in local government, a majority of contemporary observers of local government reform in Australia and abroad now single out shared services as a better alternative to municipal mergers in securing the benefits of greater scale and scope in service provision. According to this view, ‘amalgamating service delivery’ is superior to ‘amalgamating councils’ to achieve scale and scope economies in municipal service provision.

However, despite the comparative advantage of shared services agreements (also known as inter-jurisdictional agreements and inter-local agreements) in reaping the benefits of scale, various factors have inhibited the adoption of shared service models in local government (Hawkins and Feiock, 2011; Hawkins, 2009, 2010a, 2010b; Dollery *et*

al., 2012; Tomkinson, 2007). In particular, in the case of small regional, rural and remote local authorities, the administrative and establishment costs associated with founding and running a separate entity to undertake shared service operations for a group of these small councils can often swamp any cost savings from shared services themselves. Thereby removing the economic imperative for engaging in shared services in the first place.

This presents a challenging problem for practitioners and scholars alike: designing a shared service model which eliminates (or at least minimises) the overhead costs of running any given shared service arrangement. In this paper, we propose a Common Service Model specifically crafted for small regional, rural and remote councils which has been fashioned to limit the overhead costs of shared services. While shared service arrangements in local government inevitably involve cultural and political factors best assessed in terms of political economy, in this paper we focus on the economic dimensions of shared service models.

2. CONCEPTUAL FOUNDATIONS

Shared services, resource-sharing and other complementary inter-council cooperative approaches derive from a common theoretical foundation set out by Oakerson (1999). Oakerson (1999, p. 7) drew a critical distinction between service *provision* and service *production*. Moreover, he argued that different principles applied to these different functions. Thus the provision of municipal services requires deciding whether or not to provide a service, with all the ancillary factors flowing from a decision. However, production involves rendering a service 'in-house' rather than simply funding it.

Oakerson (1999, p. 15) argued that 'almost all' local public services "depend upon the availability of specific time-and-place information, such as neighbourhood conditions, to support effective production choices". This means that "the scale and organization of the production process should allow producers to make locally informed judgments". If provision is divorced from production, then its council size and service scale are independent of each other.

Oakerson (1999, pp. 15-16) proposed that local public services possess three characteristics which distinguish them from other public services. Thus local public service provision involves 'co-production', which refers to the "productive efforts of citizen-consumers as an integral part of the production process". This must be differentiated from the 'citizen-voter' role of local residents in local service provision. In the local

government realm, local residents provide vital information to local authorities on service performance. Local public participation is thus essential to the effectiveness of service delivery.

Second, local public goods are different in kind from local public services. Local public goods are usually capital-intensive, such as domestic waste processing, storage and management. As a result, they often exhibit economies of scale. However, local public services, which encompass services like health inspection and building permit provision, are characteristically labour-intensive. This means they have limited scale economies. It is thus obvious that scale economies differ widely between different municipal activities. In an analogous manner, Oakerson (1999, p. 16) argued “much different economies may also be involved in increasing the level of production per capita as opposed to extending the same level of production per capita to a larger population”. It need hardly be stressed that this has important ramifications for municipal service provision.

Finally, management costs are critical. Oakerson (1999, p. 16) set the argument out as follows: “The production and delivery of goods and services can be broken down into a large number of components, distinguishing direct service components delivered to citizens from various support-service components to direct service producers”. This implied that service possessed different scale characteristics. Nonetheless, he observed that “different components of service production require coordination to varying degrees” adding that ‘coordination is costly’. These costs thus serve to limit the number of separate production entities within a given municipality, as well as the number of separate services. In essence, a trade-off exists between scale economies and economies of coordination.

The separation of production from provision means local authorities’ chose between alternative methods of producing local services. Oakerson (1999, pp. 17-18) has identified seven models for linking provision with production: ‘In-house production’; ‘coordinated production’ (i.e., two councils synchronise services); ‘joint production’ (i.e., shared rate notice processing); ‘intergovernmental contracting’ (i.e., a council contracting local services from another council); ‘private contracting’ or outsourcing; ‘franchising’ (i.e., a council allows firms to provide service direct to residents); and ‘vouchering’ (i.e., residents use municipal vouchers to secure services from private providers).

In addition, unpaid work by volunteers could be included. Warner and Hefetz (2008) have also added local services provided by unpaid local volunteers.

A closely related avenue falls under the institution collective action (ICA) framework proposed by Feiock (2013, p. 399). He has noted that the ICA can be applied to municipal entities to “achieve better outcomes collectively” and minimise barriers to inter-council cooperation. The ICA framework stems from the broader collective action literature (see, for instance, Ostrom, 2005).

3. EMPIRICAL EVIDENCE ON SHARED SERVICES

In Australia, the extant empirical evidence on shared services is based almost entirely on case studies and surveys. To date, this evidence includes four case studies from South Australia (SA) and New South Wales (NSW), a literature review conducted by KM Management Consulting (KMMC, 2005) for the Local Government Association of Queensland (LGAQ) and three surveys undertaken for councils in NSW, SA and Western Australia (WA). In essence, this body of work indicates that shared services arrangements can offer a range of benefits to local councils (Table 1).

In a survey of 34 SA councils, Lawson (2007) established that pecuniary benefit was a central rationale for shared services arrangements. Lawson (2007) also found that the six most frequent areas for shared services encompassed: (i) waste management, (ii) urban planning, (iii) joint purchasing and shared physical assets, (iv) ‘back-office’ operations, (v) shared IT services, and (vi) financial and corporate services.

Surveys of WA and NSW councils (BJA, 2006; Byrnes, 2005) identified a number of areas suitable for shared services arrangements including: (i) waste collection and disposal, (ii) IT services, (iii) library and museum services, and (iv) land management services. Among WA councils it was noted that regional and remote councils were more likely to engage in shared services arrangements (BJA, 2006), while NSW councils identified a number of areas – public cemeteries, public toilets, public halls, and swimming pools – where ‘in-house’ service provision was the preferred delivery model (Byrnes, 2005).

A number of case studies have concluded that shared services arrangements confer a range of economic and social benefits on citizens. For example, in a case study of the SA Walkerville Council by Dollery and Byrnes (2006) it was found that shared services arrangements

between Walkerville and nine adjoining councils resulted in either cost savings or improvements to service delivery. Similar benefits were also identified in cases studies that examined the strategic alliance model employed by Armidale Dumaresq, Guyra, Uralla and Walcha councils in NSW (Dollery *et al.*, 2005) and shared services arrangements of the Riverina Eastern Regional Organisation of Councils (REROC) – a cooperative venture between 13 councils in southern NSW (Dollery *et al.*, 2004). In addition, the LGAQ also noted that the strategic alliance among the NSW councils of Wellington, Blayney and Cabonne accrued significant cost savings.

Finally, the literature review conducted by KMMC (2005) for the LGAQ argued in favour of shared services on the basis of theoretical conjecture and a review of related research. Nevertheless it failed to distinguish between shared services arrangements at the local government level and other tiers of government. The report thus failed to adequately identify and justify the possible benefits of shared services arrangements.

In contrast, there is growing corpus of international empirical evidence on shared services arrangements, of which Table 2 presents a representative selection of studies from the United Kingdom (UK) and the United States (US). In the UK, for instance, many British councils have reported that the introduction of shared services has not only reduced costs but has also led to improvements in service delivery particularly in the areas of procurement, IT services, and ‘back office’ functions (CLG 2006a, 2006b, 2006c, 2006d, 2006e). Similarly, the consultancy report by PriceWaterhouseCoopers (PWC, 2005) on the Anglia Revenue Partnership – a shared services centre established for residents in two rural councils – reported that these municipalities not only performed better but had accrued substantial cost savings. In an interesting study, Murray *et al.* (2008) explored the benefits of shared services arrangements for procurement among 15 English councils and found that some smaller councils benefitted from such an arrangement.

In the US, a range of studies have empirically examined shared services arrangements. For example, according to Hawkins (2009) the three most prevalent reasons for shared services arrangements include: (i) improving a council’s economic advantage; (ii) securing presently unavaible resources; and (iii) developing economies of scale. Along similar lines, Chen and Thurmaier (2009) found that the equitable sharing of benefits among participating councils was critical to the success of inter-local cooperative ventures.

Further studies by Hawkins (2010a, 2010b) have examined: (i) the conditions under which councils were likely to establish shared services arrangements; and (ii) the role that institutional arrangements play in promoting the establishment of joint economic development ventures. Hawkins (2010a) found that cooperation on economic development joint ventures between councils is influenced by a range of factors including regular communication and high levels of social capital. With regard to institutional arrangements, Hawkins (2010b) found evidence that, compared to a 'council-manager' form of government, a 'mayor-council' form of government is more likely to participate in 'developmental' joint ventures. Hawkins (2010b, p. 382) has argued that one possible explanation for this finding is that a developmental joint venture "provides a way for elected officials to claim for the benefits that can be directed to certain constituent groups". In a further study, Hawkins and Feiock (2011) found empirical evidence to support the proposition that previous collaborative arrangements positively impact on the likelihood of entering into a future collaborative venture.

A succession of studies by LeRoux and Carr (2007, 2010), and LeRoux and Pandey (2011) examined shared services in the US. The first of these (LeRoux and Carr, 2007) considered local government collaboration on public services (for example, sewerage) among Michigan councils. The authors identified that collaboration among councils is motivated by a range of factors including: (i) the characteristics of adjacent communities, (ii) population growth, and (iii) economic considerations. The second study (LeRoux and Carr, 2010) examined shared services arrangements among 44 municipalities in Michigan. The findings indicated that councils were more likely to participate in inter-local collaborative arrangements for the provision of local public services like waste disposal and water management. In a subsequent study, LeRoux and Pandey (2011) also established evidence that larger US councils are more likely to pursue inter-local collaborative arrangements if senior managers are motivated by career progression.

Finally, Kwon and Feiock (2010) argued that inter-local collaborative arrangements should be best viewed as a two stage process. Employing a two-part econometric model, they considered whether communities wish to participate in shared services arrangements and then the likelihood of entering into an inter-local cooperative agreement conditional upon the preference of a community for such an arrangement. Kwon and Feiock (2010, p. 881) report that, in the first stage, inter-local cooperation is "likely to be considered in relatively affluent cities experiencing population declines and economic conditions" while in the

second stage, 'at large' election of US councillors and former inter-local agreements were predictive of local communities entering into shared services arrangements.

In sum, the findings from the empirical literature suggest that shared services can enhance service delivery although some services appear to be more conducive in interlocal arrangements than others (Dollery *et al.*, 2012).

4. CHARACTERISTICS OF LOCAL GOVERNMENT

Australian local government exhibits considerable diversity, especially among regional, rural and remote local authorities. Diversity extends further than population size, population density and population composition. It is particularly important to stress that local community preferences for services differ markedly, particularly for city councils as compared with their regional, rural and remote cousins. However, diversity also exists between metropolitan councils with different socio-economic characteristics.

These differences can be intensified by 'environmental' factors. For instance, the cultural, economic, physical and social circumstances facing local authorities differ markedly across Australia. This can dramatically affect the costs of service provision. Similarly, demographic factors also influence council service provision and thus municipal finances.

These considerations place substantial constraints on the design of shared services entities. These restrictions can be classified into four main areas: cost, flexibility, independent oversight and voluntarism:

- (a) **Cost.** Shared service arrangements must be designed to minimise the administrative and overhead costs involved, given the relatively small modest average size (by population) of Australian regional, rural and remote councils. If these costs are prohibitive, then local councils are discouraged from involvement in shared service provision. This obviously impedes the use of shared services in local government. It follows that a Common Service Model minimise administrative and overhead costs.

- (b) **Flexibility.** Given the limited size of non-metropolitan Australian local authorities, together with great variation in administrative and technical capacity, shared service arrangements should concentrate on small-scale shared service provision between single providers and single recipients of council services. This in turn means that transactions costs must be low as possible, administrative hurdles reduced and flexibility maximised. A Common Service Model must maximise flexibility to encourage discrete types of shared services.
- (c) **Independent oversight.** Since municipal government falls within the public sector, all transactions must be transparent, with full accountability to local rate-payers. Independent scrutiny and oversight of shared service arrangements between provider and recipient councils are thus paramount, necessitating an 'independent arbiter' and sound record-keeping. This will also serve to provide certainty to provider and recipient councils. A Common Service Model must thus embody these features.
- (d) **Voluntarism.** Flexible low-cost shared service measures, designed to facilitate single-service provision between a single provider council and a single recipient council, can be adopted by groups of councils which wish to participate in shared service arrangements on a voluntary basis, in contrast to regional groupings of councils obliged by law to belong to shared service bodies. The principle of voluntarism is thus crucial for a successful Common Service Model.

Empirical work on shared services in local government in Australia and other countries (see, for example, Tomkinson, 2007; Warner and Hefetz, 2008; Hawkins, 2009; and Dollery, Grant and Kortt, 2012) has shown that shared service entities everywhere must surmount several common barriers which constrain their effective operation. In their book *Councils in Cooperation*, Dollery et al. (2012) set out a full analysis account of these barriers to success.

Two factors are especially important in the design of shared service entities: voluntary engagement and organisational structures.

- (1) **Voluntary engagement.** Dollery *et al* (2012) demonstrate that historically the conditions for membership of shared service entities have been problematic. This has been especially marked in cases where members of a shared service alliance consist of local authorities in a specific area. In these circumstances this frequently results in the alliance moving at the pace of the least enthusiastic member council, sometimes termed the 'convoy problem', in reference to maritime convoys which can only proceed at the speed of the slowest ship. Several steps can be taken in the institutional design of shared service entities to avoid this problem: (i) ensuring membership is voluntary, (ii) enabling councils to 'pick and choose' which shared services they can use, and (iii) allowing participation and non-participation by local councils at the sole discretion of those municipalities.
- (2) **Organisational structures.** Structural factors in the design of shared service entities can make a substantial difference not only to their operations, but also to their long-term performance (Dollery *et al.*, 2012). Several important factors must be addressed: (i) the ownership structure of the shared service entity, inclusive of asset ownership and voting rights; (ii) distribution of the establishment costs of the entity and its ongoing running costs; and (iii) the distribution of surpluses and losses among member municipalities.

Thus, a Common Service Model suited to regional, rural and remote councils in Australia and elsewhere must be carefully designed to accommodate all these factors and their associated conditions. Some existing shared service models, notably the Brighton Model (Valle De Souza and Dollery, 2011), meet some of these requirements.

5. COMMON SERVICE MODEL

As we have seen, the design of an appropriate model to facilitate greater use of shared services by local authorities must accommodate not only the four main constraints of cost, flexibility, independent oversight and voluntarism, but also 'voluntary engagement' and a suitable

organisational structure. The question thus arises: what would a model embodying these characteristics look like?

We contend that Common Service Model designed to accommodate groups of local authorities wishing to take part in shared services would take the following form: The councils involved would establish a Board made up of the General Managers of the interested councils, which would be chaired by an agreed Chair and supported by an agreed Chief Administrator. The Board would establish a Common Service Model based on numerous *ad hoc* but formalised Shared Service Agreements (SSAs). An SSA would be drawn up between the provider council(s) and the recipient council(s) for each of the specified service(s) in question.

Each SSA would prescribe the specific service which would be provided, the costs of service provision and the term of provision. The implementation of the SSA would be overseen by a Committee made up of representatives drawn from each of the provider and recipient municipalities, as well the Chair and Chief Administrator. Establishment and administration costs of an SSA would be shared equally between provider and recipient councils in proportion to the service delivered and received by each respectively. In addition, each SSA would prescribe the nature of service provision, and together dispute procedures, extensions of SSAs and other specific details.

A Common Service Model of this kind offers several distinct advantages. In particular, it satisfies the cost, flexibility, independent oversight and voluntarism criteria. For instance, through cost minimisation and flexibility maximisation, each SSA would meet cost and flexibility requirements. Similarly, since a Common Service Model establishes a Committee with a Chair and a Chief Administrator it ensures SSA operations are carried out in a transparent manner. Lastly, participation in a SSA is entirely voluntary.

The Common Service Model enables voluntary engagement and provides an appropriate organisational structure. For instance, in regard to voluntary engagement, only councils willing to participate actually participate in practice, thereby ensuring voluntary participation. It is noteworthy that voluntary participation by councils necessarily implies that the optimal area for a given service is decided by participating municipalities using detailed local information.

Because each SSA only applies to participating councils question on an overall ownership structure do not arise. Similarly, surpluses and deficits are not relevant to all member councils because they apply to participating councils only and have in any event already been agreed under the SSA.

The formal objectives of SSAs are straightforward. An SSA seeks to foster cooperative relationships between participating councils under a Common Service Model framework and provide cost-effective access to expensive and scarce expertise. It establishes a Committee to coordinate and monitor the provision of services under the SSA, generates a single legal document specifying the responsibilities of all councils in the provision and use of services, provides for administration of the Committee, and secures the funds necessary to oversee the SSA.

What benefits would flow from the adoption of SSAs under a Common Service Model? Several benefits to provider councils and recipient councils under the SSA approach can be identified. First, SSAs allow participating councils access to expertise in circumstances where councils cannot otherwise acquire these skills themselves, due to expense or the availability of appropriately skilled workers, a common problem faced by regional, rural and remote local authorities. A related benefit resides in enabling small councils to fully deploy their existing staff and generate revenue from them, where they are 'under-employed'. Along similar lines, SSAs permit councils to secure commercial returns on investments in IT systems, as well as other capital investments, by making these available to other local authorities.

6. CONCLUSION

In this paper we have presented a Common Service Model designed to meet the specific requirements of regional, rural and remote local authorities found in Australian local government. In particular, the Common Service Model enables the minimisation establishment and transaction costs, the maximisation of flexibility and stimulates shared service activity of even the most modest kind. These characteristics mean that the Common Service Model avoids the problems associated with other shared service models, especially rigid membership requirements, burdensome governance provisions and communal risk-sharing provisions (Dollery *et al.*, 2012). As a consequence of its 'minimalist' organisational arrangements, which hinge on individual SSAs, monitored by a Committee with an independent Chair, and representatives of participating councils, overseen by a Chief Administrator, and fully funded by participating councils, the Common Service Model provides the most cost effective and flexible method of facilitating shared service provision in local government.

The Common Service Model developed in this paper allows voluntarily participating local authorities to reap not only the benefits of scale and scope in local services where economies of these kinds apply, thereby securing gains normally attendant upon council size, but also to acquire administrative, managerial and technical skills not otherwise available to regional, rural and remote local authorities. In contrast to forced amalgamation, these advantages do not come at a heavy cost in terms of community divisiveness, dismantled small councils merged into larger entities, and attenuated local democracy.

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