

# THE LOCAL BENCHMARK

## WHEN SMALLER IS BETTER

JASON KRUPP

WITH FOREWORD BY MICHAEL BARNETT



THE  
NEW ZEALAND  
INITIATIVE

LOCAL GOVERNMENT  
BUSINESS FORUM



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**THE  
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INITIATIVE**

**2016**

The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. We believe in evidence-based policy and are committed to developing policies that work for all New Zealanders.

Our mission is to help build a better, stronger New Zealand. We are taking the initiative to promote a prosperous, free and fair society with a competitive, open and dynamic economy. We develop and contribute bold ideas that will have a profound, positive, long-term impact.

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# FOREWORD

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In New Zealand the conventional wisdom when it comes to local government is ‘bigger is better’. Proponents say that bigger provides economies of scale and opportunities to drive cost savings and lower rates while delivering better levels of service.

And not only is bigger supposedly better, but there’s a similar acceptance that central government can and should call the shots. Local government is after all a creature of statute that owes its existence and its powers to Parliament.

So for years there’s been a tendency both to consolidate councils into fewer bigger entities and to centralise decision-making and intervene when things aren’t going to plan.

The 1989 local government reforms and 2010’s creation of Auckland Council are examples of government-imposed restructuring into fewer, bigger councils. And there are numerous examples of central government setting and changing the rules councils must operate under – just think of all the tinkering to the RMA since 1991 – and then jumping in to fix performance issues at councils.

The problem is that bigger isn’t necessarily better. Central government doesn’t have all the answers and doesn’t always get it right.

International experience and what we’ve seen in Auckland is challenging both long-held assumptions.

The Super City was supposed to be ‘lean and mean’ and it was going to be the answer to the region’s clogged roads and increasingly unaffordable housing. Yet what we have seen is ballooning staff numbers and spending, and rates and debt that are on the rise. Auckland Council continues to struggle to deliver infrastructure and services for its growing population and we all know how a lack of land supply is driving Auckland house prices ever higher and out of reach.

The Local Government Business Forum is here to promote effective local government. I therefore welcome The New Zealand Initiative’s ongoing work on localism and for this report, the second of three in this series.

*The Local Benchmark: When Small is Better* examines the experience in Switzerland, the Netherlands, Manchester, and Montreal. Although all have local government environments very different to New Zealand’s, all I believe provide us with valuable insights and lessons that would make local government more effective.

I commend this report not only to those interested in local government but to anyone interested in how we can make New Zealand an even better place to work, live, and play.

Michael Barnett  
Chair, Local Government Business Forum



# INTRODUCTION

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Countries that manage to attract talent and capital – the currency of the global marketplace – are rewarded with higher rates of growth, better wages, and a more sustainable economy. The competition is so aggressive it has transcended international borders. Even cities, which noted urban economist Edward Glaeser says are the new global “engines of growth”, are vying against internal and external competitors to lure talent and capital to their jurisdictions. New Zealand, and its regions, also competes with other countries for these sought-after resources.

The public face of this competition is often expressed as ‘place-making’. Auckland City wants to be the “world’s most liveable city”<sup>1</sup>; Wellington City Council wants to create “Australasia’s most prosperous, vibrant, and liveable region”;<sup>2</sup> and Christchurch City Council wants to be recognised as “the best place for business, work, study and living in Australasia” by 2030.<sup>3</sup> These cities are making vigorous sales pitches to businesses and individuals about the quality of their infrastructure, lifestyle, affordability, skilled workforce, and connections to markets. They have experienced decades of physical growth, such that their footprints now extend beyond their jurisdictional borders. Cities like Auckland and Wellington – once comprising independent local authorities separated by distance – are now conurbations. Even rural regions are competing for global talent and capital.

Unfortunately, this has created governance and efficiency challenges in decision-making that span political borders. Councils and voters are often criticised for focusing too much on local issues and being painfully slow to reach consensus. This

parochialism, especially when it impedes regional or national initiatives, can be frustrating to central government and its plans to grow the economy, as we noted in the first report of this series.<sup>4</sup> In New Zealand, central government likes to think that amalgamating local authorities into bigger units will ease its frustrations. Unitary authorities promise streamlined decision-making, coordinated service provision, greater economies of scale, as well as better transparency and accountability. The discord between Auckland’s local councils was a key driver behind the central government’s 2010 decision to merge the region’s eight local authorities into a ‘super city’. That was followed by (unsuccessful) attempts to merge councils in Northland, Wellington and Hawke’s Bay.

But just because central government likes amalgamation does not mean it is necessarily the correct policy choice. As this report will discuss in detail, greater centralisation of local government functions often fails on two counts. The first is democratic. All three recent merger proposals failed to win popular support. The Hawke’s Bay merger alone proceeded to the referendum phase, only to be soundly defeated by a two-to-one margin. The second is the supposed efficiency gains. Economic literature on Canadian municipal mergers shows the process can increase rather than reduce the costs of running a city.

This leaves New Zealand policymakers at an impasse. To leave the local government structure as it stands is to ignore the efficiency benefits that scale brings to service provision. Potable water and roading infrastructure are clear examples of where bigger is better. And yet to forcibly merge councils into unitary authorities is to ignore a consistent democratic preference in New Zealand for a diverse local government landscape. Furthermore, policymakers cannot ignore the risk that municipal

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1 Auckland Council, “The Auckland Plan,” Website.

2 Wellington City Council, “Wellington Regional Economic Development Agency (WREDA),” Website.

3 Canterbury Development Corporation, “Economic Strategy,” Website.

4 Jason Krupp, “From Red Tape to Green Gold” (Wellington: The New Zealand Initiative, 2015).

mergers could exacerbate the underlying problems they are trying to fix. The formation of the Auckland Unitary Authority has done little to ease the high cost of housing in the country's biggest city.

### So what is the right size for local government in New Zealand?

This report seeks to inform this debate by looking at jurisdictions that have stepped beyond the 'right size' and adopted flexible structures to achieve efficiency on multiple levels. The division of power in Manchester, Switzerland and the Netherlands is such that local tasks are performed by local bodies, regional tasks by regional bodies, and national tasks by national bodies. In economic literature this is called the principle of subsidiarity. This report also examines the City of Montreal's track record with amalgamation, subsequent de-amalgamation, and the consequent confused local government structure. These topics are relevant as 175 years of local government consolidation in New Zealand have still not created an efficient structure.

The four case studies in this report argue for greater powers for local government by presenting a 'life cycle' of localism. The United Kingdom is experimenting with devolution to tackle longstanding social and investment problems in Manchester. Switzerland, consistently ranked as the most competitive economy in the world, showcases a mature localist political system. The Netherlands demonstrates not only how a country can reorganise from a centralised system to a

decentralised one, but also how municipalities can self-organise to address big challenges. Lastly, Montreal's amalgamation and partial de-amalgamation processes offer a cautionary tale of localism in decline.

These four jurisdictions were carefully chosen for two reasons. First, The New Zealand Initiative believes local people are best placed to decide on local matters, and that a competitive local government ecosystem produces the best outcomes. Switzerland, the Netherlands and Manchester embody this belief. Second, as a former colony, New Zealand's political structure closely resembles that of England – local government in both countries is a creature of central government statute. Politicians in central government seem content with this arrangement, citing a perceived lack of alternatives to consolidation and centralisation. And yet the case studies in this report clearly show there are viable alternatives.

Local government can seem dull and unexciting but this could not be further from the truth. As the tier of government that people interact with the most, local authorities play an important role in the lives of the people living within their jurisdictions. On this basis alone, everyone has an interest in ensuring that local government bodies operate in the most efficient and effective manner.

One final note on the style of this report. A journalistic tone is used to bring some colour to the local government sector. Those seeking more detail are advised to consult the bibliography.

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# CHAPTER ONE

## MANCHESTER

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Visiting Manchester after 26 years, I find the city radically changed. The changes are not immediately obvious at the airport. Nor on the trip to the city centre by train, which picks its way through terraced suburbs that look much the same as I remember, barring newer cars and signage. But it becomes obvious as the doors open at Piccadilly Station to a throng of people jostling about, and is further reinforced on the short walk to my hotel on Portland Street. The streets are full and the shops busy. Even though it is a damp Sunday afternoon, there is a buzz, a sense of purpose that was missing a couple of decades ago. The city centre is alive.

At first, I chalk this sharp contrast to unreliable memories and the intervening 26 years, but delving into the city's history confirms I wasn't imagining the transformation. Manchester in the 1980s was moribund, a once-great city left directionless and, in many respects, dying as global economic shifts rendered its traditional heavy industries uncompetitive. The radical restructuring of the British economy by Prime Minister Margaret Thatcher almost brought this former industrial powerhouse to its knees. The city lost more than 200,000 jobs from 1972 to 1984, and the region's unemployment rate rose to 20% during that time.<sup>5</sup> By the end of the 1980s, Manchester was "marked by high unemployment, very low levels of educational qualifications, industrial decline, racial discrimination, very poor quality housing and large numbers of especially disadvantaged residents, particularly lone parents".<sup>6</sup>

That is not the case now.

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- 5 David Rudlin, "4 Recessions Part 2: The 1980s: Manchester and Thatcher's Britain," blog post (25 April 2014).
- 6 Ian Christie, Michael Carley and Michael Patrick Fogarty, "Profitable Partnerships: A Report on Business Investment in the Community: Case Studies from Three British Cities" (London: Policy Studies Institute, 1991), 136.

Today, Manchester is a thriving capital of the new economy. Based on a highly skilled workforce, a growing services sector, and cutting-edge innovation, it is a bright city on a hill attracting people to its prosperity – a far cry from the early 1980s when the population was running the other way. The streets are thronging with young people, many of whom attend the city's three universities, and businesses are humming with activity. Construction cranes stalk the skyline, and the stone facades of the Industrial Revolution sit so comfortably with modern glass and steel counterparts that it is hard to imagine a time when this was not the case.

Greater Manchester is one of the fastest growing regions in the United Kingdom after the thriving mega-agglomeration that is the City of London. The metropolitan area's population grew by 6.5% from 2003 to 2013, and now totals more than 2.8 million people. The economy generates £56 billion of gross value added (GVA) annually,<sup>7</sup> and this is expected to grow by 2.8% per year between 2014 and 2024.<sup>8</sup> Manchester has hitched its wagon to the modern economy, and is enjoying impressive rates of economic growth compared to other parts of England, particularly the north.

Looking at Manchester through the lens of economic statistics helps understand the ongoing devolutionary process in the United Kingdom, of which Greater Manchester stands in the vanguard.

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- 7 A productivity metric that measures the difference between output and intermediate consumption. Gross value added provides a dollar value for the amount of goods and services that have been produced, less the cost of all inputs and raw materials that are directly attributable to that production. This is the regional equivalent of GDP. Investopedia, "Gross Value Added – GVA," Website.
  - 8 New Economy, "Greater Manchester Fact Sheet" (Manchester: Manchester Growth Company, 2015).

In 2017, central government will hand the Greater Manchester Combined Authority (GMCA) near-complete control of the running of the city's transport system, business support, policing and fire services, criminal justice system, infrastructure investment, housing and planning, skills and employment development, as well as the £6 billion health and social programmes (see Manchester sidebar). In addition, the city-region will have greater control over its finances, with new revenue streams and the ability to issue debt (which was previously limited to central government). This is remarkable in a country that for most of the 20th century had steadily constrained and limited the scope of local government, such that by 1999 only two tiers of government existed: Whitehall and district councils. But it is also incongruous. If all the development and transformation in Manchester was achieved under a highly centralised system of governance, why are officials in Whitehall changing it now?

### Lingering malaise

The answer is simple. Manchester's outward success, impressive as it is, disguises the city's legacy of a decades-long decline. That was apparent in my discussion with Sir Richard Leese in the Manchester Town Hall, a building of such old-world grandeur that I first mistook it for a cathedral.

Sir Richard has headed the Manchester City Council since the late 1990s and, along with Chief Executive Sir Howard Bernstein, is credited with steering Manchester's devolution and much of the city's turnaround. He notes:

Those old manufacturing industries created work for large numbers of unskilled and semi-skilled workers. So we were left with a heritage of an old workforce with a relatively low skill level. We have had to radically improve skill levels in a modern economy, and we've been largely successful. But we are still on the trajectory of putting back not what we lost, because we are doing things differently, but compensating for what we had lost.<sup>9</sup>

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9 Sir Richard Leese, Personal interview (27 October 2015).

The statistics paint a grimmer picture of this city of 2.8 million people. Despite significant investment, Greater Manchester is still struggling to reduce the number of people claiming benefits. The most recent data show 202,000 claimants in 2015, with jobseekers (28,730), employment support and incapacity (143,740), lone parents (24,460), and carers benefits (32,860) making up the biggest groups. Excluding Greater Manchester's jobseeker benefit, the four remaining subcategories exceed the United Kingdom's national average. Indeed, the city's total unemployment rate as of 30 June 2015 stood at 6.8%, higher than the northwest regional rate of 5.9% and the national rate of 5.7%.<sup>10</sup> Even those employed in the north are more likely to work in less productive jobs, and hence are lower paid than their counterparts in the southeast.<sup>11</sup>

Unemployment and low productivity are not the city's only problems. For all the prosperity of the inner city and wealthy boroughs like Trafford, Greater Manchester fares badly on measures of deprivation. According to the Department for Communities and Local Government, as of 2015 the city-region is the fifth most deprived region in the United Kingdom out of 326 regions. This is a composite score, reflecting Manchester's ranking on deprivation measures of crime (10th); education (39th); employment (35th); health (2nd); and income (7th).<sup>12</sup>

To make matters worse, these problems are spilling over into the next generation. Only 40% of children in Manchester are school ready (16,000 children) in any one year when measured on their cognitive, social and emotional development. This seems incongruous for a region that spends approximately £300 million every year on centrally

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10 Nomis (UK Office for National Statistics), "Labour Demand – 2014," Website.

11 Katie Schmuecker, "Employment and Skills in the North of England," NEFC Briefing Paper No. 2 (Newcastle Upon Tyne, UK: Northern Economic Futures Commission, IPPR North, 2011).

12 Manchester City Council, "Public Intelligence Population Publications: Deprivation," Reports from the Indices of Deprivation 2015 for Manchester, Website.

run childhood programmes.<sup>13</sup> Such deprivation is costly from both human capital and fiscal points of view. The city remits £20 billion a year to central government in tax, but draws £27 billion in central government funding to operate annually.<sup>14</sup>

These financial statistics and deprivation rankings are a longstanding problem in Manchester. One former central government official, who asked not to be named, remarked: “The way they [Manchester City] are portrayed in the media, you would never think they are a massive net recipient of money”.<sup>15</sup>

To belabour an earlier metaphor, although Manchester has hitched its wagon to the global economy, that horse has yet to drag it out of the mud completely.

## Growing pains

Manchester’s politicians are remarkable for their ability to unite behind a single vision and work towards making that vision a reality over many years. This was evident in the 1980s, when the 10 district councils formed the Association of Greater Manchester Authorities (AGMA) after Thatcher’s government abolished the Greater London Council and six other metropolitan county councils as part of a political clash with Labour-dominated local authorities at the time. AGMA coordinated the city’s 10 boroughs, such as public transport, fire and police services, and waste disposal, while the councils were solely responsible for local services. AGMA also acted as a strategic agency whose purpose was to further the interests of the Greater Manchester region.

City officials also have considerable experience collaborating with the private sector, and in many respects this was key to reversing the city’s decline. For example, a new Economic Development department was established in the 1980s to canvass ideas on restructuring the city’s economy with input from research bodies, businesses, trade unions, the voluntary sector, and the wider

community.<sup>16</sup> In 1984, Salford City Council, one of Manchester’s metropolitan boroughs, bought the derelict Salford Docks using grants from the Ship Canal Company, and started redeveloping the land in partnership with private industry. Today, Salford is a highly desirable part of Manchester to live in, a high-rise neighbourhood that also hosts Greater Manchester’s creative industries hub, the second biggest in Europe.<sup>17</sup> The Central Manchester Development Corporation was set up in 1988 to redevelop land in some of the inner city’s most deprived areas using private and public capital. During the eight years of its existence, 140,000 square metres of non-housing development and 2,500 new or refurbished residential dwellings were built, and 5,000 new jobs created.<sup>18</sup>

Such arrangements represent only a fraction of the private-public partnerships that have been established over the past 30 years, and have been key to reviving Manchester’s economic fortunes. They were especially important for the city to quickly recover from a terrorist attack that destroyed large parts of the city centre in 1996. Although the bomb blast did not claim any lives, it damaged more than 100,000 square metres of buildings, and caused £700 million worth of damages.<sup>19</sup> Headed by Leese and Bernstein (both of whom were subsequently knighted for their services to local government), the city established a new urban plan to redevelop the northern part of the city. With private and central government support, Manchester secured more than £2 billion to fund the redevelopment project. Reconstruction under the urban plan was well underway by the end of the decade, and in 2002 the city hosted the Commonwealth Games.

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<sup>13</sup> The Manchester Partnership, “0–5 Early Years,” Website.

<sup>14</sup> Rebecca Heron, Personal interview (27 October 2015).

<sup>15</sup> Anonymous, Personal interview.

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<sup>16</sup> David Carter, “Manchester,” in Leo van den Berg and Jan van der Meer (eds), *Cities as Engines of Sustainable Competitiveness* (New York: Routledge, 2014), 194.

<sup>17</sup> Salford City Council, “The Story of Salford Quays” (Manchester: Salford City Council, 2008).

<sup>18</sup> Iain Deas, Brian Robson and Michael Bradford, “Re-thinking the Urban Development Corporation ‘Experiment’: The Case of Central Manchester, Leeds and Bristol,” *Progress in Planning* 54 (2000), 43–47.

<sup>19</sup> Geoffrey Lean, “Hands off our land: Behold the miracle of Manchester,” *The Telegraph* (30 September 2011).

Manchester's success is not limited to urban redevelopment, either. Transitioning the economy from low-skill manufacturing to high-skill services has been an important part of the city's Economic Development Strategy, with a focus on the creative industries, technology and innovation, and also leveraging the city's cultural and educational capital. This has culminated in the establishment of the Manchester Science Park, the second fastest growing science park in the United Kingdom. The National Graphene Institute was also established at the University of Manchester, and five BBC departments are now based at MediaCityUK in Manchester. Large multinationals like Siemens have established bases in the city, and the financial services sector is also growing due to the cost advantages of Manchester over London.

It was also widely recognised by almost everyone I interviewed that many of these initiatives would not have started, or succeeded to the same extent, without a strong push from the city's political

leaders. Greater Manchester, represented publicly by Leese and Bernstein and behind the scenes by a string of well thought of city officials, is trusted and respected by central government and the private sector alike.

Despite this pull, Greater Manchester's unemployment and deprivation statistics are worrying. An obvious explanation is the city has been underfunded for many years, but this is not convincing given the level of investment that has poured into the city over the last three decades. Official figures back this up, showing that more public money is spent in the country's north than in any other part of England, barring the London-dominated southeast (Table 1).<sup>20</sup>

So if it is not funding, local politics, or poor relationships with the private sector and central government, what exactly has prevented Manchester from tackling its lingering social and economic problems?

**Table 1: Total identifiable expenditure on services by country and region per head in real terms (2008–09 to 2012–13)**

	National Statistics (£ per head)				
	2008–09 outturn	2009–10 outturn	2010–11 outturn	2011–12 outturn	2012–13 outturn
North East	9900	10300	10076	9448	9582
North West	9479	9843	9643	9257	9411
Yorkshire and the Humber	8745	9139	8927	8706	8758
East Midlands	8186	8592	8380	8161	8258
West Midlands	8837	9113	8871	8591	8645
East	7888	8424	8233	7906	8000
London	10084	10655	10314	9705	9598
South East	7838	8107	7943	7650	7770
South West	8217	8584	8365	8239	8360
England	8770	9169	8946	8604	8676
Scotland	10345	10618	10376	10221	10327
Wales	9927	10255	10107	9984	9877
Northern Ireland	11081	11335	11116	10966	11064
UK identifiable expenditure	9025	9407	9184	8874	8940

Source: HM Treasury, "Public Expenditure Statistical Analyses 2014" (London: HM Treasury, 2014).

<sup>20</sup> HM Treasury, "Public Expenditure Statistical Analyses 2014" (London: HM Treasury, 2014).



To answer this question, I travelled to Trafford, the home of Manchester United Football Club, to speak to Councillor Sean Anstee. The tram that takes me there from the city centre is excellent. Trafford is remarkable because it is wealthy, and because it is the only Conservative-led local council in Greater Manchester.

Politically, the right-of-centre Anstee is almost the mirror opposite of Sir Richard. Anstee believes the current Whitehall-dominated governance arrangements have delivered growth, but have been unable to reform national-level social programmes in a way that makes a difference for Manchester. He says:

[With devolution] you can start to remove a siloed mentality from Whitehall where, through no fault of its own, it is not able to connect its decisions, or look at the unintended consequences from those decisions, because it is too big. It is not a criticism of national government – it is just that they can't look at how well things like transport planning and skills planning could work together for a local area.<sup>21</sup>

These sectors certainly seem excessively centralised. Since the 1980s, when Thatcher abolished the Greater London Council and six other metropolitan county councils, government power has been highly concentrated in Whitehall, such that 95% of all taxation is determined by the UK Treasury. Local councils have some say in the remaining 5% but even then it is subject to caps.<sup>22</sup> For all their political differences, Anstee's view is remarkably similar to Sir Richard's. As Sir Richard puts it: "Intuitively, if you want common outcomes, then doing the same thing with different people will not produce common outcomes".<sup>23</sup>

This view is not exclusive to Manchester's political officials. Tony Travers, a professor of government at the London School of Economics and long-time

proponent of devolution, more or less shares the same view of central government as Anstee and Sir Richard. "The truth is the National Audit Office's suite of reports are an endless tragic concatenation of failure in central government because it is too big to plan, too big to deliver, and often not very good at buying things", Travers says.<sup>24</sup>

Closer to Whitehall, Alex Thomson, head of the local government-focused think tank Localis, too is sceptical about the effectiveness of the United Kingdom's highly centralised governance. "Basically, centralising government doesn't seem to work".<sup>25</sup>

On the opposite side of the ideological divide, Ed Cox, a director of the IPPR North's Manchester branch, also believes that highly centralised governance is not working for northern cities.<sup>26</sup>

## Evidence base

The merits of devolution over centralism may be quite evident in the United Kingdom right now, but this was not the case 15 years ago when Manchester started formally pitching to central government on the matter.

To support its position, AGMA developed the Greater Manchester Economic Plan in 2005, a strategy document aimed at closing the economic gap with London by creating 160,000 jobs, as well as improving skills and education outcomes.<sup>27</sup> To build its case, in 2009 AGMA's economic development agency commissioned the Manchester Independent Economic Review, conducted by Sir Tim McKillop, former chairman of the Royal Bank of Scotland; Jim O'Neil, head of global economic research at Goldman Sachs; and noted urban economist Edward Glaeser, among others. The review aimed to strategically understand how the region's economy functioned. It looked at factors such as agglomeration

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21 Sean Anstee, Personal interview (28 October 2015).

22 Tony Travers, "Devolving Funding and Taxation in the UK: A Unique Challenge," *National Institute Economic Review* 233:1 (2015).

23 Sir Richard Leese, Personal interview (27 October 2015).

24 Tony Travers, Personal interview (30 October 2015).

25 Alex Thomson, Personal interview (2 November 2015).

26 Ed Cox, Personal interview (28 October 2015).

27 William Hall, "Manchester to get 160,000 new jobs," *Financial Times* (18 January 2005).

economics; innovation in trade and connectivity; inward and indigenous investment; labour markets, skills and talent; and what makes sustainable communities.<sup>28</sup> Broadly, the reviewers concluded that while the city-region had high agglomeration economies, productivity at a firm level was lower than elsewhere in England. This was largely attributed to a skills gap, exacerbated by poor transport links across the city-region and high housing costs. The review recommended:<sup>29</sup>

- Sustained efforts to improve the experience of young people, especially in the early years
- Review of housing strategy, especially demand conditions and easing of planning restrictions
- Review of transport planning within Manchester to improve productivity and connectivity
- Review of planning policy to acknowledge the reality of economic demand
- Implementation of a unified regime for planning, regeneration and neighbourhood renewal
- Identification of potential government investments in science in Manchester to enhance productivity for the country as a whole
- Review of how a city-region considers and makes major and difficult decisions effectively
- Development of a more effective system of programme and project evaluation, and analysis of policy areas such as housing, economic development, regeneration, and skills on a city-region basis
- Investigation of the potential for delegating and devolving some decision-making powers, including funding, by Manchester and central government
- Development of trading links and skills by the private sector.

## Willing partner

All in all, the Manchester Independent Economic Review made for a compelling platform from which the city's authorities could lobby central government to create a new statutory local authority that could take over decision-making powers. Politicians too were open to the idea of devolution.

In 1998, the Labour government under Tony Blair began passing legislation that would allow Northern Ireland, Scotland and Wales greater political autonomy. In 2000, the Greater London Authority was established, setting up the first city-region government structure since the 1980s. Manchester's case that devolution would spur economic growth was also aided by the global financial crisis – the Labour government granted the city and its northern neighbour, Leeds, Statutory City Region Pilot status in 2009.<sup>30</sup> In 2010, a coalition between the Conservative Party and the Liberal Democrats was formed after the general election. This did not, however, destabilise the devolution process, and in 2011 the voluntary structure of AGMA was transformed into a statutory body called the Greater Manchester Combined Authority (GMCA). This authority has since negotiated and signed a devolution deal with the government, encompassing planning, infrastructure, skills, transport, finance, housing and health. Cox says of the deal:

Manchester has definitely been more proactive in deciding what it thinks it could deal with. But it has been a two-way street. Central government has equally said, "Come on, bring forward your ideas". And equally government has said, "No, you can't have this, you can have that".<sup>31</sup>

At the same time, the Conservative government, spearheaded by Chancellor George Osborne, is seeking to extend the devolution deal across England. Many authorities – some in Scotland and Wales – are negotiating their own devolution deals.

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<sup>28</sup> MIER, "Manchester Independent Economic Review," Website.

<sup>29</sup> Ibid.

<sup>30</sup> Association of Greater Manchester Authorities, "Manchester: Statutory Region City Pilot" (Manchester: 2009).

<sup>31</sup> Ed Cox, Personal interview (28 October 2015).

This has been aided by sluggish economic growth, and Sir Michael Heseltine's report on restarting economic growth in Britain's post financial crisis environment by reversing English centralism.<sup>32</sup> In 2015, the Conservatives won sufficient votes in the general election to govern alone. Interestingly, this has sped up the pace and scope of devolution, driven largely by Osborne to boost economic growth in England. Sir Richard says the major change in the past six or seven years is using devolution to spur economic growth:

Growth is the main driver for the UK Treasury at the moment with what is now termed the public service reform agenda. This is largely an acknowledgment that in big chunks of social policy, the national one-size-fits all programmes are broken, that they don't work, [and] that we need to deliver public services in a different way, in a locally tailored way.<sup>33</sup>

### Will devolution work?

With many of the powers negotiated under the GMCA deal only starting to commence in 2016, huge question marks hang over the devolution process. It is a calculated gamble driven by the necessity to restart economic growth in England at a time when fiscal prudence requires central government to cut spending and pay off public debt. If ever central government were to transform Greater Manchester, and indeed northern England, from fiscal drain to economic self-sufficiency, this is the time to do it. Yet there are risks aplenty.

The first risk is that devolution does not go far enough, and that too much power is left in the hands of central officials who may resist their new role as advisers on government services as opposed to providers. Cox says:

That is the game the civil servants are playing. They almost realise that if they make it a little bit difficult and convoluted, it will all come back

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<sup>32</sup> Michael Heseltine, "No stone unturned in pursuit of growth" (London: Department of Business, Innovation and Skills, 2012), 31.

<sup>33</sup> Sir Richard Leese, Personal interview (27 October 2015).

to them ... If you give a little power here and a little power there, you can be sure they won't be able to deliver any efficiencies or savings and they won't be able to change too much because the main action is somewhere else.<sup>34</sup>

This ties in with the second risk, namely capacity. This is not a problem for Greater Manchester, which has been preparing for this handover for many years. But there exists a danger that in the rush to get a deal, some city-regions may take on too much responsibility for which they are ill-equipped. Many see a failure at this level as a blow to the entire devolution process, even if it is an isolated case.

The third risk is regional. Agglomeration has served London well because it is the clear centre for much of the southeast. To paraphrase Travers, if you live in the southeast, you know you can head to London to see the opera – and so wouldn't build an opera house in Reading. That mono-centricity does not exist in the north, where city-regions like Leeds, Manchester and South Yorkshire are being offered devolution deals independent of each other, and in some cases where their territorial boundaries overlap. Travers says deal-by-deal devolution increases the potential for investment duplication without a population base to ensure sustainability of investments like opera houses and museums. Places like the Netherlands, which features later in this report, get around these challenges through fast transport connectivity, mostly by rail, but such connectivity and regional planning does not exist in northern England as yet.

The fourth risk is political in nature. Devolution deals predominantly involve the Conservative government negotiating with city-regions led by Labour, which is deeply unpopular with the national Labour Party in London. Furthermore, Chancellor Osborne has insisted that every city-region accept an elected mayor as part of the deal the same way London has. Those on the Left resent this as a form of imposed democracy, and say such arrangements could be reached voluntarily if the city-regions desired them. Those on the Right see it as a necessary compromise

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<sup>34</sup> Ed Cox, Personal interview (28 October 2015).

city-regions must make to show they ‘can behave like adults’. Despite their stated reasons, both sides see this as an attempt by Osborne to establish a Conservative power base in the northern cities and replicate Boris Johnson becoming the Lord Mayor of London in other regions.

Lastly, city-regions like Greater Manchester have to lift economic performance, remedy social ills, and avoid problems such as house price bubbles associated with sharp spikes in growth.

Devolution must also pass the democratic test. I spent an afternoon wandering around Manchester’s central business district (CBD), randomly asking people if they had heard of the devolution deal. I was universally met with blank stares, and regarded as mad, or worse, a policy wonk.

But just as there are risks, there is also opportunity. The first is the chance to turn around moribund northern cities and boost national economic growth. Cities such as Manchester get a toolkit to help tackle longstanding social problems, reverse the decline of the north, and improve democratic outcomes.

Travers observes that the relationship between central and local government in England is often framed as “they are always asking for more/ they never give us enough money”,<sup>35</sup> without providing any meaningful insight into how well the respective tiers of government perform. Restoring the link between local expenditure and tax could meaningfully address this deficit. It also could also incentivise city-regions, and indeed local councils, to pursue public initiatives that grow the overall economic pie. Manchester is notable for its 10 local authorities uniting behind a single goal for such a long time. This is not the case in many other parts of England. Having decision-making power and the resultant positive or negative consequences, devolved to a local level, central government expects local authorities to help overcome divisions that would have otherwise scuppered worthwhile projects. Sir Richard says:

It ought to be [a step] for far greater freedom for metropolitan areas like Greater Manchester, where we are incentivised to grow business, and where growing business is investing in infrastructure. If we use local tax revenue to invest, then we ought to reap the benefit instead of it going off to the Treasury.<sup>36</sup>

## Distilled wisdom

Drawing out relevant lessons from the British devolutionary process for New Zealand is complicated by differences in government structure. Local councils here have considerable revenue-raising powers (albeit limited to property taxes) that are only starting to be divested in places like Manchester. Similarly, New Zealand’s regional authorities have long been part of the political landscape, whereas in England they were abolished 30 years ago by the Thatcher government. These lessons will be explored in greater detail in the third report in this series. Nevertheless, some lessons are self-evident, even at this early stage.

The first is while there are structural differences, New Zealand and England both operate under a highly centralised form of government. In a scenario where local authorities are claiming a greater measure of independence, Greater Manchester provides a roadmap to do it.

The second is that change has to be initiated at a local level. Waiting for central government to devolve power, regardless of the economic case, will not get the ball rolling. The third is to develop a clear vision for a region the public and private sector can buy into. This takes strong leadership to ensure parties work together on a shared strategy. Once this buy-in is established, an evidence base needs to be assembled to back up the strategy, and subjected to rigorous independent scrutiny. Fourth, central government in a unitary state is a partner that must be coaxed, not a rival to be fought. Finally, Greater Manchester’s devolution has been the work of decades, and there is no reason to expect that timeframe to be any shorter in New Zealand.

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<sup>35</sup> Tony Travers, Personal interview (30 October 2015).

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<sup>36</sup> Sir Richard Leese, Personal interview (27 October 2015).

## WHAT IS BEING DEVOLVED TO GREATER MANCHESTER?

### TRANSPORT:

- Responsibility for a joined up and multi-year transport budget
- Responsibility for franchised bus services, including the power to set fares, routes and frequency
- Power to introduce integrated smart ticketing across all local modes of transport
- Ability to shape local rail policy and development across the Greater Manchester area
- Control of a reformed Earnback Deal, which will yield up to £30 million a year for 30 years for GMCA to invest in further schemes

### BUSINESS SUPPORT:

- Responsibility for business support budgets, making it easier for businesses to access the right support at the right time to help them grow and innovate

### BUSINESS RATES:

- Retain 100% of any growth in business rates, where previously all business rates were paid to central government and then redistributed

### HOUSING AND PLANNING:

- Powers over strategic planning, including creating a statutory spatial framework for Greater Manchester
- Control over a new £300 million recyclable Housing Investment Fund
- Power to establish a Greater Manchester Land Commission to best use publicly owned land
- Power to designate mayoral development corporations and compulsory purchase powers
- Power to vary Sunday trading regulations

### BORROWING POWER:

- Power to borrow in respect of any combined authority function, subject to compliance with the Prudential Borrowing Code

### BLUE LIGHT SERVICES:

- The Greater Manchester mayor will assume the duties of the Police and Crime Commissioner and the Fire and Rescue Authority, which are currently under the purview of central government

### SKILLS AND EMPLOYMENT:

- Power to restructure Greater Manchester's Future Education, which ensures the local education system produces the skills sets sought by local industries
- Jointly commission the next phase of the Work Programme with the Department of Work and Pensions to enable the city-region to tailor services to best meet the needs of residents

### COMPLEX DEPENDENCY:

- Power to expedite public service reform programmes

### SERVICES FOR CHILDREN:

- Review how existing budgets can be used more effectively to deliver better integrated and more efficient children's services

### HEALTH:

- A new partnership arrangement between Greater Manchester's health and social care bodies and NHS England by 2016 will give the city-region full control of all funding and decision-making for health and social care within Greater Manchester



# CHAPTER TWO

## SWITZERLAND

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If the United Kingdom's devolutionary process represents the first step on the path to localism, then my next destination is literally and figuratively many hundreds of kilometres away. Wedged between central and southern Europe, Switzerland is a small country famed for its chocolate, watches, private banking, and pristine pastures. Roughly the geographical size of Canterbury, Switzerland is nestled between snow-capped mountains and has few natural resources. The population of nearly 8 million is divided into two main language and cultural groups (German and French speaking). For the politically inclined, the country is probably more remarkable for its decentralised governance arrangements. Not that this distinction is immediately obvious.

Travelling from the airport to the Bern city centre, I could not spot anything to differentiate the Swiss capital from Manchester (barring cultural and historical factors, and of course the backdrop of the Alps). Extensive bus, tram and train networks service Bern, as they do in Manchester. The quality of roads is comparable, and the myriad local government services modern cities supply, such as street cleaning and refuse removal, were similar enough that only someone with strong nationalistic views could distinguish between the two. Both countries are thus broadly comparable within the developed world social-democratic continuum.

But to come to this conclusion is to miss some startling facts about the Swiss economy. Far from the pastoral stereotype, Switzerland is one of the most economically efficient countries in the world, topping the World Economic Forum's Global Competitiveness Index for the past seven years.<sup>37</sup> In the most recent report in 2015, Switzerland

was commended for its high level of innovation, academic-private sector cooperation, business sophistication, education system, labour market efficiency, public institutions, infrastructure, connectivity, financial markets, and stable macroeconomic environment.<sup>38</sup> By comparison, the United Kingdom was ranked 10th in 2015 and New Zealand 17th in 2014 (the last year New Zealand featured in the survey). Other economic indicators show this is not a fluke.

The Swiss state's role in the economy is fairly limited, with government spending equivalent to 33.5% of gross domestic product (GDP) in 2014, according to OECD data (compared to 44.4% in the United Kingdom and the OECD average of 41.9%).<sup>39</sup> Swiss GDP per capita (expressed in purchasing power parity terms) was US\$59,535 in 2014, exceeding the United Kingdom (US\$40,209), the OECD average (US\$39,211), New Zealand (US\$38,223), and EU average (US\$36,818).<sup>40</sup>

What makes this achievement more remarkable is the governance structure by which this was achieved.

The Swiss federalist structure consists of three tiers of government. At the top is the federal government, followed by 26 cantons, which are the equivalent of provinces or states in a typical federalist model. Below them are about 2,400 political communes, the Swiss equivalent of municipalities or district councils. The canton of Bern alone has almost 400 communes for a population of 1 million people.<sup>41</sup> By comparison,

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37 Klaus Schwab, "The Global Competitiveness Report 2015–2016" (Geneva: World Economic Forum, 2015), 7 and 23.

38 Ibid.

39 OECD, "OECD Economic Surveys: Switzerland" (Paris: OECD Publishing, 2015).

40 OECD, "Level of GDP Per Capita and Productivity," Website.

41 City Population, "Switzerland: Bern," Website.

Greater Manchester has just 10 boroughs to service a population of 2 million people.

For the traditionally centrist Whitehall, the Swiss system of governance must seem a recipe for inefficiency and wasteful spending. Indeed, it would be the same for New Zealand's political establishment, which over the past 175 years has reduced the number of local authorities to "improve" local government efficiency.<sup>42</sup> Even for someone such as myself, who believes in the merits of devolution, the sheer abundance of local government in Switzerland seems excessive. And yet that the Swiss system works cannot be doubted, as the World Economic Forum and GDP data show. More practically, Switzerland's public infrastructure was the best of the four developed countries I visited on my research trip. One would be hard pressed to find any public service that runs with the same split-second consistency in any of New Zealand's major cities.

### The body of localism

The highly decentralised Swiss governance system seems to produce better economic outcomes compared to the United Kingdom and New Zealand. Are the Swiss inherently different or is there something highly centralised governance systems can learn from Switzerland? Pierre Bessard says the answer is "yes and no" – as you might expect from an economist specialising in institutional competition.

Bessard and I met at the Liberales Institut, an economic think tank with offices in the historic part of Bern's city centre. The stonework in this part of the city dates back to the 1600s – a fitting setting to discuss the non-replicable part of Swiss localism, namely its history.

Unlike some developed countries that have only recently begun to embrace decentralisation, Switzerland was never centralised in the first place. Abstracting the details of military victories,

defeats, the Napoleonic invasion, and a civil war, the theme that undercuts the history of Switzerland over the last 800 years is of small fiefdoms merging to form a confederation out of self-interest – but without sacrificing their political autonomy to the nation-state.<sup>43</sup> As such, cantons and communes were used to providing services to the local populations, and this bottom-up approach to government underpins the modern Swiss political system.

"Switzerland never centralised", says Bessard. "It is a completely different starting point than if you had a unitary state that you then divided".<sup>44</sup>

This explains some of the peculiarities of the Swiss system. Communes have exclusive powers over local service delivery. This is true to some extent for municipalities in New Zealand, but the scope of the Swiss communes is wider, and includes providing some social services such as welfare and primary education. Communes, as the lowest tier of government and closest to the people, are the "bed rock of Swiss governance", whose control over financial, policy and political matters makes "British parish councils seem totally impotent", to quote political scholars Clive Church and Paolo Dardanelli.<sup>45</sup> The country's history also explains the special place of communes in the Swiss national identity, such that citizenship is conferred at a municipal level.<sup>46</sup> Communes, while under the direction of cantonal governments, have a high degree of autonomy. Such is the independence of local government in Switzerland that should a commune fall into fiscal default, it is unlikely to be bailed out by higher levels of government.<sup>47</sup>

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<sup>42</sup> Jason Krupp and Bryce Wilkinson, *The Local Formula: Myths, Facts and Challenges* (Wellington: The New Zealand Initiative, 2015), 5–8.

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<sup>43</sup> Wolf Linder and Andrea Iff, "Swiss Political System" (Bern: Federal Department of Foreign Affairs, 2010), 4.

<sup>44</sup> Pierre Bessard, Personal interview (3 November 2015).

<sup>45</sup> Clive H. Church and Paolo Dardanelli, "Twelve Key Points about Swiss Politics and Democracy," Centre for Swiss Politics, (Kent: University of Kent, 2008).

<sup>46</sup> Pascal Bulliard, "Local Government in Switzerland" (Johannesburg: Konrad-Adenauer-Stiftung, 2005).

<sup>47</sup> Jonathan A. Rodden, "Hamilton's Paradox: The Promise and Peril of Fiscal Federalism" (London: Cambridge University Press, 2006), 250.



Switzerland's cantons are largely responsible for regional functions such as health, police, broader social policy, and also cultural matters. Conceptually, since each maintains its own parliament, it is probably more useful to see each canton as a separate nation-state rather than as a province in the traditional federal structure. Cantons can pursue their own legislative agenda with minimal direction from central government, provided it does not conflict with the national constitution and national policy guidance.

National matters like defence, foreign policy, monetary policy, and trade are ceded to the federation, as well as policy areas that require a high degree of cross-jurisdictional coordination, such as major transport networks and infrastructure works. However, the constitution strictly limits the scope of these powers. Furthermore, central government in Switzerland does not have operational capacity, and must

rely on the cantons and communes to execute its policies.<sup>48</sup> Further protecting the separation of powers are the constitution, tax system and direct democracy. The Swiss constitution clearly defines the role of each tier of government, and prevents the encroachment of one tier into another. Indeed, the system was designed to ensure political power does not gravitate towards the centre, but remains with the respective tiers (Table 2).

Political power is also assumed to reside in the individual and flow up to the various government structures. This is expressed by allowing individuals to challenge a law at a federal or cantonal level via referenda, as well as propose cantonal laws and votes on constitutional amendments, provided there is sufficient popular backing. The system is further underpinned by a direct tax system, under which each tier of government raises revenue from citizens separately. Until the Manchester deal, nearly all tax

**Table 2: Distribution of powers and responsibilities in Switzerland**

<b>Federal powers</b> Based on the Swiss Constitution	<b>Cantonal powers</b> Based on cantonal constitutions	<b>Municipal powers</b> Depending on cantonal legislation
Organisation of federal authorities Foreign affairs	Organisation of cantonal authorities (own constitution, own anthem, own flag)	Education (kindergartens and primary schools)
Army and civil protection	Cross-border cooperation	Waste management
National streets (highways)	Police	Municipal streets
Nuclear energy	Relations between religion and state	Local infrastructure
Postal services and telecommunication	Culture	Local police
Monetary policy Social security (pensions, invalids)	Public health	Zoning
Civil law, criminal law	Cantonal streets	Citizenship
Civil and criminal procedure	Forests, water, natural resources	Municipal taxes
Customs	Education (secondary schools and universities)	
Education (technical universities)	Protection of the environment	
Energy policy	Protection of nature and heritage	
Principles for zoning Protection of the environment Citizenship	Citizenship	
Federal taxes	Cantonal taxes	

Source: Wolf Linder and Andrea Iff, "Swiss Political System" (Bern: Federal Department of Foreign Affairs, 2010), 4.

<sup>48</sup> Ibid.

revenues in the United Kingdom accrued to central government and then reallocated according to a set formula. New Zealand's own local tax system is also less direct than that of Switzerland, as rates are only levied on property owners.

Even more peculiar when compared to the adversarial Westminster system is the 'consensus politics' approach used in the Swiss democracy. After an election, all the major parties at the federal level form a grand coalition and jointly appoint the seven ministers responsible for running central government on a consultative basis, while also recognising the demographic proportions of the country. The Federal Supreme Court of Switzerland acts as a check and balance on central government. It can be difficult for an outsider to understand how this works in practice, but what is certainly clear is that localism is embedded in the Swiss DNA.

### The spirit of localism

This discussion of the Swiss political system only captures the headline features. In reality it is far more complicated, which is unsurprising given the plethora of local authorities and the freedoms extended to them. This is clearly the part Bessard views as non-replicable. But to only focus on the specifics of structure, while important, would be to miss the parts of the system that are replicable, namely the spirit of localism.

This important distinction was clarified by Beat Kappeler, an economist, long-time business columnist, academic and former adviser to the Swiss Federation of Trade Unions. Our meeting took place at Café Federal, a restaurant opposite the federal government buildings in Bern. It is also the place where the national political parties meet to negotiate who will fill the seven ministerial positions after an election. Kappeler, who chose this restaurant for its symbolism, stresses that the key to localism is a principled trust in the individual.

It is a given that people will act responsibly, and will make practical decisions when it comes to their affairs, be it at a federal, cantonal or

communal level. If people are used to deciding such things they can decide quite rationally.<sup>49</sup>

This seems a stretch from the political deadlock evident in New Zealand, where the democratic preferences of the public appear to run counter to regional economic growth initiatives. To test Kappeler's assertion, I later informally quizzed a number of people over my stay about the decision-making process in local government politics. Almost everyone I spoke to flippantly dismissed the question. "It is just a process of business-like administration" and "they just decide among themselves what makes sense" were the most common answers. The practical boringness of these answers was refreshing compared to the overt antagonism in New Zealand.

Even at a national policy level, there appears to be a high degree of conservatism and personal responsibility among the public not always evident in other countries. For example, parliamentarians in neighbouring Austria recently voted to extend annual leave to five weeks. When unions in Switzerland sought to extend annual leave from four weeks to six, it was decisively voted down by the public in a referendum, with two-thirds of voters saying it would act as a major drag on the economy.<sup>50</sup> This is the part of the Swiss localist tradition Kappeler believes is not only replicable but also desirable in its own right:

If you have the institution of voting you get used to it, and you think of it more rationally. And this attitude of "they should do this, they should do that" [still exists], but it is me paying for it.<sup>51</sup>

### Contest in context

Another important replicable element of Swiss localism is its competitive nature. From the discussion above, it may be tempting to view the

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<sup>49</sup> Beat Kappeler, Personal interview (4 November 2015).

<sup>50</sup> Agencies, "Swiss vote to reject longer holidays," *Al Jazeera* (12 March 2012).

<sup>51</sup> Beat Kappeler, Personal interview (4 November 2015).

Swiss arrangements as an elaborate and efficient clockwork mechanism. The only problem with this simile is that it is wrong. The system is rather a set of tiered rules that allow Switzerland to function as a nation-state, but in manner that allows significant scope for differentiation and experimentation.

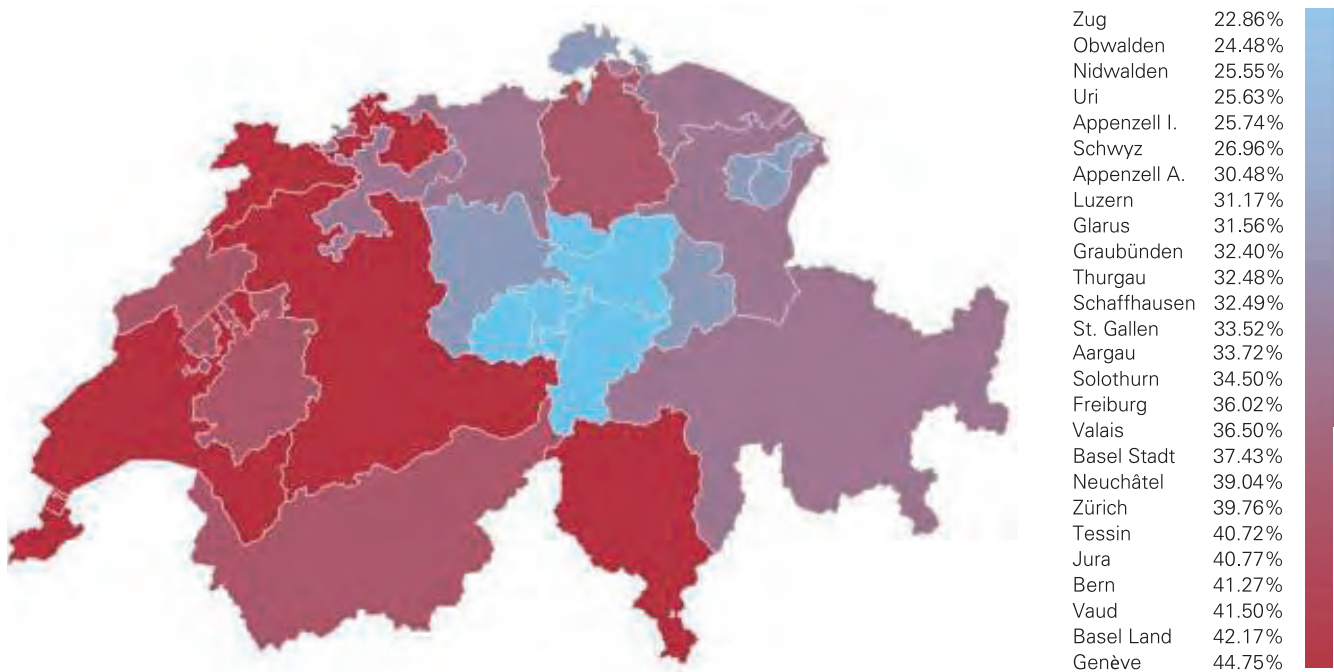
Federalist scholar Pascal Bulliard says this is key to the Swiss system. “Switzerland shows what the essence of federalism is: a multi-level state architecture in which the architects are always drawing new plans and building new constructions according to the people’s will”.<sup>52</sup>

No element of the system demonstrates this more clearly than tax competition at the cantonal and communal levels. Under Swiss law, cantons have considerable control over what they can levy taxes

on (e.g. tobacco, income, property, etc.), as well as the rate of tax, subject to certain federal rules. For example, cantons cannot charge a value added tax on goods and services, as this is a federal tax. Furthermore, income taxes cannot be regressive. Nevertheless, this still leaves considerable scope for variation (Figure 1).

Even the communes, which cannot determine the type of taxes they levy, have significant control over the tax rate.<sup>53</sup> And because taxes are individually levied at the federal, cantonal and communal levels, it makes comparisons between jurisdictions easy. The Swiss are also highly mobile. The homeownership rate is 44%, estimated by the OECD to be the lowest in Europe.<sup>54</sup> And although the country has two main official languages (French and German<sup>55</sup>), these bands tend to be intertwined (unlike Belgium, which is clearly

**Figure 1: Maximum individual income tax rates for single taxpayers with no children**



Source: KPMG, “Corporate Tax Rates in Comparison,” [www.kpmg.com/CH/en/services/Tax/Documents/20150401-swiss-tax-report-individual-tax-en.pdf](http://www.kpmg.com/CH/en/services/Tax/Documents/20150401-swiss-tax-report-individual-tax-en.pdf).

<sup>52</sup> Pascal Bulliard, “Local Government in Switzerland,” op. cit. 144.

<sup>53</sup> Bernard Dafflon, “Fiscal Federalism in Switzerland: A Survey of Constitutional Issues, Budget Responsibility and Equalisation,” University of Fribourg Working Paper 278 (1999), 11–12.

<sup>54</sup> OECD, “OECD Economic Surveys: Switzerland,” op. cit. 62.

<sup>55</sup> Italian is the third-most spoken language in Switzerland and is concentrated in the south of the country.

divided into Flemish and French speaking parts). As a result, there are strong incentives for local authorities in Switzerland to be responsive to the needs of their communities, and to provide their particular basket of public goods and services as cost-effectively as possible. To do otherwise would likely result in citizens moving to any of the 2,600 other communes or 26 cantons that do.

In Zurich I met Lukas Rühli, an economist at Avenir Suisse, Switzerland's best-known think tank. Rühli said outsiders, especially those coming from countries with a more centralist form of government, find it difficult to grasp why the Swiss system is so efficient. That is largely because the comparison is made on a bottom line level, between a single national police service, say in New Zealand, versus 26 separate police services in Switzerland. However, he notes that the Swiss system shows the benefits of adaptability and competition outweigh the bottom line costs. Rühli says:

Switzerland truly has its efficiency problems – you cannot deny that. In a static sense, it is not efficient to have 26 cantons with an average population of 300,000 inhabitants and 2,600 communes. But in a dynamic sense it is more efficient because of competition.<sup>56</sup>

One area that clearly demonstrates the benefits of local government competition is housing. OECD figures show that in real terms, house prices in Switzerland have declined by 27% from 1990 to 2007,<sup>57</sup> even as the country's population grew by 11% over the same period.<sup>58</sup> This data should be treated with some caution as it partially captures the effects of a housing crisis in the late 1980s and early 1990s. The crisis was caused by overly tight monetary policy when the Swiss economy was in recession, dousing demand for housing. But even so, OECD data shows that prices are still below the 1989

peak even as Switzerland has become an attractive destination for investors seeking less risky assets after the Euro crisis. By comparison, New Zealand housing prices rose by 58% in real terms from 1990 to 2007,<sup>59</sup> outstripping a population growth rate of 27% over the same period.<sup>60</sup>

To further put this in perspective, large tracts of land in Switzerland are not suitable for development because of the country's topography. New Zealand, by comparison, is sparsely populated and its surface area is broadly comparable to that of the United Kingdom. Economists Oliver Hartwich and Alan Evans attribute the affordability of housing in Switzerland to tax incentives and the decentralised planning system.<sup>61</sup>

From a legislative view, the Swiss planning system looks similar to that of New Zealand. Central government provides a broad framework, cantons are responsible for regional planning, and communes handle local land use matters. However, Hartwich and Evans note that since communes and cantons must compete for taxpayers in the highly mobile Swiss system, local authorities are incentivised to respond to the needs of residents to a much higher degree than in New Zealand, albeit within the broader constraints of the system.<sup>62</sup> To do otherwise would result in a loss of revenue.

The legislative freedom afforded to communes also gives them the freedom to experiment with different processes and building types. Hartwich and Evans note that the housing market is very flexible as a result, and different housing types are produced to meet the varied demands of Swiss buyers.<sup>63</sup> The flexibility of the system also enables yardstick competition.

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<sup>56</sup> Lukas Rühli, Personal interview (5 November 2015).

<sup>57</sup> OECD, "OECD Analytical House Price Database (Paris: OECD Publishing, 2015), [www.oecd.org/eco/outlook/House\\_Prices\\_indices.xlsx](http://www.oecd.org/eco/outlook/House_Prices_indices.xlsx).

<sup>58</sup> Google, "Public Data," Website, [www.google.co.nz/publicdata/explore?ds=d5bncppjof8f9\\_&met\\_y=sp\\_pop\\_totl&idim=country:CHE:SWE:AUT&hl=en&dl=en](http://www.google.co.nz/publicdata/explore?ds=d5bncppjof8f9_&met_y=sp_pop_totl&idim=country:CHE:SWE:AUT&hl=en&dl=en).

<sup>59</sup> OECD, "OECD Analytical House Price database," op. cit.

<sup>60</sup> Google, "Public Data," Website, [www.google.co.nz/publicdata/explore?ds=d5bncppjof8f9\\_&met\\_y=sp\\_pop\\_totl&idim=country:NZL&hl=en&dl=en](http://www.google.co.nz/publicdata/explore?ds=d5bncppjof8f9_&met_y=sp_pop_totl&idim=country:NZL&hl=en&dl=en).

<sup>61</sup> Oliver Hartwich and Alan Evans, "Bigger, Better, Faster, More" (London: Policy Exchange, 2005), 42.

<sup>62</sup> Ibid.

<sup>63</sup> Ibid.

Kappeler cites the city of Davos to show how this works in practice. Many decades ago, local authorities in this picturesque alpine city passed a by-law requiring all buildings to have flat roofs. But since this added considerably to the costs of construction, few communes have implemented the by-law. Local government diversity works to isolate bad policy ideas, and propagate good ones.

Critics say this competitive system is a formula for a tax race to the bottom, a problem well-recognised in economic literature. This is where policymakers set tax rates lower than their neighbours to attract high earning individuals and firms to maximise tax revenue. Neighbouring authorities respond by lowering their tax rates, triggering a chain of responses whereby total revenues are insufficient to pay for the provision of public goods. The race to the bottom problem could also apply where poor people move to high tax jurisdictions because of the level of social services this implies, thereby increasing costs and encouraging wealthy residents to emigrate to other cantons or communes.

A superficial examination suggests the ingredients for a tax race to the bottom are evident in Switzerland. Econometric analysis shows that for every percentage point increase in the cantonal company tax rate, the percentage of holding companies decreases by 0.2%.<sup>64</sup> Other quantitative studies too show evidence of a fiscal migration of both wealthy and poor residents in Switzerland.<sup>65</sup> The mobility of firms and individuals is a necessary condition for a tax race to the bottom.

However, a more in depth analysis shows these ingredients have not manifested into a race to the bottom. For example, one study found that although overall tax rates have tended to converge towards a lower level between 1990 and 2007 (a condition necessary for a race to the bottom) this

was concentrated at the lower end of the earnings spectrum, whereas tax rates on high income earners were more heterogeneous.<sup>66</sup> Indeed, income redistribution at a sub-central government level actually increased between 1977 and 1992, and was accompanied by a corresponding increase in tax redistribution.<sup>67</sup>

Another empirical study supports this, finding a positive relationship between expenditure decentralisation and education attainment.<sup>68</sup> This means the more control communes have over the appointment of teachers, salary levels, teacher incentives, and school structure, the higher the education attainment in that jurisdiction. The effect was particularly beneficial to boys, who typically lag girls in academic performance.<sup>69</sup> This runs counter to the view that large economies of scale are needed for the efficient provision of local goods and services. Indeed, other quantitative research found no evidence of economies of scale among Swiss cantons, justifying the public's longstanding resistance to communal or cantonal mergers.<sup>70</sup>

Several reasons explain why a race to the bottom has not occurred, according to Fabrizio Gilardi, et al.<sup>71</sup> First, tax differences are capitalised in house prices so low tax jurisdictions have higher property prices. This can be seen in Zug, which is Switzerland's richest canton due to its longstanding low corporate tax policy. Property

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<sup>64</sup> Gilberto Cárdenas and Sofía García Gamez, "The Influence of the Tax System on the Location of Holding Companies in Switzerland," *Competitiveness Review* 25:2 (2015), 218–237.

<sup>65</sup> Lars P. Feld and Gebhard Kirchgässner, "Income Tax Competition at the State and Local Level in Switzerland," *Regional Science & Urban Economics* 31:2–3 (2001), 181–213, 201.

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<sup>66</sup> Fabrizio Gilardi, Daniel Kübler and Fabio Wasserfallen, "Cantonal Tax Autonomy in Switzerland: Trends, Challenges and Experiences," Paper presented for Tax Autonomy of Subnational Entities seminar (Madrid: 25 February 2010), 12.

<sup>67</sup> Lars P. Feld and Gebhard Kirchgässner, "Income Tax Competition at the State and Local Level in Switzerland," op. cit. 207.

<sup>68</sup> Iwan Barankay and Ben Lockwood, "Decentralization and the Productive Efficiency of Government: Evidence from Swiss Cantons," *Journal of Public Economics* 91:5–6 (2007), 1197–1218, 1203.

<sup>69</sup> Ibid., 1215.

<sup>70</sup> Philippe Widmer and Peter Zweifel, "Fiscal Equalization, Tiebout Competition, and Incentives for Efficiency in a Federalist Country," *Public Finance Review* 40:1 (2012), 3–29, 17.

<sup>71</sup> Fabrizio Gilardi, Daniel Kübler and Fabio Wasserfallen, "Cantonal Tax Autonomy in Switzerland," op. cit. 12.

prices have risen so high that companies with headquarters in Zug are struggling to find lower and mid-tier staff, and the canton has had to build subsidised housing to attract such workers.<sup>72</sup>

Second, cantons do not just compete on tax rates but also levels of service. Kappeler says watchmaker Swatch was persuaded to build a factory in Biel, a city in the canton of Bern, because of favourable planning arrangements, not because of the canton's corporate tax rate,<sup>73</sup> which ranks among the highest in Switzerland at 21.6%.<sup>74</sup> Rühli too said cantons tend to compete on services because the incentive effect from a tax cut is likely to be weaker than generally estimated as a result of Switzerland's tiered government structure. Should a commune slash tax rates, the effect will be diluted because municipal taxes only account for about a third of an individual's overall tax bill. Furthermore, institutional arrangements also act as a brake on tax competition. The high degree of autonomy afforded to cantons and communes allows them to enter into mutual cooperation agreements, where both parties agree to minimum service levels on matters such as healthcare and building standards. This creates a cost floor, limiting the scope of revenue cuts. Switzerland's direct democracy also acts as a control on politicians pursuing a low tax strategy.

Finally, fiscal equalisation is used to compensate cantons with few economic advantages (such as rural regions), which experience higher service costs because of spill-over problems ('out of jurisdiction' free riders on public services) or unfavourable demographics.<sup>75</sup> This redistribution ensures minimum standards on public services, such as primary schooling and public transport in non-urbanised cantons. Furthermore, it does so in a way that eliminates the tax policy idiosyncrasies that make the Swiss system so

competitive (although these transfers are highly controversial).<sup>76</sup>

## Conclusion

It is beyond the scope of this report to capture the full inner workings and complexities of the Swiss political system. The focus has been on the broader dynamics of how local authorities operate, and not so much on the federal government and its relationships with the cantons and communes. Nevertheless, the themes of local incentives, personal responsibility, competition, and decentralised decision-making should be clear.

Another important theme has been of adaptability. The Swiss political system is not perfect, as even its strongest proponents readily admit. But even if it were, the perfect rules for today are not likely to remain so tomorrow as inputs and attitudes change. The Swiss have instead created a political system that is responsive to these changes to a much greater degree than the more centrally controlled and planned approach in New Zealand or the United Kingdom. These elements are critical to the long-term success of the Swiss system.

People are trusted to make rational decisions about the running of their locality. Clear financial incentives provide natural constraints on public spending, and these incentives encourage responsiveness to local needs. Competition also ensures there is an evolutionary process in place to promote good polices and isolate the bad. And finally, the direct democratic process means policy mistakes are quickly corrected. These are all replicable factors that should be considered to some extent in any local government reform in New Zealand.

THE  
NEW ZEALAND  
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<sup>72</sup> Deborah Ball, "Tax haven's tax haven pays a price for success" *Wall Street Journal* (29 August 2011).

<sup>73</sup> Beat Kappeler, Personal interview (4 November 2015).

<sup>74</sup> KPMG, "Corporate Tax Rates in Comparison," Website, [www.kpmg.ch/swisstaxes](http://www.kpmg.ch/swisstaxes).

<sup>75</sup> Wolf Linder and Andrea Iff, "Swiss Political System," op. cit.

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<sup>76</sup> Details of the cantonal equalisations equation can be found at Bernard Dafflon, "Fiscal Equalization: The Swiss Way, Federal, Cantonal, Local," Fiscal Equalization Transfers – International Perspectives: Lessons for Poland – Warsaw 11–12 December 2014 (World Bank, 2014).

# CHAPTER THREE

## THE NETHERLANDS

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Bern and its orderly profusion of city life showcase the similarities between Switzerland and New Zealand. That is not the case at Amsterdam's Schiphol Airport, which teems with the kind of orderly chaos only found at major aviation gateways. The hustle and bustle of the airport continues at Amsterdam Central, where throngs of tourists, residents, and business people blend into each other. Beyond the footpaths, cyclists, trams, private cars, buses and pedestrians weave together in a dance that looks discordant but never really skips a beat.

Standing on the balcony of my 12th floor hotel room, overlooking the huge RAI business event complex and the city of Amsterdam beyond, I was struck by how dissimilar this place is to cities in Switzerland, let alone those in New Zealand. With 17 million people<sup>77</sup> crammed into an area roughly equivalent to Switzerland, the Netherlands is one of the most densely populated countries outside Asia. It is also situated in the middle of the European mega-market. A massive amount of goods pass through the Netherlands due to its position at the mouth of the Nieuwe Maas River, which connects the Rhine and Maas rivers to the North Sea. The Netherlands has a strong agricultural sector and a thriving services sector with well-developed financial and innovation industries. Indeed, the country's GDP of US\$831

billion was five times bigger than New Zealand's in 2015 in purchasing power parity terms.<sup>78</sup>

However, to get caught up on the surface differences between the two jurisdictions would be to miss an important point about their recent history. Just under 40 years ago, both the Netherlands and New Zealand structured their affairs along similar lines, with highly protectionist and state-dominated economies. The rigid system, and the resulting blowout in public debt, forced both states to undergo radical market-oriented restructuring of their economy. Both countries implemented New Public Management reforms and introduced private sector type operations at a local government level in the 1990s.<sup>79</sup> But where New Zealand continued to concentrate political power at a central government level in accordance with Westminster traditions, the Dutch chose to pursue decentralisation, mirroring a deeply rooted cultural belief in self-governance.<sup>80</sup> Indeed, local Dutch authorities perform many of the same functions as the communes in Switzerland, such as welfare and policing, even though the country has a unitary state structure.<sup>81</sup>

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77 Statistics Netherlands, "Population: Key Figures 2015," Website, [http://statline.cbs.nl/statweb/publication/?vw=t&dm=slen&pa=37296eng&d1=a&d2=0,10,20,30,40,50,60,\(1-1\),l&hd=160114-1555&la=en&hdr=g1&stb=t](http://statline.cbs.nl/statweb/publication/?vw=t&dm=slen&pa=37296eng&d1=a&d2=0,10,20,30,40,50,60,(1-1),l&hd=160114-1555&la=en&hdr=g1&stb=t).

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78 International Monetary Fund, "World Economic Outlook Database 2015: Report for Selected Countries and Subjects," Website, [www.imf.org/external/pubs/ft/weo/2015/02/weodata/weorept.aspx?pr.x=82&pr.y=3&sy=2014&ey=2020&scsm=1&ssd=1&sort=subject&ds=.&br=1&c=138%2C128%2C142%2C172%2C936%2C174%2C961%2C144%2C146&s=NGDPD%2CNGDPDPC%2CPPPDP%2CPPPPC&grp=o&a=](http://www.imf.org/external/pubs/ft/weo/2015/02/weodata/weorept.aspx?pr.x=82&pr.y=3&sy=2014&ey=2020&scsm=1&ssd=1&sort=subject&ds=.&br=1&c=138%2C128%2C142%2C172%2C936%2C174%2C961%2C144%2C146&s=NGDPD%2CNGDPDPC%2CPPPDP%2CPPPPC&grp=o&a=).

79 Jason Krupp and Bryce Wilkinson, *The Local Formula: Myths, Facts and Challenges*, op. cit. 6.

80 Frits Bos, "Fiscal Decentralisation in the Netherlands: History, Current Practice and Economic Theory" (The Hague: Netherlands Bureau for Economic Policy Analysis, 2010), 38.

81 Even before the adoption of the current decentralised structure in 1853, municipalities provided many goods and services to their communities on an independent basis.

This divergence is useful when examining devolved forms of government. For New Zealand, Swiss federalism may seem like an impossible system to copy. The Dutch system, however, provides a concrete example of how a centralised state can reorganise itself. More specifically, it shows how local government can tackle the challenges of globalisation, urbanisation, ageing, and rural depopulation that both nations face.

## Anatomy of the lower countries

Before looking at the forces that have shaped Dutch local government since 1982, it is useful to examine the structure of the country's political landscape. In many respects, it appears similar to Switzerland, with a profusion of local authorities.

At the lowest level of the Dutch government are more than 400 municipalities. They vary in population size, from 1,000 inhabitants to nearly 800,000 in Amsterdam (the average municipality's population is around 35,000). Municipalities are responsible for not only public services such as waste removal and roads, but also social services such as aged care and welfare.

Unlike the Westminster system, where the role of local government is strictly determined by parliament, municipalities in the Netherlands are free to provide almost any good or service their communities demand, albeit guided by provincial and central government oversight. The municipalities are governed by directly elected councils, who appoint aldermen (individuals who represent political parties) to run jurisdictional operations. Interestingly, municipal mayors are not elected but appointed by central government – they act as chairs and are responsible for safety and security (although municipalities can oust unpopular mayors).

At one level above, the Netherlands is divided into 12 provinces, which are broadly comparable to regional councils in New Zealand. The role of the provinces is twofold, namely spatial planning and oversight of the municipalities in their jurisdiction, albeit under central government guidance.

Water boards are another regional structure in the Netherlands, and oversee the various water related issues such as sewerage, drinking water, and water defence in conjunction with the provinces and municipalities. This is a particularly important role in a country where close to a quarter of the landmass is below sea level.<sup>82</sup> The water boards, provincial governments and municipalities are subject to central oversight and legislative direction, although each tier of government is considered equal from an institutional perspective.<sup>83</sup>

This is where the neatly quantifiable part of the governance structure ends. The Dutch system is less clear cut and definable in describing how it functions as a political machine. That is because unlike more adversarial political systems, the Dutch system is underpinned by 'consensus politics'. Often described as the Polder Model, this form of decision-making was institutionalised as part of the 1980s reforms to sidestep disputes between government, labour unions and businesses. This informal (and idiosyncratic) aspect of Dutch politics since at least the 1950s<sup>84</sup> ensures the winning party in political negotiation does not get 100% of its demands and the loser does not leave the table empty-handed.<sup>85</sup>

This culture of compromise pervades the Dutch political system. Nationally, the parliament is run on a proportional basis, and the political landscape is highly fragmented with 17 parties currently in parliament. This means the biggest winner in an election has to enter into a coalition with several parties to form a government (there has never been an outright parliamentary majority in modern Dutch history).<sup>86</sup> However, unlike adversarial political systems (such as New Zealand's Mixed Member Proportional system, where there is a clear

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<sup>82</sup> Dutch Water Authorities, "About Us," Website.

<sup>83</sup> Association of Netherlands Municipalities, "Local Government in The Netherlands" (The Hague: 2008), 14.

<sup>84</sup> "Model makers," *The Economist* (2 May 2002).

<sup>85</sup> Arnold van der Valk, "The Dutch Planning Experience," *Landscape and Urban Planning* 58:2-4 (2002), 201-210, 205.

<sup>86</sup> Association of Netherlands Municipalities, "Local Government in The Netherlands," op. cit. 18.



Left-Right divide<sup>87</sup>), the Dutch system produces political coalitions that often cross the ideological spectrum. For example, the current ruling coalition comprises the conservative-liberal People's Party for Freedom and Democracy and the left-wing Labour Party.

Coalitions can often involve three or more political parties, and conceding ground on a particular issue – even if an outright win were possible – tends to be wise as it leaves the door open for coalition deals in the future. However, municipalities and provinces are free to run their own affairs under the decentralised arrangements, but cabinet ministers are directly accountable for all activities under their portfolio. This is what the Dutch refer to as the paradox of decentralisation. Central government can only intervene by introducing new legislation.

The party system is also prevalent at the local level. However, in recent years the emergence of local political parties has eroded the dominant position the majors once held.<sup>88</sup> Another distinctive feature of the Dutch governance structure is the funding model. Central government provides more than 60% of local government funding in the Netherlands, unlike in Switzerland where local authorities generate much of their revenue through local taxes.<sup>89</sup>

## Adaptability

Having just seen Switzerland's highly competitive fiscal federalism, it was initially difficult for me to see how Dutch localism functions on a self-sustaining basis. Swiss autonomy over local tax matters and the clear delineation between federal, cantonal and communal taxes is the key to the

country's hyper-competitive economy. It could be said the Swiss are so externally competitive because they compete with themselves first and foremost. It is not immediately clear the same scope for competition exists in the Dutch governance structure, especially since a significant chunk of local funding comes from central government grants. An informal rule in politics is the person who controls the purse strings controls the political agenda. How is it that the Dutch system is not more centralised, let alone decentralised, than it is? And if competitive forces are the key to the localist political philosophy, how are they expressed in the Dutch unitary state, where central government ultimately sets the legislative agenda?

To get to the bottom of this, I travelled to the Dutch capital of The Hague to meet with Ruurd Palstra, a senior policy adviser at the Association of Netherlands Municipalities (VNG). Even though The Hague is a densely populated city that forms part of the Randstad – a massive conurbation in the western part of the Netherlands spanning four major cities – The Hague, Amsterdam, Rotterdam and Utrecht – it still has a familiar public service town air about it. The streets are widely spaced; stately buildings line the pavements; and commemorative plaques and statues peak out from behind rows of mature trees. VNG is based along one of these wide boulevards in a deconsecrated church that has been substantially renovated and modernised. During our meeting, it was hard to ignore the impression that the religion of politics is not limited to central government.

The discussion with Palstra revealed that the Dutch and Swiss models have more in common than it first appears. As a political philosophy, one of the main constraints on centrist tendencies is a 'real' belief in devolution, backed by constitutional protection. Admittedly, this protection has been ignored to some extent in the Netherlands for much of the 20th century, but since the reforms of the 1980s the trend has run towards greater decentralisation, not less. This, Palstra notes, has progressively empowered local authorities to push back when central government oversteps. Of

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<sup>87</sup> It should be noted that a consensus political approach is being trialled in New Zealand with the establishment of the Land and Water Forum, a multi-stakeholder group whose task it is to develop a national framework for water use and rights allocation.

<sup>88</sup> Marcel Boogers and Gerrit Voerman, "Independent Local Political Parties in the Netherlands," *Local Government Studies* 36:1 (2010), 75–90.

<sup>89</sup> Frits Bos, "Fiscal Decentralisation in the Netherlands," *op. cit.* 42.

course, central government has little operational capacity, and it has to rely on municipalities to execute policies.

“Municipalities have in the past said [to central government], ‘it is not you who sets the quality standards, it is our civilians’”, Palstra said.<sup>90</sup>

What is hinted at but not explicitly said in my three-hour meeting with Palstra is that the VNG also enhances the voice of municipalities. The association is one of the most powerful lobbies in the Netherlands, and it ensures that central government negotiates with the sector as a whole rather than individual municipalities. Another factor holding back central government is its mixed track record when directly getting involved in local affairs. High welfare spending and an inability to cope with the economic effects of a natural gas boom were directly responsible for the liberal reforms of the early 1980s.<sup>91</sup> Even after the reforms, central government involvement in major projects at a local level did not deliver notable results. Research into two tranches of government-led urban redevelopment projects in the mid-1980s and late 1990s found “no conclusive evidence of any [economic or spatial] surplus value as a result of the involvement of the national government”.<sup>92</sup>

The local government funding system plays a major – and quite nuanced – role in maintaining the decentralised status quo in the Netherlands. Under the current grants system, 27% of municipal funding comes from tied transfers from central government, while 37% comes from a general municipal fund that municipalities are free to spend as they see fit. The remainder of municipal funding comes from goods and services fees (23%), local taxes (9%), and property income (4%).<sup>93</sup> This is more restrictive than in Switzerland, but

it still affords Dutch local authorities a degree of discretion in local spending, and hence differentiation in service levels. Inter-municipal competition is thus on a yardstick rather than on a fiscal basis. As such, local government has a strong incentive to find efficient and effective ways of delivering services to their communities. “The funding from central government is tied to the population, so if your population is declining, your funding is declining”, Palstra said.<sup>94</sup>

Yardstick competition has the potential to create negative spill-over effects, such as concentrating welfare recipients in municipalities with high welfare benefits. These are mitigated by the tied grant elements of Dutch local government funding. These act as an equalisation transfer mechanism to ensure citizens receive a similar quality of core public services (education, welfare, social housing, etc.) regardless of which municipality they live in. These tied grants are allocated via a complicated formula consisting of more than 40 variables specifically designed to minimise fiscal disparities and municipalities’ ability to influence their share of this funding.<sup>95</sup> The size of the pooled municipal funds from which general transfers to local government are made is also linked to changes in central government expenditure. As such, local authorities benefit when central government expenditure increases, but they have to make cuts when overall expenditure shrinks. Local government has little certainty over this portion of the transfer revenues, constraining spending.

This fiscal responsibility is evident in the low number of Dutch municipalities that have needed financial rescues – just 10 between 1998 and 2014 – even though Dutch law explicitly requires central government to intervene and help local authorities that cannot balance their books.<sup>96</sup> Municipal spending is fairly low, too. In total, municipal

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<sup>90</sup> Ruurd Palstra, Personal interview (9 November 2015).

<sup>91</sup> “Model makers” *The Economist*, op. cit.

<sup>92</sup> Marjolein Spaans, Jan Jacob Trip and Ries van der Wouden, “Evaluating the Impact of National Government Involvement in Local Redevelopment Projects in the Netherlands,” *Cities* 31 (2003), 29–36, 36.

<sup>93</sup> Frits Bos, “Fiscal Decentralisation in the Netherlands,” op. cit. 42.

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<sup>94</sup> Ruurd Palstra, Personal interview (9 November 2009).

<sup>95</sup> Maarten A. Allers and J. Paul Elhorst, “Tax Mimicking and Yardstick Competition Among Local Governments in the Netherlands,” *International Tax and Public Finance* 12:4 (2005), 493–513, 4 & 9.

<sup>96</sup> Maarten A. Allers, “The Dutch Local Government Bailout Puzzle” *Public Administration* 93:2 (2015).

revenues were equivalent to 8.4% of GDP in 2009, while for the provinces it was 0.4% of GDP. This is more than double that of New Zealand, but local authorities in the Netherlands provide a number of social services that local government in New Zealand does not.

All in all, it is a complicated and competitive arrangement. And yet, like Switzerland's devolved model, it seems to work. The Netherlands is rated the fifth most competitive country in the world by the World Economic Forum, and is highly ranked in education (3rd), infrastructure (3rd), and institutions (10th). Indeed, the forum ranks the Dutch economy as one of the most sophisticated and innovative in the world, characterised by open and efficient markets.<sup>97</sup> And although the country is still reeling from the global financial crisis and the Euro crisis, the local-centric formula seems to have constrained central government's role in the economy. Total public spending was equivalent to 46.4% of GDP in 2014, down from nearly 60% in 1983.<sup>98</sup> This is high by New Zealand's standards, but sits at the lower end of the spectrum compared with other EU countries, which tend to be high spending and high borrowing welfare states.<sup>99</sup>

## Partnerships

The freedom extended to municipalities to enter into partnership arrangements is critical to local government efficiency in the Netherlands. The Dutch municipal landscape is fragmented so it is very difficult to achieve economies of scale, particularly in the rural northeast, which is characterised by an ageing and declining population. To work around this, a group of local authorities collectively perform a service, such as household rubbish removal. Smaller municipalities surrounding a large urban centre contract the city to perform various services

for them. This is done by creating a separate legal entity to perform these services; assigning these tasks to one municipality; or privatising, franchising or making similar arrangements. The academic literature refers to this as 'automisation', a process whereby third-party managers are empowered to make independent decisions about the day-to-day running of a service, but who also remain accountable to local government.

National legislation too encourages these cooperation agreements.<sup>100</sup> As a result, the number of cooperation agreements has exploded. The variation is also impressive with about 800 municipal arrangements and more than 1,200 other cooperative arrangements in place.<sup>101</sup> On the small end of the spectrum are arrangements where municipalities have vested ownership of a sports hall or swimming pool in the community to lower council spending while still keeping the facilities open. The municipalities continue to advise the community, who in turn generally outsource the running and maintenance to a third-party provider. This also has the advantage of revealing community preferences. Far more common are shared services agreements, where municipalities pool their human resources or information technology functions the same way businesses use shared service centres. These in turn are often outsourced to specialist companies. On the large end of the cooperation spectrum are the agreements between local government, the business community, and other knowledge and education institutions to coordinate planning on a regional scale. The most well-known is Brainport Eindhoven.

Eindhoven is a city in southern Netherlands with a long history of industrial innovation, thanks to the presence of electronics giant Philips. The deal between the municipalities of Breda, Eindhoven, Helmond, Hertogenbosch and Tilburg and the province of North Brabant has helped turn the

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97 Klaus Schwab, "The Global Competitiveness Report 2015–2016," op. cit. 24.

98 Trading Economics, "Netherlands Government Spending to GDP," Website.

99 OECD, "General Government," Website, <https://data.oecd.org/gga/general-government-debt.htm>.

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100 Wet gemeenschappelijke regelingen, or the law on local government cooperation.

101 Association of Netherlands Municipalities, "Local Government in The Netherlands," op. cit. 38.

region into a leading international knowledge centre. This was done by coordinating planning on infrastructure, housing, and social services such as education and welfare with private industry and the Eindhoven University of Technology in a ‘triple helix’ arrangement.

Palstra cites Eindhoven Airport as a good example of how this arrangement works in practice. The city’s old airport, with its low capacity, was seen as a handbrake on regional economic activity. However, the city could not accommodate a larger airport within its highly developed municipal footprint. To overcome this problem, the Brainport partnership – with help from central and provincial governments – built a new airport in an adjacent municipality and negotiated compensation payments between them to make up for the loss of revenue this development would have on the affected municipality. Today, Brainport is one of the top three economic growth engines within the Netherlands, and much of its success has been attributed to the regional governance arrangements.<sup>102</sup>

Peter Teunisse, a senior director at PricewaterhouseCoopers in the Netherlands, and Egon de Haas, the global director for PricewaterhouseCooper’s government and public services industry network, say these arrangements help identify and exploit regional strengths. Teunisse says the appeal of such coordination is threefold. First, it allows local authorities to achieve economies of scale across different types of services. For example, the sweet spot for waste collection services in the Netherlands is about 300,000 inhabitants. Any smaller and it is inefficient, and any larger and it creates coordination problems. Few municipalities have the population to hit this sweet spot, but they get around this impediment by contracting and cooperating. Second, cooperation agreements between several municipalities improve their ‘execution and bargaining powers’. And third, coordination allows a group of local authorities to

brand themselves as a single entity when trying to attract investment, and sends a strong signal that all parties are politically aligned without the need for municipal mergers. For example, the seaport of Eemshaven convinced Google to build a datacentre on its harbour to take advantage of the natural cooling, wind powered energy, and regional capabilities. Collaboration is effective when provinces and city-level authorities join business, De Haas says. “Together they can get the Googles”.<sup>103</sup>

Teunisse and De Haas say regional collaboration is vital for the smaller EU countries, where municipalities have to compete with much larger jurisdictions for subsidies and infrastructure investment. Alone, they stand little chance of competing against mega-conurbations like Barcelona or Paris, but coordination gives them scale.

What is remarkable about these arrangements is their political maturity and focus on an end goal. De Haas cites the example of the Amsterdam Economic Board, a public and private body that promotes economic growth in the region. Smaller municipalities such as Almere that participate in this board brand themselves as being part of Amsterdam because of the spill-over benefits that accrue to them when the region as a whole grows faster. Regional structures and economic growth promotion bodies in New Zealand have yet to show the level of cooperation and regional thinking as their Dutch counterparts.

## Complex world

On the whole, the Dutch system of local government appears to work well. The high level of autonomy afforded to local authorities gives them the ability to respond to changing inputs in a way New Zealand’s more prescriptive arrangements can’t. Implemented correctly, this feature could significantly improve the flexibility of New Zealand’s local government arrangements, particularly if it were backed by Dutch-style legislation, which provides structural partnership options to local authorities, instead of prescriptive limitations.

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<sup>102</sup> Wei-ju Huang, “Accountability and Relational Governance: The Case of Brainport Eindhoven, The Netherlands,” AESOP Annual Conference 2015 (Prague: 2015).

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<sup>103</sup> Egon de Haas, Personal interview (11 November 2015).

That is not to say the Dutch system is without flaws. Land use is one area not to be emulated. Municipalities highly controlled land in the 1970s and 1980s and developed their own housing projects in partnership with private sector firms. While this provided them with non-state revenue, it artificially suppressed the price of housing. Land use allocation became highly inefficient in a country with limited space. Central government was subsequently forced to intervene and regulate the supply of land to ensure it was more efficiently used.<sup>104</sup> As a result of these compact development policies, real house prices rose over 165% from 1985 to 2000, according to OECD data.<sup>105</sup> To correct for historical factors and distortions, greater private sector participation was introduced into the housing market in the 1990s, which saw the pace of house price increases tail off (real house prices rose 18.6% between 2000 and 2007).<sup>106</sup>

Any emulation of the Dutch system has to consider its other flaws as well. Martijn van der Steen, an adjunct director and co-deacon at the Netherlands School of Public Administration, believes one of the issues with the current model of Dutch localism is democratic accountability. Municipal councils are entirely responsible for operations within their jurisdiction and the actions of the aldermen. However, the sheer number of cooperation agreements and the plethora of parties involved mean local body politicians do not always know how all the parts work. This is backed by academic literature, with one study of local government audits concluding: “In the majority of cases, local government insufficiently controls associated entities”.<sup>107</sup>

The question then is if local elected officials cannot see the entire system, how can ministers, and indeed voters, trust it is functioning efficiently? “I don’t know how much complexity these local entities can handle”, Van der Steen said. “What I

know for sure is that it is very hard for the national level to accept that this amount of complexity is in the system, [and that it is] out of their control”.<sup>108</sup> This poses the risk of central government stepping and legislating away the complexity, transforming the Dutch system from a decentralised one to a de-concentrated one. The distinction is that the former allows for local differentiation, whereas with the latter local government is simply an agent of central government. Van der Steen said:

What parliamentarians will say here in The Hague is “we want a basic level of service and on top of that municipalities can choose”. Most people agree that there should be some sort of baseline, but the question is of course how high the baseline should be. Right now there is a very strong push to push the baseline up so that 98% of what you can get is the same everywhere, and on top of that is a very small margin of choice. I think it is a very bad thing.<sup>109</sup>

While acknowledging the risks, Van der Steen is optimistic the Netherlands will find a way to address these flaws – consensually, of course.

One of the best elements in the system is the ability to make the most out of a very complex and densely over-organised system. If it does not function properly, I think the answer is not to organise it better but to remind the people that they are working in that system, and it is the ability to deal with the complexity that counts.<sup>110</sup>

The Netherlands has clearly found a local government system to deal with a complex range of municipal outcomes, myriad partnership arrangements, and individual service standards. There is much that New Zealand policymakers can learn from this case study, as long as they avoid the transparency and accountability issues raised by Van der Steen. More broadly, though, the Netherlands shows that shifting from an overly centralised system to a decentralised one is possible, and indeed, worthwhile.

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<sup>104</sup> Arnold van der Valk, “The Dutch Planning Experience,” op. cit. 202–204.

<sup>105</sup> OECD, “Focus on House Prices,” Website.

<sup>106</sup> Ibid.

<sup>107</sup> Johan A.M. de Kruijf, “Controlling Externally Autonomised Entities by Dutch Local Governments,” *International Journal of Productivity and Performance Management* 60:1 (2011), 41–58, 55.

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<sup>108</sup> Martijn van der Steen, Personal interview (9 November 2015).

<sup>109</sup> Ibid.

<sup>110</sup> Ibid.



# CHAPTER FOUR

## MONTREAL

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After the wheels of my plane lifted off the runway at Pierre Elliott Trudeau International Airport, the impression of Montreal as one of the most exciting cities in the developed world washed over me. It's a feeling that has been hard to shake off even months after my research trip ended, and the more challenging task of capturing the essence of the island city began. London and Amsterdam of course far outpace Montreal on measures of hustle-and-bustle, overall place in the world, and cultural verve. On vintage, Zurich, Bern and The Hague casually exude more history than Montreal's old town even if it were triple the size. Nevertheless, this city is thrilling. That's partly because beneath the familiar North American urban veneer is a city wrestling with a cultural identity crisis, a legacy of corruption,<sup>111</sup> and a simmering class struggle.

But this is not why I am in Canada. I am here to study the city's local government, which is interesting enough even without these Gotham-esque characteristics. This is because the island of Montreal, situated at the confluence of the St Lawrence and Ottawa rivers, has since 2000 gone through two local government reorganisations, and is going through a third in some respects. It is not just the pace of change that makes Montreal interesting, but the direction too. Where Switzerland, the United Kingdom and the Netherlands embraced devolution in various degrees, Montreal first headed towards centralisation, then partially backtracked, before simultaneously centralising and decentralising decision-making power.

The resultant fractured municipal landscape is complicated enough before factoring in militant unions, anglophone-francophone tensions, crumbling infrastructure, as well as regional,

provincial and national power struggles. Nevertheless, the city's experience first as a merged urban centre and then as a partially de-amalgamated entity is highly applicable to New Zealand, and Auckland in particular. Both Montreal and Auckland are trying to attract investment to their shores in a highly competitive globalised market. In both cases, officials believe simplifying governance structures will make their city more competitive.

Concentrating powers in a unitary authority must surely speed up decision-making, and one of the fundamental lessons of economics is that scale can enable efficiencies in the production of goods and services. Unfortunately, this has not been the case in Montreal, and recent reports suggest a similar trend in Auckland.<sup>112</sup> Indeed, much of the academic literature on municipal mergers concludes many of the claimed efficiencies are in fact illusionary. But Montreal's value is not limited to lessons on local democratic choice and the chimera of merger efficiencies. It has valuable lessons on how not to go about unscrambling a megacity egg.

### Pancakes, maple syrup and mergers

Much like New Zealand's own history with local authorities in the 20th century, Canada too has trended towards consolidation. Ontario province undertook one of the earliest amalgamations in 1935, when the wealthy municipality of Walkerville was merged with three surrounding authorities to stave off a local government insolvency.<sup>113</sup> This set the trend for the next 60 years, whereby

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<sup>111</sup> Linda Gyulai, "UPAC outlines a system of corruption," *Montreal Gazette* (11 August 2015).

<sup>112</sup> Bernard Orsman, "Council's \$1b in IT costs 'wasted'," *New Zealand Herald* (29 February 2016).

<sup>113</sup> Lydia Miljan and Zachary Spicer, "De-amalgamation in Canada: Breaking Up Is Hard To Do" (Fraser Institute, 2015).

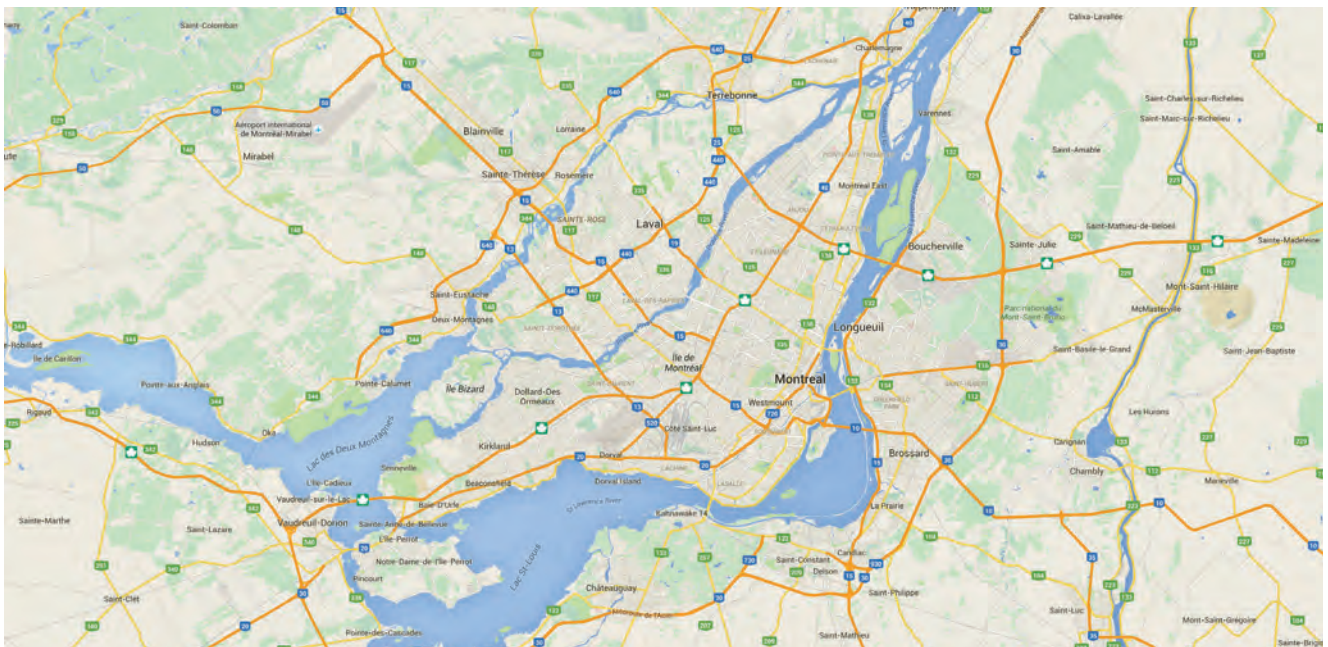
provincial authorities oversaw the annexation of municipalities by inner city governments, largely because of exigent financial and governance reasons. However, in the 1990s, the provinces of Ontario and Quebec proposed reshaping the governance structure of Toronto and Montreal respectively through mergers to make these regions more competitive.

The Pichette report set the ball rolling for Montreal in 1993. At the time, provincial authorities were concerned that the greater Montreal metropolitan region was losing its competitive standing. Montreal straddles both sides of the St Lawrence and Ottawa rivers, with Montreal Island at the centre and the smaller cities of Laval and Longueuil to the northwest and southeast of the St Lawrence River, respectively. The City of Montreal is the urban core of the region, and is situated on Montreal Island. The city had already lost the designation as Canada’s biggest city to Toronto as attempts by Quebec’s francophone political party to secede from Canada in the 1980s started

an emigration of capital and talent to other less risky parts of the country. In addition, much of the growth in the Montreal region has taken place outside the main urban centre, namely off the island, and was seen by officials to be messy and inefficient.<sup>114</sup>

To stem this decline, the authors of the Pichette report proposed creating a new regional governance tier: the Montreal Metropolitan Region. This indirectly appointed 21-member council would be responsible for planning and development, economic development, environment, culture, transport, and public safety across the Island of Montreal, the cities of Laval and Longueuil, and the surrounding municipalities. The Pichette report however proposed retaining the municipal structures, consisting of 102 local authorities, to balance regional competitiveness and local accountability. The tasks of existing regional bodies, such as the Montreal Urban Community (MUC), which was responsible for administration, planning, economic development, environment,

**Figure 2: Map of Montreal Island**



Source: Google Maps

<sup>114</sup> Zachary Spicer, “Too Big, Yet Too Small: The Mixed Legacy of the Montreal and Toronto Amalgamations,” Institute on Municipal Finance and Governance Perspective No. 5 (Toronto: University of Toronto, 2014), 2.



and public safety across the island, were to be ceded to the new regional body over time, the Montreal Metropolitan Council (MMC).<sup>115</sup>

Regional reform was taken up by municipalities and the Parti Québécois (PQ), the political party in provincial government at the time. However, the PQ used this momentum and the reformist mood to fix what it saw as problems in the municipal system: fiscal disparities between authorities, wasteful municipal competition, and urban sprawl.<sup>116</sup>

Amalgamation of the municipalities presented a neat mechanism to do this, as unitary authorities across the province were considered better placed to ensure tax rate and service equity. At the same time, these bigger entities could use their size to achieve efficiencies of scale that were beyond most municipal bodies. The PQ's strategy aligned with the 'bigger is better' thinking on municipal matters that was in vogue among academics at the time. One-tier urban authorities were seen in political circles as an ideal municipal form due to their perceived ability to streamline decision-making and better coordinate service provision, while providing greater accountability and transparency to the running of local government.<sup>117</sup>

Lastly, the PQ saw the restructure as a way to solve urban free rider problems, whereby residents consumed urban services while living in suburban communities on the mainland where they paid lower taxes. This problem was considered to be particularly acute on Montreal Island, and to a lesser extent in Laval and Longueuil. This was seen as a contributing factor to the region's suburban sprawl (although it did – and still does – constrain housing costs as residents are able to move to more affordable areas with ease). The PQ's plan was to establish a three-tier government structure.

The lowest level would consist of unitary city authorities, who would assimilate their municipal neighbours to form megacities. In Montreal, the unitary authorities would be the new City of Montreal (encompassing all of Montreal Island) as well as the newly amalgamated cities of Laval and Longueuil. Above this would be a regional authority to coordinate regional tasks such as planning and transport, with both tiers under the control of the third tier, the provincial government. In December 2000, Bill 170 was introduced into the Quebec National Assembly to do this, and was passed. Over the next 18 months, 213 municipalities were consolidated into 42 local authorities, marking one of the biggest local government shakeups in Canada's history after the Toronto amalgamation.

### One island, one city

The changes were significant for Montreal Island. When the law came into effect in 2002, the 28 municipalities located on the island were restructured into a single authority: the City of Montreal. The local authority controlling the island's CBD instantly saw its power expand across the whole island. The city's population grew from just over 1 million residents to 1.8 million with the stroke of the legislative pen, while the number of city councillors fell from 256 to 73, plus 31 borough councillors and the mayor.

The newly enlarged city was subdivided into 27 boroughs, which was largely seen as a concession to the island's bilingual municipalities, whose residents spoke English and French. However, this was not a simple carbon copy of the old jurisdictional divides, as eight of the existing municipalities disappeared and 14 of the bilingual municipalities were amalgamated into nine boroughs. Shape was not the only thing to change for these boroughs. Where municipalities previously had significant fiscal independence (90% of revenue was locally raised<sup>118</sup>), the boroughs now had to cede much of their independence to the

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<sup>115</sup> Andrew Sancton, "Differing Approaches to Municipal Restructuring in Montreal and Toronto: From the Pichette Report to the Greater Toronto Services Board," *Canadian Journal of Regional Science* 22:1–2 (1999), 187–199.

<sup>116</sup> Zachary Spicer, "Too Big, Yet Too Small," *op. cit.*

<sup>117</sup> Roy Bahl and Johannes Linn, "Urban Public Finance in Developing Countries" (New York: Oxford University Press, 2002).

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<sup>118</sup> Mariona Tomàs, "Exploring the Metropolitan Trap: The Case of Montreal," *International Journal of Urban and Regional Research* 36:3 (2012), 554–567, 558.

City of Montreal, including the ability to borrow. Although they retained some property taxing power, this accounted for only a small proportion of their total income, with the remainder financed by transfers from the city. The operational scope of the boroughs also narrowed, with the focus on local matters such as arterial roads, parks as well as community and cultural promotion activities.<sup>119</sup> Much like pre-merger Auckland, which consisted of Auckland City Council and six adjacent councils, the City of Montreal had gone from a core urban authority surrounded by 28 municipalities to a unitary city. The Island of Montreal was now a megacity in earnest.

### Efficiency chimera

The obvious question about the amalgamation process in Montreal is whether it achieved its stated aims. To answer this question, I travelled from the eastern fringe of Montreal's CBD to Westmount, an affluent bilingual municipality on the other side of the city centre. There I met Peter Trent, the municipality's mayor from 1992 to 2001. Trent relinquished the role after a legal challenge to the merger was defeated in the courts and he refused to get involved in the megacity, but he became mayor again in 2009. Trent is also the author of *The Merger Delusion*, a peer-reviewed insider's account of the amalgamation process in Montreal published by McGill University. He is emphatic that the process failed in achieving its aims based on the city's democratic participation, financial performance, and regional competitiveness.

By Trent's own calculations, the costs of running the megacity rose by C\$473 million, or C\$278 million on an inflation adjusted basis, between 2001 and 2005.<sup>120</sup> This contrasts with the C\$175

million in annual savings the process was supposed to reap.<sup>121</sup>

"I even got a chartered accountant to check all my numbers", Trent told me at his office inside Westmount's stone-clad municipal building. "In a way that is my gift to posterity, because it is true that the C\$400 million extra it costs Montreal to run is not a fictional number".<sup>122</sup>

Trent mainly blames the cost blowout on salary harmonisation. The merger benchmarked the salaries and benefits for all municipal positions with the City of Montreal's, the highest on the island. The strong position of labour unions in Quebec compounded the problem. Under the previous structure, wage negotiations were highly competitive as unions had to collectively negotiate an agreement with each municipality. Under the merged City of Montreal, unions only had to negotiate with one party, and the collective agreement would apply to all municipal workers ('blue and white collar', as they are called in Quebec province) across the island.

Trent is not alone in this view.

Mario Polèse, an urban economist and professor at the Urbanisation Culture Société Research Centre in downtown Montreal, also believes the lack of a competitive wage bargaining mechanism has driven up the city's operating costs. This is aided by two idiosyncratic parts of the Quebec political landscape. The first is the scope and power of the labour movement. To illustrate, 400,000 public employees downed tools in late December 2015 in a one-day strike to protest the delays in the contract negotiation process with the province.<sup>123</sup> This was part of a broader industrial action involving rolling strikes across Quebec by teaching assistants,

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<sup>119</sup> Brenda Branswell, "Megacity Madness," *Maclean's* 113:51 (18 December 2000).

<sup>120</sup> This estimate was reached by tallying the total cost of running all local authorities on the Island of Montreal before and after the merger process. It excludes costs unrelated to the merger such as public transit and interest charges, as well as the one-off costs that stemmed from the merger itself.

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<sup>121</sup> Peter F. Trent, *The Merger Delusion: How Swallowing Its Suburbs Made an Even Bigger Mess of Montreal* (McGill-Queen's University Press, 2012), 523.

<sup>122</sup> Peter F. Trent, Personal interview (16 November 2015).

<sup>123</sup> Katherine Wilton, "Public sector workers stage one-day strike, large protest over contract talks," *Montreal Gazette* (9 December 2015).

the City of Montreal's blue-collar workers, and teachers over a number of days.

Nor are these events exceptional. I saw more strikes in one day in Montreal than in five years in New Zealand.

The second idiosyncratic feature is that under provincial law, municipalities cannot lock out unionised workers during collective agreement wage talks, nor is there any way to resolve deadlocks in the arbitration process (although moves are afoot to change this).<sup>124</sup> The amalgamation removed wage competition and locked the city into a single negotiating position where legislatively it always has the weaker hand. Unions are strongly in favour of municipal mergers. "The union thing is very touchy. Once you amalgamate you go to the highest common denominator. It is a political issue and has nothing to do with economics", said Polèse.<sup>125</sup> This wage inflation also occurred as the city hired 400 more people in the four years under Trent's review, and despite projections that the merger would cut 1,700 jobs. Furthermore, Trent notes that removing competitive forces on the island blew out the city's operating costs, as yardstick comparison was no longer possible.

Polèse's and Trent's positions are backed by recent academic literature. The most notable from a Canadian perspective was conducted by Enid Slack and Richard Bird. After finding many of the same post-merger cost escalations in Toronto, the authors concluded: "The argument that reducing the number of local governments will cut costs is true in the sense that amalgamation usually reduces the number of politicians and administrators. However, the amalgamation of municipalities with different service levels and different wage scales tends to increase expenditures".<sup>126</sup> This statement specifically

refers to the amalgamation process in Canada's biggest city, Toronto, but a review of contemporary literature on municipal mergers in Australia<sup>127</sup> and Europe<sup>128</sup> shows it could apply there equally. Indeed, it could also apply to Auckland.<sup>129</sup>

On measures of equity, the amalgamation did resolve some of the pre-merger municipal issues such as harmonising service standards. However, this was only partially successful as the equity gains were largely limited to the island. Regional body MMC was, for example, unable to resolve the free rider problem for those who lived on the mainland and commuted to the city centre. In addition, while the reforms homogenised the tax rate to a large extent across the city, they did not correct for many historical discrepancies due to the sheer complexity of the task. Poorer suburbs like Anjou, which was characterised by low taxes and low service levels before the merger, saw taxes rise after the amalgamation while service levels remained the same.<sup>130</sup>

Lastly, Trent believes the merger process failed democratically because the PQ did not include mergers in its manifesto while campaigning to become the provincial government in the 1990s. As such, it did not have an electoral mandate to pursue amalgamations, but did so anyway.

## Fusion, de-fusion, confusion

Ultimately, the democratic deficit rather than the yet-to-surface fiscal issues unravelled Montreal's amalgamation.

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<sup>124</sup> Keith Jones, "Quebec criminalizing working-class struggle," *World Socialist Web Site* (25 May 2015).

<sup>125</sup> Mario Polèse, Personal interview (17 November 2015).

<sup>126</sup> Enid Slack and Richard Bird, "Merging Municipalities: Is Bigger Better?" *Institute of Municipal Finance and Governance*, University of Toronto (2013), 20–21.

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<sup>127</sup> Joel Byrnes and Brian Dollery, "Do Economies of Scale Exist in Australian local Government? A Review of the Research Evidence," *Urban Policy and Research* 20:4 (2002), 405–406.

<sup>128</sup> Sylvie Charlot, Sonia Paty and Virginie Piguet, "Does Fiscal Cooperation Increase Local Tax Rates in Urban Areas?" *Regional Studies* 49:10 (2012), 1718.

<sup>129</sup> Bernard Orsman, "Council's \$1b in IT costs 'wasted'," *op. cit.*

<sup>130</sup> Jean-Philippe Meloche and François Vaillancourt, "Public Finance in Montreal: In Search of Equity and Efficiency," *Institute on Municipal Finance and Governance Perspective No. 15* (Toronto: University of Toronto, 2013), 22–24.

The merger stoked long-simmering tensions between anglophone and francophone municipalities on the Island of Montreal. Wealth also played a part, as anglophone authorities tended to be more affluent. Mariona Tomàs suggests the merger was primarily perceived as a threat to the anglophone culture. Suburban municipal culture has Anglo-Saxon roots that are an important part of an anglophone democracy, but this was not sufficiently factored into the merger thinking.<sup>131</sup> Anglophone suburban municipalities saw themselves as bodies of probity, against whose example the City of Montreal could be compared – a role that was threatened by assimilation into a francophone political structure.

This discontent was seized upon by the Parti libéral du Québec (PLQ), which was in opposition at the time. The PLQ promised to put the municipal mergers to a referendum if voted into power. It is debateable how much of a role this political promise made in turning the election in its favour, but in April 2003 the PLQ was voted in as Quebec's provincial government. The PLQ followed through on its promise, and citizens in affected areas were given the chance to have their say on the merger process in June 2004.

However, the PLQ was not in favour of a return to the original system. Trent says the provincial government feared the public's deep dissatisfaction with the mergers might make them vote for demerging and contrary to their true preference.<sup>132</sup> To soothe this anger, the PLQ introduced a law that strengthened the boroughs' advisory and decision-making ability, gave them greater control of their finances (including the ability to borrow), and even introduced directly elected borough mayors.<sup>133</sup> The pitch was: "Why change to an independent suburban municipality

when boroughs will have exactly the same powers inside the City of Montreal?"

To further tip the odds in favour of the status quo, the PLQ lifted the standard referendum threshold so that 35% of all registered voters in a borough had to opt for the demerger for it to proceed. This is contrary to the standard referendum threshold of a simple majority. In the end, 31 municipalities across Quebec province voted to demerge, including 15 on the Island of Montreal (except for one anglophone municipality).<sup>134</sup>

Trent calculates that if standard referendum rules had applied to the demerger vote, another seven island municipalities would have demerged, upping the island's total demerged population from 243,000 to 517,000.<sup>135</sup> On the island, the vote to demerge from the City of Montreal left the merger structure in a shambles. To compensate, the PLQ created the Agglomeration Council, an upper-tier structure responsible for higher-order services across the island, such as property assessments, large parks, public transit, major roads, water supply, and sewerage.<sup>136</sup> It was in effect a regional service delivery body. On top of this tier, the MMC was still responsible for coordination across the greater Montreal metropolitan region. So where the aim of amalgamation had been to simplify and reduce Montreal's government structures, the backlash against the mergers resulted in an additional tier of government.

In 2006, the Island of Montreal's partially demerged structure came into effect, reversing the merger changes, but without restoring the city to its original form. The island was now divided into the City of Montreal and the boroughs that elected to remain in the unitary authority, plus 15 independent municipalities.

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<sup>131</sup> Mariona Tomàs, "Exploring the Metropolitan Trap," op. cit. 560.

<sup>132</sup> Peter F. Trent, *The Merger Delusion*, op. cit. 460.

<sup>133</sup> Parliament of Quebec, Bill 33 (2003, chapter 28), <http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=5&file=2003C28A.pdf>.

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<sup>134</sup> Zachary Spicer, "Too Big, Yet Too Small," op. cit.

<sup>135</sup> Peter F. Trent, *The Merger Delusion*, op. cit. 460.

<sup>136</sup> Lydia Miljan and Zachary Spicer, "De-amalgamation in Canada," op. cit. 15.

## Break-up blues

On paper, this outcome may seem to satisfy proponents of localism since it created more local government. In reality, it added to the governance complexity while constraining the competitive benefits thereof. This is the view of Russell Copeman, a Montreal city councillor and the borough mayor of Côte-des-Neiges-Notre-Dame-de-Grace, the latter colloquially referred to as NDG. He also heads the city's housing and urban planning portfolio and as well the Office of Public Consultation.

“It makes things cumbersome and expensive the way they go together, and very, very time consuming”, he said. “Years later we are still working out where the responsibilities end and begin”.<sup>137</sup>

Copeman's office is in the Hôtel de Ville de Montréal, a grand council building in the old part of the city, replete with cobblestone streets and 17th century architecture. The area sits between the CBD and the decaying post-industrial waterfront. Copeman's concerns over the current structure extend to the democratic process.

The City of Montreal and its boroughs account for 83% of the votes in the Agglomeration Council, based on a proportional weighting of the population. This gives little say to the independent municipalities in the overall running of Montreal Island, even though 60% of their property taxes pay for Agglomeration Council services (or 50% of revenues). Copeman said the current administration informally canvasses the views of these areas on agglomeration matters to avoid shutting them out of the process, but warned that there is no procedural guarantee this will remain the case.

“Once you permit demerger, and once you permitted these former [municipalities] to demerge, you had to have a structure of governance for regional services ... you had to create this new

process which is not satisfactory to anyone really”, Copeman said.<sup>138</sup>

Adding to the democratic deficit, the City of Montreal is lobbying the provincial government to abolish many of the powers ceded to the boroughs under Bill 33. These include powers to set salaries, negotiate collective agreements, create departments, purchase buildings, and take loans to pay for infrastructure work.<sup>139</sup> The PL had used some of these perks before the referendum to entice boroughs to remain in the unitary structure.

The current administration's rationale is to fix the parts of the system deemed dysfunctional or wasteful. Given the track record of the Montreal amalgamation, it is surprising the city is doubling down on a centralised governance structure again. But Trent says it was entirely predictable because administrative and political power is 'centripetal'. He had indeed predicted the return of centralisation in his book. But Trent is less concerned now about these centralising tendencies than he was in the late 1990s because the independent municipalities act as an institutional tier that resists the concentration of political power. In his view, these bodies will continue to act as yardstick comparisons. Plus there seems little appetite to spend further political capital in tinkering with the municipal structure in Montreal anytime soon. Trent believes the yardstick role of the municipalities will lead to further devolution in the end.

We are slowly increasing those little slivers of power, and if there is no other reason than to show what a huge mistake was made, then our life [as demerged municipalities] is worthwhile. It is a thorn in the side of Montreal. Well, tough. They should have a thorn because it was a mistake.<sup>140</sup>

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<sup>137</sup> Russell Copeman, Personal interview (19 November 2015).

<sup>138</sup> Ibid.

<sup>139</sup> René Bruemmer, “Projet Montréal says Coderre has ‘personal agenda’ in rearranging borough powers,” *Montreal Gazette* (15 January 2016).

<sup>140</sup> Peter F. Trent, Personal interview (16 November 2015).

Polèse thinks the current arrangements, while far from optimal, are not totally without merit. Overall, the city's finances are in better shape, and the MMC, as a regional body, is starting to address the regional issues the Pichette report sought to fix.

## Lessons learned

The lessons from Montreal's merger experience are clear. Promises of municipal amalgamation efficiencies cannot be trusted. Furthermore, unpicking a merger is a slow, difficult and risky process. Perhaps what was more useful for this report were the answers to the question: "How would you fix it?"

Copeman's solution is to go through public services with a fine toothcomb and reassign them, item by item, to the appropriate tier of government so that municipalities deal with local issues, city bodies deal with city issues, and regional issues are left to regional bodies. This however raises unanswered questions about democratic legitimacy, a major flaw with the original merger process.

Trent's fix is along similar lines, and he notes that many of the necessary structures were already in place before the merger. All that was required was to correctly assign responsibilities and costs

to ensure greater equity. "I have always said until I was blue in the face that it is not the Island of Montreal that should be the focus of how we structure, it should be the entire region", he said.<sup>141</sup>

Polèse too focuses on delegating decision-making power to the appropriate level of government, albeit one where the lower levels of government are responsible for inanimate matters like local infrastructure, and higher levels of government are responsible for social services to ensure equity of public services.

Although Copeman, Trent and Polèse are somewhat on equilaterally distant sides of the amalgamation debate, they all believe the city needs varied and responsive local authorities to serve diverse communities. That city-wide structures are needed to deliver capital intensive utility services. That a regional body would correct for externalities and provide planning and utility services extending beyond the limits of any one jurisdiction. In short, the cure is subsidiarity.

Montreal is certainly an exciting city, particularly from a local government perspective. It seems there may yet be more local government excitement in store for those who live on the slopes of Mount Royal, the hill from which the city takes its name.

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<sup>141</sup> Ibid.

# CONCLUSION

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This report opened by noting that New Zealand must compete for talent and capital if it is to sustain the pace of economic growth and improve the wellbeing of its citizens. Indeed, one only has to glance at the headlines to see this is more of a truism than a statement. Commodity prices, the strength of the Kiwi dollar, housing affordability, tax rates, investment paths, and the country's green branding are common themes in the press. Many of these stories contain appeals for central government action to improve New Zealand's international standing, including calls for subsidies, regulation, deregulation, and infrastructure investment. Balancing the merits of these appeals against the limits of the public purse is a complicated task for a single agency, even a national one. Yet, as this report has shown, it is cities and regions that now compete for these highly sought-after resources. Council by-laws, tax rates, and local environmental policy can be as important to a firm or an individual's investment decisions as national policy over the same matters. This is why it is important to get the local government structure right. When local government is efficient, effective and responsive, the rewards are faster economic growth, higher wages, and an improved quality of life.

The introduction of this report asked: "What is the right size for local government?" After the discussion on Switzerland, the Netherlands, Manchester and Montreal, it should be clear it is not size that matters, but the assignment of responsibilities to the appropriate level of government. Asking central government to manage local service issues, like solid waste removal, is to invite coordination problems. Equally, assigning local councils regional level tasks, such as provision of potable and waste water, is to court inefficiency. The research shows that structures also need to be combined with trust in local people, through local authorities, to make decisions that are in their best interests. Switzerland underscores this point. There, direct taxes ensure revenue-raising by local authorities is clearly linked to local investment and expenditure. This stands in contrast to New Zealand,

where the link is less obvious, and contributes to the slow pace of growth-enhancing infrastructure investment discussed in the first report of this series.

Trust in local people is, however, pointless without giving them the freedom and flexibility to experiment with different policies. The Netherlands and Switzerland clearly demonstrate how variations in local policy contribute to overall economic efficiency when matched by well-balanced equalisation mechanisms. Officials in England have also come to realise this, which is why city deals are being negotiated with local authorities across the country. As if to stress the point, Montreal's brief history as an amalgamated entity shows how the removal of competitive forces can increase the costs of local service provision. Moreover, it also stands as a cautionary example of how risky the demerging process can be.

These case studies of two countries and two cities raise some interesting questions worth considering to make cities and regions more alluring to talent and capital. Should New Zealand veer from its centralised governance model? Will localist policies here achieve the same efficiency gains as they have overseas? What risks would restructuring the local government sector pose, and how could they be mitigated?

These questions, and many others, only just start to scratch the surface of the topic. These and many other such questions will be answered, and policy recommendations presented, in the third report of this series. Nevertheless, two statements can be firmly established at this point. First, the evidence from Switzerland, Montreal, Manchester and the Netherlands strongly suggests that localism is a viable and efficient form of governance. Second, as the level of competition between states, regions and cities heats up, so will the pressure on local authorities to find new ways to attract talent and capital. If New Zealand is to maintain its position as a desirable destination for both, at the very least local government should be given the tools and flexibility to compete.

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What is the right size for local government? That is the question that policymakers in New Zealand have been pondering for over 170 years. It is not a simple question to answer. On one hand, local services like water provision and flood control benefit from economies of scale, but make councils too big and you lose the democratic accountability that make communities vibrant.

*The Local Benchmark: When Smaller is Better* has sought to answer this question by examining jurisdictions that have embraced the diaspora of local government. Part travelogue, part-economic analysis, Research Fellow Jason Krupp explores the cities of Manchester and Montreal and their respective approaches to devolved decision-making, and also analyses the Swiss and Dutch local governance systems.

What the report finds is that when it comes to local government, bigger is not always better, and large numbers of competing local authorities can meaningfully contribute to economic efficiency when incentives are carefully aligned.

This is an important consideration, particularly as New Zealand's cities and regions position themselves against their international counterparts in the competition of talent and capital in the modern global economy.

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