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NELSON TASMAN CHAMBER OF COMMERCE

LOCAL GOVERNMENT: CONSTRAINED OR
UNCONSTRAINED?

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Local government matters. It is part of our democratic system. As a branch of government, it has coercive powers to tax and regulate. As citizens, we all have a keen interest in seeing that its powers are exercised well.

In his famous book, *The Road to Serfdom*, the economist and philosopher F A Hayek made an important point about government powers, including the powers of local government. He wrote:

Who can seriously doubt that the power which a multiple millionaire, who may be my neighbour and perhaps my employer, has over me is very much less than that which the smallest *fonctionnaire* [for example, a council officer] possesses who wields the coercive power of the state and on whose discretion it depends whether and how I am to be allowed to live or to work?

Hayek also made the point that the most important safeguard against government coercion is secure rights to private property. We can immediately think of tools like district plans and the Resource Management Act that can be used to threaten private property.

Local government certainly matters for business and the economy. Its operating spending is equal to around one dollar in 30 of our national income; it is responsible for key infrastructure; it controls assets comparable to the total value of our publicly listed companies; and it has major regulatory powers, most notably under the RMA and the Building Act.

Local government, including its responsibilities for the RMA and infrastructure, is a high priority for all national business organisations. It ranks with matters such as government spending, taxation, employment law, education, and other business regulation. Local government is also a very high priority for local chambers of commerce.

At the national level, the Business Roundtable joined forces some years ago with Business NZ, Federated Farmers and other national organisations in the Local Government Forum to undertake research and advocacy on local government issues. We all have very similar perspectives on local government.

Our advocacy is based on an analysis of what we see as the overall interests of the community, not just the interests of business.

This is not always easy to explain. Councillors often tell us they get submissions from many other groups, and that their job is somehow to 'count heads' for or against particular council proposals and balance other views alongside those of business. This is not a principled approach. Our position is that there are well-accepted principles of public policy that should guide councils in making decisions in the general public interest. They should apply these principles, and standard tools of analysis, rather than be swayed by noisy lobby groups pushing narrow interests.

Thus we do not favour, for example, handouts or other forms of special assistance to business. A number of councils have such programmes, and some business groups lobby for them. But simple economics tells us that a favour to some firm or industry automatically disadvantages others. Competitors are unfairly penalised and resources are misallocated. As a result, the local economy is less efficient and the community is poorer than it would otherwise be.

Instead of pushing for welfare schemes for business, we argue that the main contribution councils can make to growth and employment prospects in their regions is to reduce the rates and regulatory burdens they impose on the private sector, focus on the funding of genuine public goods and services, and facilitate the provision of necessary infrastructure.

This is the approach described by a former mayor of Indianapolis, Stephen Goldsmith, in an excellent book, *The Twenty-first Century: Resurrecting Urban America*. Indianapolis, one of America's most successful cities, followed what he called:

... our small-government approach to economic development, which deemphasizes the role of tax incentives and other traditional approaches and focuses instead on cutting taxes and reducing regulations.

Standard public policy analysis indicates that the business of councils has to do with public goods, not private goods. Public goods in the local context are things like parks and reserves, stormwater, streetlighting and necessary local regulations. Generally speaking, these services cannot be

funded by user charges; the private sector cannot supply them on a commercial basis; and they need to be financed by general rates. Councils do not necessarily have to supply services of a public good nature themselves, however; often they can be contracted to the private sector.

Conversely, private goods, which can be supplied commercially and paid for through user charges, should be left to the private sector, which is generally more efficient at doing the job.

An example that I understand is topical in the Tasman district is refuse collection. Refuse collection is not in the nature of a public good; users can be charged directly for the service; and private operators can readily provide it. The same goes for landfills. General rates, targeted rates or uniform annual general charges are poor mechanisms for funding such services. Unlike user charges, they do nothing to encourage waste minimisation; different categories of users cross-subsidise others; and in the absence of economic charging, private operators struggle to compete with council services. Businesses and households should face the true costs of disposing of waste, including the costs of recycling and providing landfills.

According to Stephen Goldsmith's book, the city of Indianapolis adopted a number of other simple principles to guide its decision making:

- People know better than government what is in their best interest.
- Monopolies are inefficient, and government monopolies are particularly inefficient.
- Wealth needs to be created, not redistributed.
- Government should do a few things and do them well.
- Cities must not raise taxes or allow excessive regulations to make them unattractive to business and residents.

By following this approach, the city budget was cut each year between 1992 and 1997. Actual spending was cut, not just the rate of growth – the budget was 7 percent lower in 1997 than in 1992. This is a far cry from the record of metropolitan councils in New Zealand. Indianapolis flourished: it

enjoyed an influx of businesses, several years of record job creation, and an unemployment rate that fell below 3 percent.

Two of the principles mentioned by Stephen Goldsmith deserve highlighting.

First, councils should not be in the redistribution business. They have neither the information on incomes and wealth nor the mechanisms to do the job properly. Rates are a tax on property – not incomes. It should be left to voluntary organisations and central government to look after those in genuine need. Thus councils should not be in the housing assistance business, for example. By far the best contribution they can make to the community's housing needs is to avoid artificial restrictions on land supply and to provide efficient services.

I am told that even Nelson is falling for some of the 'smart growth' follies that pushed up land prices in Christchurch until the council realised the errors of its ways, and are now rampant in Auckland.

It is arrogant of local politicians to want to dictate where people should live, and to try to pack them into high-density accommodation. Whatever happened to people's freedom to make their own choices, provided they meet the costs of doing so? 'Sprawl' is a loaded planner's term. There is no general shortage of land in New Zealand. Ours is one of the least densely populated countries on earth. Restrictions on land supply simply push up house prices, as Nelson's experience shows. The 2005 Demographia International Housing Affordability Survey of the major US, Canadian, Australian and New Zealand urban areas clearly illustrates that in normal circumstances median house prices need not exceed about 3 times median household income.

Artificially pushing up housing prices by restricting the supply of land benefits the well-off and established property owners – middle class 'Greens' often lobby for such restrictions – but it prices housing out of reach of the poor. The new Building Act is another example of regulatory overkill and is adding needlessly to housing costs.

Mayor Goldsmith's other point worth highlighting is that councils should do a few things and do them well. There are not many genuine public goods, and the number may be diminishing as it becomes increasingly economic to charge for things like water and roads and run them on commercial lines. Councils are overstretched doing things they don't need to do, and as a result often do a poor job with their core responsibilities.

Water is a good example. Drinking water quality in parts of New Zealand is a disgrace. We have fallen far behind Australia in introducing more market-based systems of water allocation, corporatising water and wastewater services, and applying economic user charges. Environmentalists should be leading the charge for such reforms, but they are largely missing in action. The Nelson City Council deserves credit for introducing water charges, and I understand it has had a dramatic effect on wastage. But Nelson and the Tasman District Council should surely be looking at a joint commercial operation for the region. Industry experts have suggested to me that the optimal configuration for New Zealand might be three water and wastewater operations – two in the North Island and one in the South. England and Wales have ten main water companies and France three, all privately owned. I don't know what the right configuration is, but it isn't the present one. Inefficient operation of such a huge industry may be costing New Zealanders dearly.

The Local Government Forum has consistently argued that the first issue in local government is not the number of councils in New Zealand but rather what activities they should undertake and how they should be structured. Major services such as ports, airports, water and sewerage, public transport and, increasingly, roads should be run commercially, and normal market forces should determine the optimal shape and size of these businesses. Given moves in this direction, the evidence suggests that there are not many economies of scale in local government. Indeed smaller, not bigger, often seems best – smaller councils are more closely in touch with their local communities and tend to have fewer flights of fancy about what is affordable. In the case of some services such as libraries, joint ventures between councils may be better than amalgamations. But if functions were reorganised in this fashion, there may well be further gains

from reducing the number of councils, and perhaps doing away with regional councils altogether.

Unfortunately, rather than encourage councils to exit from unnecessary activities and look at better ways of providing core services, recent policy changes at the national level have gone in the opposite direction. The Local Government Act 2002 broadens the permitted scope of local government and confers a so-called power of general competence on councils. This is an unconstrained rather than a constrained conception of the role of local government. It is consistent with the prime minister's view that "the role of government is whatever the government defines it to be." It is also consistent with Michael Cullen's view that whoever holds the levers of political power can do what they like: "we won, you lost, eat that!"

The costs of these changes in the constitutional framework of local government that gave councils a more expansive role are showing up in the form of spending and rates increases which are typically far above the nominal growth rates of the local and national economies. Last year local authority spending grew by 8.8 percent – much faster than the economy. By and large, these increases are not due to additional responsibilities dumped on councils by central government; they are due to councils' own decisions. Along with the massive increases we are seeing in central government spending, they are squeezing the private sector of the economy, which is the source of most wealth creation. Unsurprisingly, the stronger growth rates that New Zealand has enjoyed over the past decade are falling away.

Some of the expansive moves by councils are truly mind-boggling. This year the mayor of Wellington campaigned feverishly for ratepayers' money to be poured into a V8 car race; she was opposed mainly by so-called left-wing councillors. The Invercargill City Council acquired a franchise for Lotto and is looking at getting one for Kiwibank. The South Waikato District Council has tipped more than \$600,000 into two failed companies that tried to set up a wireless broadband network in competition with Telecom. How many more fiascos like the failed sock factory set up by the Buller District

Council or the Westland District Council's failed plastics factory project do we need before councils are deterred from such follies?

Local government needs to be reined in to make it more effective, accountable and democratic. Endless and costly consultation processes are no substitute for proper constraints and safeguards. In the context of the parliamentary review of our constitutional arrangements, ACT MP Stephen Franks has noted that giving powers of general competence to councils:

... swept away the centuries-old protection created by the courts, when they confined artificial legal persons strictly to the purposes and powers expressly granted. How will 'consultation' protect citizens from being taxed to fund their competitors, or to pay for bread and circuses for mass voters, or to favour particular business owners with grants and rate relief, or to promote contentious socio-religious or political causes. What now protects individual liberties from local authorities' new powers?

Too often local government operates without the consent of the governed. Businesses, which pay around 50 percent of all rates, are largely disenfranchised. Local democracy is often weak – the nationwide turnout at last year's elections fell to 45 percent. Voters often do not know who or what they are voting for. As a Nelson ratepayer, I did not know a single candidate on the ballot paper for last year's elections, or what they stood for. A poll in September last year found that almost 90 percent of Aucklanders could not name one member of the Auckland Regional Council – perhaps the most important council in our largest city. How many members of the Nelson City Council, which has put up rates by 9.1 percent this year, campaigned last year on such a policy? There is a serious democratic deficit in local government.

The US Constitution delegates specific ('enumerated') powers upwards from the people to the states and to the federal government to provide public goods such as national defence. Its leading architect, James Madison, championed a government of "distinct departments" and "balances and checks" to combat the "violence of faction". In a New Zealand context, a good case can be made that the powers of councils should be defined and enumerated in legislation. Councils should be prohibited from engaging in other activities unless they obtain ratepayer consent in a poll supported by more than a simple majority.

As far back as 1988, an Officials Coordinating Committee on Local Government expressed the view that “the key role for local government lies in the provision of local public goods where such goods are not more efficiently provided by markets, voluntary arrangements, or by central government.” This principle should be the basis of enumerated powers.

Such a charter would see councils exit from a range of private good activities (eg commercial enterprises) and focus on performing their core functions better.

In addition, councils should be constrained in their spending and rating. The Business Roundtable has been promoting the idea of incorporating limitations on central government spending and taxation in the Public Finance Act. A reasonable rule, modelled on US state government legislation, would be to constrain increases in spending to no more than population growth plus inflation, unless taxpayers voted otherwise in a referendum.

A similar ‘ratepayer bill of rights’ would have merit for local government. Referenda at the local government level are very feasible, and can help sort out genuine popular feeling from special interest pleading. The current proposal to spend a large amount of money upgrading Trafalgar Park in Nelson might be a good candidate for a ratepayer poll.

We should also revert to the earlier practice of not allowing councils to discriminate against businesses by imposing differential rates. If services are properly charged for, including to businesses, a standard general rate should be applied. To its credit, the Tauranga City Council has recently scrapped its rate differential.

The government is currently reviewing the funding of local government. Changes along these lines should be part of any open-minded exercise. There would be no need for basic changes to funding arrangements if councils were constrained to their proper roles.

Voters are going to be offered a choice between a largely unconstrained vision of local government and a constrained vision in the forthcoming general election.

The government seems committed to an unconstrained vision. Its response

to the escalating costs of local government under the new legislation has been to provide relief to low-income ratepayers through an increased rates rebate. However, this just transfers some of the burden from ratepayers to taxpayers, and weakens the link of accountability for spending and funding decisions.

The opposition parties have a more constrained vision. National is committed to reviewing the 2002 Local Government Act and its thinking is more in line with that of the business sector. The ACT Party has proposed a ratepayer bill of rights limiting annual growth in council spending.

This debate is healthy. Local government must keep adapting and changing if New Zealand is to have a dynamic economy and be an attractive location for people to live, work and do business. Regardless of the election outcome, that debate should continue.