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LOCAL GOVERNMENT: A BUSINESS ASSESSMENT

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I am very pleased to be here today because local government is important to the business community. An open dialogue between the local government sector and the business community on major policy issues affecting the sector is very welcome.

My observation is that there is no shortage of engagement between central and local government on such issues. The Local Central Government Forum, chaired jointly by the prime minister and the president of Local Government New Zealand, is the umbrella for such contacts. Both sides make much of the spirit of 'partnership' that the Forum embodies.

The constitutional position of central and local government is, however, vastly different from that of a partnership. Central government is responsible for the legal framework that establishes local government and governs its activities. Local authorities are, however, relatively free to decide how to carry out the functions delegated to them.

While a close association between central and local government is obviously desirable, it is a relationship between two levels of the executive branch of government. It is no substitute for the constitutional relationship between the governed and those who govern on their behalf, that is, between ratepayers and residents on the one hand, and central and local government on the other.

The overriding objective of constitutional arrangements is to uphold individual liberties while empowering governments to undertake activities that cannot be efficiently undertaken on a voluntarily basis by individuals, community organisations and firms. That objective is reflected in the principle that those who govern do so only with the consent of the governed.

Respect for longstanding constitutional principles – not simply unprincipled rule by an elected majority – is a vital aspect of consent. Proposals of

constitutional importance, such as fundamental changes to the legal framework for local government and voting and rating arrangements, should command wide support from the public before they are enacted by parliament, even when the government of the day 'has the votes'.

Protection of minority interests is much weaker in local government than in the private sector. Consider the relationship between a shareholder and a company. A person voluntarily becomes a member of a company by buying shares. This is a voluntary choice, whereas many ratepayers don't have a lot of choice about the council that governs them – voting with their feet is often not a practical option. Even so, the right to vote or to dispose of shares is not regarded as sufficient protection for a minority shareholder in a company. Other protections are provided. If, for instance, a company plans to engage in a major transaction it is required to obtain the support of at least 75 percent of its members. The shareholders of Air New Zealand passed such a resolution in August 2004, approving the purchase of 10 new aircraft valued at more than \$1.8 billion. There is no comparable provision for 'super majority' votes in central or local government. If the Auckland City Council by a bare majority had proceeded with the Eastern corridor when the estimated cost was approaching \$4 billion, ratepayers would simply have been stuck with the bill.

The review that led to the Local Government Act 2002 illustrates the fragility of our constitutional arrangements, especially in relation to the consent of the governed and those who pay the rates. The discussion paper was a product of close collaboration behind closed doors between local and central government, with no input from ratepayers during the crucial formative stages. The outcome of the consultative process was pretty much a *fait accompli*. The Local Government Bill largely mirrored the discussion paper's proposals, despite the weight of submissions on the discussion paper being opposed to its approach.¹ The consultative process, measured against the guidelines laid down by the courts for

¹ A summary of submissions prepared by the Department of Internal Affairs indicated that those opposing the thrust of the discussion document outnumbered those in favour, with the weight of submissions being overwhelmingly opposed when submissions from the local government sector were excluded.

consultation, for example with Maori, was seriously deficient.

As a constituency that pays around half the total rates bill, the business community wanted a say in the process. Business organisations made lengthy, detailed and considered submissions on the discussion paper and the subsequent legislation. Their views should have been considered on their merits by an open-minded government, and wide parliamentary and public support should have been a prerequisite to change. This was not forthcoming. The government relied on its narrow parliamentary majority to bring in the new Act. It will remain tainted as a consequence and is likely to be changed with the next change of government. Instability in constitutional arrangements is not a good thing.

Business sector criticisms of the new legislation were not limited to matters of process and consent. Another key concern is that the Act, and particularly its purpose section and provisions relating to the power of general competence, does not constrain local government to its proper role.

There was broad agreement that the prescriptive Local Government Act 1974 was outdated and overly complicated. It too placed few constraints on council activities. Councils were permitted to engage in a wide range of activities, some of them truly weird and wonderful. For many years Wellington City Council owned and operated an abattoir at Ngauranga, Manukau City had a business that mowed lawns in Queensland, Waitakere and North Shore cities jointly own a maintenance contracting business that seeks non-council work, and the Buller District Council set up a sock factory in Westport. Nor did the old Act prevent massive flops such as Wellington City's 1990 'Sesqui' festival.

The business community was concerned that the proposed Act would give councils even more encouragement to engage in virtually any activity they chose, provided it was lawful and had been subject to consultation.² Ominously, the Act's purpose statement is all-encompassing and requires councils to be active promoters of economic, social, environmental and

² Local Government New Zealand's 2003 Conference theme was 'Unlimited'.

cultural well-being. This can mean all things to all people and, with the power of general competence as a powerful implementation tool, there is a strong steer for local authorities to expand their activities, and increase their spending and rates. There is already evidence that this is happening.

The government argued that councils would be constrained by democratic processes and consultation requirements. Experience shows, however, that local democracy is generally weak. Voters often do not know who or what they are voting for in local body elections. The low and declining voter turnouts weaken council mandates. The nationwide turnout of 45 percent at the recent election was by far the lowest since the 1989 reforms³.

Problems associated with low participation levels are particularly evident in the larger cities. Moreover, the Local Government Forum's 'Hot Councils' exercise confirmed impressions that councils in the main centres are generally the worst performers. Smaller councils seem to have their feet more firmly planted on the ground. The evidence seems to run against the argument many make that bigger is better.

This point is relevant to the calls to amalgamate the Auckland territorial authorities into a 'super city'. The elected representatives would be even more remote from local residents. A Herald-DigiPoll conducted in September found that almost 90 percent of Aucklanders could not name one Auckland regional councillor. Moves to more commercial structures and private sector participation in the key activities that require better coordination across the Auckland region – transport, sewerage and water – rather than administrative reorganisation, should be the priority for raising performance.

Consultation on the draft annual plans of councils also provides few checks and balances. The submission process tends to be captured by small but vocal minorities pushing agendas that have to be paid for by other ratepayers, typically businesses. As the Auditor-General has commented, consultation can be little more than a sham with councils paying no more

³ Local Authority Elections Statistics, Department of Internal Affairs.

than lip service to the views of submitters. A recent example is the apparent attempt by Dr Hucker, deputy mayor of Auckland, to change many objectives and policies of Auckland City without regard to consultative and planning processes.

Another problem with consultative processes is the low quality of analysis behind many policies and projects. At central government level, decisions usually undergo close scrutiny within and between government departments, and the Treasury provides ministers with independent advice. The quality of comparable analysis in councils is often embarrassingly low. It took business organisations several years to persuade the Wellington City Council that the basis on which it was assessing the tax treatment of rates was simply wrong. Wellington City is making a similar Econ 101 error in its treatment of the cost of capital for financing purposes, but it is refusing to engage in debate on it at a professional level. On a brighter note, business organisations are pleased that the chairman of the Auckland Regional Council has recently agreed to an open, technical review of the case for a business rating differential.

Quality control by councils of consultants' reports is also often poor. The BERL report on Auckland's Eastern transport corridor is one of several that could be cited. If the directors of a company included a shoddy analysis in a prospectus, they could well find themselves in the dock. You as professional local government managers have a role to play here. There is no excuse for inadequate analysis in reports and proposals coming before elected councillors.

I have argued that voting and consultative processes constitute insufficient checks and balances on local government. Allowing territorial authorities to do largely as they please is inconsistent with sound constitutional democracy. The US Constitution delegates specific enumerated powers upwards from the people to the states and to the federal government. The intention, not always realised, was to protect individual liberty and promote prosperity and social cohesion. In a New Zealand context, a good case can be made that the powers of local authorities should be tightly defined

by central government and explicitly enumerated in legislation. Councils should be prohibited from engaging in other activities unless they obtained ratepayer consent in a poll supported by more than a simple majority.

Recent changes to voting arrangements also constitute a change of constitutional importance. The change was made with insufficient analysis, debate and support from the public.

The confusion about the single transferable vote system used in some territorial authorities and all district health boards may well have been a factor in last year's low voter turnout. Voters had lists of up to 40 candidates to rank. I would be extremely surprised if most were able to cast informed votes. Unacceptable delays in the vote count for STV contests were the last straw. There must be many people, particularly candidates, who view STV as a regrettable mistake.

A cardinal virtue of an electoral system is simplicity. I would argue that New Zealand should return to a uniform system of voting across local government. It should be well understood and simple for voters and vote counters alike. First-past-the-post is the system that best meets these criteria. In my view the Local Electoral Act should be amended to mandate the use of FPP in time for the 2007 elections.

We are seeing the consequences of these weaknesses in institutional arrangements in the performance of many councils. Local government spending continues to increase at rates that far exceed the growth in population, inflation and gross domestic product (GDP). There is little evidence of a comparable increase in community welfare. The Local Government Forum's 'Hot Councils' benchmarking exercise identified some superior performers among councils but a good deal of underperformance. We challenge those who criticised its methodology to do better. Underperformance in a sector as large as local governments is a drag on national living standards and aspirations for faster economic growth.

It is basic economics, not ideology, to argue that the core business of local authorities should be the funding and, in justifiable circumstances, the provision of local public goods that cannot be better provided by firms, households and non-profit organisations, together with the administration of appropriate local regulation. There has been a solid consensus in support of this view in professional circles. 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." I would emphasise that this is not a conclusion based on what's good for business; it's a standard analysis of what's good for the community as a whole.

In plain language, councils should focus on their core activities – the services that only councils can provide – and do them well. They should exit from activities that can be handled by the private sector such as airports, ports, forestry, subsidised housing, convention centres and off-street parking. Water and sewerage and roading should be structured on more commercial lines with efficient charges for services, and the private sector could play a larger role in these industries. New Zealand is lagging well behind many other countries, not least Australia, in adopting more modern and more efficient approaches to infrastructure.

Studies have shown that public ownership of commercial enterprises is, on average and over time, less efficient than private ownership. However, the provisions in the Local Government Act make it difficult for councils to divest businesses, particularly those deemed to be 'strategic assets'. Auckland City is to be commended for selling City Design Limited and New Plymouth for its sale of shares in Powerco. The restrictions on the sale of businesses are nonsense for legislation that purports to be empowering, and the restrictions should be repealed.

The government has recognised that the rating burden has been growing and is being spread unfairly, and is planning another review. This should go further than the 1999 review of funding powers. Rates are the

consequences of spending, and a sound review should start with an examination of what councils' core roles should be and whether ratepayers are getting value for money. A quality review should be independent, along the lines of the Tax Review 2001 chaired by Rob McLeod. It should include representatives of ratepayers as well as central and local government, and its chair should be someone independent of either tier of government.

In my view there is no need for alternatives to property-based rates such as local sales taxes or income taxes if councils focus on their core activities and apply user charges where it is efficient to do so. However, there are other rating issues that should be addressed. One is the shortfall in contributions by central government and its agencies. Another is the exemptions granted to organisations like churches and for certain Maori land. As with central government taxation, there is a good case for a broad-base low-rate structure for rates.

An issue of interest to business is the business rate differential. Although the business sector pays around 50 percent of the rates bill, it is unlikely that business receives 50 percent of the benefits of council activities. A number of councils have realised this inequity and some progress has been made to reduce business differentials. The argument that businesses are advantaged because they can deduct rates for income tax purposes and claim a credit for GST paid on rates is simply wrong. So too is the claim that businesses have a greater 'ability to pay'; taxes and rates are not ultimately borne by entities but by individuals.

New Zealand coped perfectly well without differential rating up to the 1970s. In my view there is no sound general case for a higher differential rate on businesses.

One thing a review should not do is promote ad hoc expedients to reduce rate burdens. A case in point is United Future's campaign to exempt GST from rates. This was rightly rejected by parliament. The focus should be on more rigorous and transparent budgeting. One step that would improve

transparency and accountability would be itemised rates assessments. Some councils have commendably taken this step.

Local government is a 'big business'. It is vitally important to the economy and society as a whole. The business community wants it to fulfil its proper role in the economy, use resources wisely, and perform its regulatory activities efficiently. That will not be possible, however, if it is subject to inferior constitutional arrangements.

The 1989 local government reforms reflected generally sound principles, but they were not fully carried through and they did not solve the problem of weak local democracy. The Local Government No 3 Act tried to strengthen financial disciplines but it was watered down and then often ignored. The 2002 legislation was a move in the wrong direction, away from constitutional anchorings. The story is not all bleak: the Local Government Commission has performed a useful service in cutting the size of some councils. But the broader task of creating a sound and durable framework for local government is still unfinished business, and should be undertaken at the earliest opportunity in the interests of national economic growth and prosperity.