

**New Zealand Society of Local Government Managers**

**Local Government: A Business Perspective**

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## **LOCAL GOVERNMENT : A BUSINESS PERSPECTIVE**

My brief is to offer you some business perspectives on local government and your role as managers in it. I welcome the opportunity, since the business community is taking an increasing interest in the performance of this part of the public sector. The Business Roundtable will be putting out a study on local government later this year. The Wellington Chamber of Commerce has been active in monitoring the Wellington City Council's corporate plan and budget. Federated Farmers has set up a committee to look at local government issues. These various initiatives reflect the fact that, despite the recent reforms, much remains to be done to improve efficiency in local government and its contribution to helping New Zealand make its way in the world.

The setting for your deliberations is a very tense domestic and international climate. As the New Zealand Chamber of Commerce put it in its submission to the government's conference of sector leaders:

"New Zealand's longstanding economic problems are worsening. The policy drift of the last 3 years, the irresponsible 1990 budget and an unfavourable external environment have condemned New Zealand to a period of intense discomfort. Very substantial economic adjustments are needed. There is little community recognition of the magnitude of the difficulties and the consequences of failing to deal with them."

For all sectors of the economy, it cannot be business as usual. Local government is no exception. The government's December package is only a start to the new round of efforts that are needed, in all organisations and the country as a whole, to become more productive and live within our means.

Consider some of the indicators of New Zealand's performance as assessed in the 1990 World Competitiveness Report produced by the highly respected Lausanne Business School IMEDE, in conjunction with the World Economic Forum. We were ranked 17th overall amongst the 22 OECD countries covered, only ahead of some Mediterranean countries. Many of the new industrial countries in Asia were ranked far ahead of New Zealand. Some of the individual results are sobering. For example:

- We had the lowest rate of real GDP growth and real per capita GDP growth over the 1982-88 period.
- We scored bottom for growth in employee productivity over the same period; output per employee is barely half that of the top-ranked countries.
- We are a low wage country; the only countries on the list with lower hourly wages are Turkey, Hungary, Portugal and Greece.
- We work less than most other countries. Hours per week actually worked in manufacturing activities were 36.6 compared with 40-42 for countries like Switzerland, Japan and Germany (and 45-55 for the successful Asian countries).

- Our labour force is rated as one of the least willing to accept new technology.
- We have relatively low rankings for product design and for on-time delivery of products.
- Contrary to the claims of New Zealand educationalists, the performance of the compulsory education system in meeting the needs of a competitive economy gets a low mark.
- We have almost identically low scores (17 out of 23) for managerial drive, responsibility and initiative and for worker motivation (18 out of 23).
- Of particular relevance to local government administration, we also score a low 18 out of 23 for the extent to which pressure groups limit new industrial developments.
- We have almost the worst rankings for industrial disputes, for the extent to which organised labour affects corporate operations and for the extent to which industrial relations are conducive to labour peace. (Trade union claims that the government is moving towards a more disputatious system have it exactly backwards.)

This is a sorry catalogue. Although comparisons of this sort are indicative rather than definitive in all respects, the results suggest we are failing badly in many dimensions of international competitiveness. All must be addressed if we are to do better. The tendency to focus on the value of the currency as an indicator of competitiveness is far too narrow.

We need to remember that New Zealand is a country on the periphery. The rest of the world does not need us. If we are to succeed in attracting and retaining skilled people, capital and businesses, we must allow the excellent to excel. We must not tolerate second best decision making by governments. We should aim to have the world's best labour laws, the best planning regulations and the best business codes. We need top quality and low cost central and local government services and a low tax burden.

Given that kind of business environment, there is no reason why New Zealand cannot thrive. The scales are not tilted against small-fry countries. In the period from 1960 to the mid-1980s, income per head grew by as much in small countries on average as it did in countries with larger populations or land areas. Open economies are not limited by the size of their domestic markets; they can increase their markets through international trade.

There is much international evidence that a significant factor in poor economic performance has been the growth in the size and inefficiency of the public sectors in many countries. The collapse of the bureaucratic regimes in the Soviet Union and East Europe is the extreme example. However, I do not wish to engage in an exercise in bashing the public sector, either central or local government. You would find that as tedious and unwarranted as I find the equally popular sport of bashing the oil industry. It is pleasant to record that, with some exceptions such as the Consumers

Institute, New Zealand has handled the recent oil market developments with a new maturity, by allowing markets to do their job of adjusting to changes in supply and demand. We need to avoid cheap shots and misinformed comment in talking about local government as well.

For example, the popular preoccupation with councillors' fees and executive salaries misses the real issues. There may be genuine questions to ask in this area, but they are not unique to the local government sector. Consider this story from the Australian Financial Review about the actions of one of Australia's most respected chief executives:

"BTR-Nylex ... [m]anaging director Alan Jackson won much notoriety in 1985 when BTR took over plastics manufacturer Nylex ... for the brutal way he put an end to the Nylex executives' little indulgences.

After he ousted then Nylex chief Henry Bosch, Jackson immediately sold his limousine, dismissed the chauffeur and emptied and sold off the vast quantities of liquor in the executive bar fridges.

Today the BTR-Nylex head office in Melbourne is a study in poverty - no oak desks or rich leather chairs here."

You may know that in the meantime Henry Bosch spent several years as head of the Australian equivalent of the New Zealand Securities Commission trying to regulate and restrict company takeovers, and our Securities Commission has pursued a similar crusade. Takeovers are one of the key mechanisms for disciplining poor management performance in the corporate sector. Nothing could be more detrimental to the interests of shareholders as a body than moves to weaken such disciplines. Similarly the real issue with local government is the ability to monitor management decisions and to discipline poor performance. Progress has been made in this regard in the state sector with a move to chief executive contracts and performance measurement. To date local authority management has not had to carry risks or bear the costs of poor decisions. Future contracts should not provide for any bonus element without specifying a downside for non-performance.

I have no problem with paying local authority managers well, provided the payment is no more than is necessary to attract and retain people of the necessary calibre. Nor does it bother me that the same people are now being paid more than before, provided the expectations of performance have also risen. I was amazed to hear a teachers' organisation complaining last year that the principals of some schools were having to work a 50-hour week. Most successful business executives of my acquaintance would be delighted to have their working week reduced to 50 hours and to have the annual holidays that principals enjoy. I would have little sympathy with similar complaints from local authority managers.

I believe the proper approach to this issue is not to revert to centralised controls over remuneration or to require disclosure of remuneration arrangements as some are advocating. Such approaches would only turn talented people away from local government employment. You should resist them strongly and press your councils to do likewise. Rather, the focus should be on a variety of measures to monitor the performance of managers, the introduction of competition into all operating units, and contracts which incorporate sound performance incentives. For example,

contracts with generous redundancy provisions, which raise the cost of firing unsatisfactory managers, are seldom likely to be sensible from the point of view of councils and their principals, the ratepayers.

I have every confidence that good managers in local government will welcome the greater managerial freedom combined with the pressure to perform which is inherent in the new structures. That has been the experience of managers in the private sector and in state-owned enterprises.

Only a few short years ago, much of the private sector laboured under heavy regulation and faced few competitive pressures. Productivity levels relative to our international competitors were a disgrace. The oil industry is an example of the way in which deregulation has stimulated better managerial and operating performance. Substantial cost savings have been made at the Marsden Point refinery, the threat of competition from imported cargoes has seen a reduction in coastal shipping costs and the removal of licensing has intensified competition at the distribution end. Life is tougher for managers in industry just as it has become tougher for many of New Zealand's large businesses, contrary to the popular view that they have been the main beneficiaries of the restructuring changes. But few private sector managers would wish to turn the clock back.

The scope for improvements in efficiency is even greater in the public sector, especially in local government which has lagged behind in the restructuring process. Despite the earlier denials of the Public Service Association and various academic economists, the existence of massive waste and inefficiency in the former trading departments has been exposed beyond any possible doubt. The programme of corporatisation and privatisation has been an outstanding success and reflects credit on the politicians, boards and managers involved with it. Much less has so far been achieved at the central government level in areas such as health, education and social welfare.

At the local government level, I believe the priority task following the recent reorganisation should be a fundamental reassessment of what local government should actually do. Over the past year, there has been a good deal of controversy about rate increases. In my opinion, some of these were an outrage, such as the attempts by some local authorities to impose massive rate increases on the commercial sector. As the High Court said in its decision on the case brought by the Electricity Corporation, no local authority could reasonably have taken the decision to levy the amount attempted by the McKenzie District Council. In some cases the picture is confused by central government shedding functions to the local level and by the costs of reorganisation. But to focus solely on rate demands is to put the cart before the horse. As Sir Brian Elwood has pointed out, if people want lower rates the solution is in their hands : "make councils cut spending".

Reflecting on the poll tax debate in the United Kingdom, the London *Financial Times* recently made a similar point:

"A proper examination of local government", it wrote, "would involve answering the following questions: What are the proper functions of local government? How should local governments be elected? ... How many tiers of local government should there be and what should each of them do? How should local taxation/property charges/rates be arranged? What role should

central government play in determining local authority spending and taxation patterns?"

The *Financial Times* pointed out that no British government had addressed itself to this whole complex of related issues at once. The same can be said of New Zealand.

The study being undertaken by the Business Roundtable is an attempt to answer some of these questions. A starting point is to note that under our unitary system of government, the powers of local government are delegated from central government. The decision about what to delegate to local government involves two interacting questions:

- the relative merits of private and governmental solutions to particular problems; and
- the relative merits of central and local government in performing the governmental role.

These questions can be posed in relation to the main functions undertaken by local government, which can be grouped under the headings of trading activities, public goods and services, and regulatory activities. In the interests of provoking debate, let me sketch some of the lines of thinking that seem to emerge from such an analysis.

The category of trading activities is the most straightforward. There is now widespread agreement that governments are not good at running businesses. Ratepayers should not be asked to bear the typically low returns and risks of investment in commercial operations. Early steps towards corporatisation and privatisation were taken in respect of ports, airports and, more recently, electricity supply authorities.

In the case of ports, enormous improvements in efficiency have been documented, although it is now apparent that a mistake was made to vest the shareholding of port companies initially with territorial authorities. While some of them appreciate that they have little to contribute to the management of port companies and have better uses for their funds, and have decided to sell down their shareholding, others seem inclined to hang on to their windfall gains or, worse, use ports as cash cows to fund other activities. One regional council is even considering buying the shares of a partner council which has decided to relinquish its shareholding! It is therefore pleasing that the government is committed to pursuing private ownership of port companies.

It is disappointing that local government has been slow to move in the area of trading activities, and has started to act only under pressure from central government. Fortunately this seems likely to continue. While National has promised to repeal the legislation on LATEs in its present form, it appears firmly committed to private enterprise approaches through corporatisation, privatisation or contracting out. With corporatisation of public transport operations now proceeding, the main outstanding trading activities are water supply (the most obvious privatisation candidate) and sewerage (which should at least be worth a look).

In respect of public goods and services, there is a need for a zero-based review of the need for local government involvement. The local government system was originally

created as a user pays arrangement for providing a limited range of local services. The number has grown astronomically. There now seems to be no limit to the number of activities which some councils see fit to undertake.

To take a small but scandalous example, the Wellington City Council recently agreed to fund a trade union to make submissions opposing the government's labour relations legislation. The present government spelt out clearly to the electorate its intentions in this area, and won an overwhelming mandate at the polls. Public opinion surveys have shown that the reforms are backed by a large majority of New Zealanders. A recent study by the Australian Bureau of Industry Economics estimated that labour market reforms of the type proposed here would boost GDP in that country by nearly 1 percentage point a year or \$3 billion. This episode demonstrates the propensity of local government to be captured by special interest groups at the expense of the wider community.

While there are some genuine local public goods such as streetlighting, many activities in this category turn out on closer inspection to be private goods funded publicly. No-one can accuse my company of being prejudiced against the game of golf, but it is hard to understand why most local authorities own golf courses when only those involved in the game benefit from them and there is clearly a competitive market in golf links. In terms of odd functions, zoos and cinemas also take a lot of beating. Views have been changing around the world about whether access to libraries and museums should be 'free', or whether they should be paid for, at least in part, by those - often from higher income groups - who use them.

Where genuine public goods and services are involved, and local government funding of them is justified, it is now widely accepted that local government does not have to act as a supplier. There is a large body of evidence that major cost savings are available from the contracting out of services. A United States study indicated that 98 percent of local governments have achieved a cost saving in this way. The savings are not insignificant - 80 percent of councils saved more than 10 percent and 10 percent of councils saved more than 40 percent. There is enormous scope for more contracting out of services in New Zealand.

Best practice in supplying services does not necessarily differ between public and private sector organisations. Management writer Tom Peters argues that:

"The best answer for introducing innovation ... is to turn the firm into a marketplace, with virtually every service up for bid. Insist that providers of staff services test their mettle by peddling to outsiders as well as insiders... And encourage line departments to bypass ineffective staff units and go to the market."

Transpower, the Electricity Corporation's business unit responsible for the national grid, was deliberately set up without a maintenance staff so that it was forced to contract out maintenance services. It has encouraged competitive tendering and gained substantial leverage over its costs. No particular problems have been encountered in controlling service standards.

My conclusions under this heading are threefold:

- Local governments should pare back their activities to a much narrower range of genuine public goods and services.
- The provision of services should be contracted out wherever possible. John Fernyhough has argued publicly that quite large councils such as Dunedin and Auckland cities could be run by 20 people if such a policy were adopted.
- Wherever the beneficiaries from such services can be readily identified they should be charged for them.

Local government decisions on services should not be biased by central government. I see no role for central government subsidies for local public projects for which the benefits accrue locally. Urban transport is a case in point.

The final broad category of local government functions is regulation. Local government regulation is far-reaching and not infrequently bizarre, ranging as it does from dog control to licensing of street vendors to the entire edifice of land use and construction regulation. It has pervasive effects on households and businesses.

Again, in my view, the new local authorities should be reviewing from a zero base the entire array of regulations and by-laws to see whether they are necessary, properly designed and cost-effective.

You should be questioning, for example, whether even major and longstanding regulatory functions - or at least large parts of them - such as town and country planning are necessary at all. Much of the built environment of New Zealand was developed without any form of statutory planning; the common law did the job of protecting property and third party rights. Even today, some cities such as Houston have no planning procedures.

The average town plan is not mainly about the environment but about mundane things like the size of a backyard, the siting of a hairdresser and how many carparks a suburban outlet should provide. Is all of this necessary? Local government managers have too often failed to recognise that regulation involves the prevention of activity that would otherwise occur and the distortion of resource use in their region or district. Their role as 'gatekeepers' of economic activity has the potential to inflict significant costs upon their ratepayers and the economic health of their community. As the trading arms of local government are moved into the private sector, the relative importance of regulatory functions will grow, and it should be expected that accountability for performance in discharging them should grow at an equal pace.

Recent experience in this area is not encouraging. The Resource Management Bill promoted by Geoffrey Palmer was a regulators' paradise. It was disturbing that it received considerable support from people in the planning profession and local government, who appeared to relish the thought of benefiting from an expanded bureaucratic process. The Bill requires a major overhaul if New Zealand is to have any chance of attracting investment and creating jobs. I am not sanguine that the government yet appreciates the extent of the overhaul that is needed and can achieve it within the timetable it has set itself. Neither commercial nor environmental interests would be well served by merely tinkering with the present structure of the

Bill. If it proceeds, I hope local and regional governments will make good use of provisions allowing them not to plan and intervene, and perhaps even seek the option to declare themselves Resource Management Act - free zones.

One issue that intersects with resource management is the role of regional government. I have a good deal of sympathy with the government's view that this branch of government may be unnecessary, at least in most parts of the country. I am aware that regional councils are not regarded as an extra tier but as an integral part of the local government structure. However, two factors in particular seem to me to call into question their rationale. One is the expanded boundaries of local government, which reduces the problem of coordination. The second is the potential for full privatisation of services such as ports, public transport and water where these are supplied on a regional basis. Given such developments, regional councils would become primarily regulatory bodies dealing with resource management. But if this planning function is streamlined as it should be, it seems questionable whether a separate branch of government is needed to coordinate activities across local authority boundaries. Cheaper solutions may well be available. I should be interested to hear your views on this issue.

I have omitted from my list of functions for local government a social welfare role. All that local governments can achieve is redistribution within their boundaries. It is difficult to see the justification for such redistribution given the national welfare system, the likelihood of conflicts with national policies and the absence of a mandate from central government. New Zealand has a major problem with central government's social welfare system, with respect both to its direct costs and the disincentives it creates. The presence of another layer of redistribution policies at the local level compounds the problem. Housing and many so-called community development activities are questionable on these grounds. I note that the government's policy is that the provision of health, education and social welfare services should remain the responsibility of central government.

Similarly there is little merit in the employment schemes that have been run by local authorities. These can do nothing to increase overall levels of employment. They have to be funded from rates, which reduces the spending power of households on goods and services supplied by the private sector and hence the number of jobs in it. The result is merely to shuffle jobs from the private to the public sector and typically to employ people in less productive activities. The solution to unemployment is a labour market that works, a social welfare system that does not discourage people from taking employment and a productive, growing economy. Work schemes are not the answer.

I see your role as senior managers in local government as being to ask the hard questions I having been raising and giving tough-minded advice to councils. You also have a leadership role in implementing changes and rationalising local government operations. The success of the SOE programme owes much to the selection of talented chief executives who have turned around the culture and performance of bureaucratic organisations. Some of your own roles are changing rapidly, for example from being quasi-business managers to that of advisors to shareholders seeking a commercial return on assets. In turn that role will disappear as trading activities are privatised.

Perhaps your society has a role to play as a forum for exchanging ideas and discussing common problems. In the business sector we are finding there is a convergence of interests and needs between public and private sector business organisations. For example, with the move to private sector modes of operation, three SOEs and the largest port company are now represented on the Business Roundtable. It is in the longer term interests of local government managers themselves to adopt other management practices and standards, and to welcome a much more critical monitoring of performance. Moves in these directions can only improve the current relatively low status of local government management as a career.

The issues with which you are concerned are far from academic. To return to my opening theme, the urgency and gravity of our country's economic problems cannot be overstated. Farm incomes will be down by unprecedented amounts in the current season. We still have a massive amount of public debt - around \$36,000 for every household. This must be reduced quickly. Our credit rating has been downgraded, adding to the costs of capital to the corporate sector. The risk element in our interest rates is the price we pay for having shot ourselves in the foot so many times in the past that people are reluctant to give us a fresh supply of bullets. Despite prevailing negative sentiment, I believe there are grounds for optimism about New Zealand's future. There is no reason to suppose that an ongoing economic decline is inevitable - absolutely none. But a better future will only happen if governments face up to the hard decisions and the community recognises it can only be based on hard work.

Local government operations are a major part of the economy. They employ around 50,000 people - as many as Telecom, the Railways Corporation, Electricorp, New Zealand Post and the other remaining SOEs combined. They ought to be able to achieve at least the same efficiency gains as these SOEs. The previous Minister of Transport described Auckland's bus problems as an "appalling indictment" of the Auckland Regional Council's management, but this is not a unique example. Local authorities simply must find new ways to cut costs and increase productivity.

In the past local authority reform has not come from within. It should do so in future. Your society is well placed to debate issues and show the way. The business community will be looking for actual rate reductions this year, not just a standstill. Resources must be released to the private sector, particularly the export industries, to enable them to grow and create jobs. As managers of the new local government structures, I leave that challenge with you.