

EMBARGOED UNTIL 10.00 A.M. THURSDAY 20 FEBRUARY 1997

Commerce Nelson Local Government Forum

**Promoting Economic Growth:
Challenges For Local Government**

**Roger Kerr
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE**

**Nelson
20 February 1997**

PROMOTING ECONOMIC GROWTH : CHALLENGES FOR LOCAL GOVERNMENT

Local government doesn't exist in a vacuum: rather it is one means of achieving desired economic and social goals. We therefore need to consider the role of local government in the context of all available options for meeting those goals. We need to assess which tasks it can best undertake and which are best handled in other ways.

Few people now need be convinced that New Zealand's economy is in much better shape as a result of the economic changes of recent years. Many of those changes have involved a rethinking of the role of government in the economy. But there is still much work to be done if we want to attain the living standards of leading countries and deal with outstanding social problems. That will require us to carry on rethinking current ways of doing things in both the public and private sectors, and striving for continuous improvements.

The last National government set itself the goal of an annual economic growth rate of 3.5 - 5 percent to the year 2010. NZ First has a higher target: it is committed to achieving annual growth of 6 percent by the end of its first parliamentary term. Few, if any, economic observers expect any of these goals to be achieved in the next three years on current policies, despite the stronger economy and a favourable world environment. Most expect the coalition's initial package will harm such prospects, particularly through the size and low quality of its government spending proposals. These will exacerbate tensions in the economy and hurt internationally competing industries. It follows that further bold initiatives will be needed if the coalition parties' commitments to high growth rates are to be credible.

Such initiatives must involve local government, whether they are taken by central government or the sector itself. Local government is a big player in the economy, in terms of assets, spending, employment and its regulatory role. If it is underperforming in any way - for example by not clearly identifying its proper functions, by becoming involved in extraneous activities, or by not operating at maximum efficiency - then the whole economy suffers. That

means citizens in general suffer because, contrary to popular rhetoric, the only purpose of the economy is to meet people's needs.

Of course citizens have other desires as well as an efficient economy, and public policy - including at the local government level - should also be concerned with things like public amenities and the environment. And there are some, such as Tony Simpson, president of the Public Service Association, who have argued against the idea of an efficient economy and the higher living standards that go with it, saying:

... we have to run a less than efficient economy, because if New Zealand was really running at maximum efficiency there would never be enough jobs for people to do.

This statement is presumably intended as a defence of maintaining inflated payrolls in the public sector, but it is economic nonsense. Resources, including labour, are always scarce relative to people's wants in an efficient economy, as the experience of the high employment economies of East Asia demonstrates. The PSA is perfectly entitled to argue for the acceptance of lower living standards, but New Zealanders seeking increases in wages and other incomes don't seem to share its views.

Fortunately, there is a growing recognition of what local government needs to concentrate on if it is to play an effective part in economic and social development. Let me quote you a relevant passage:

Where should local government be heading over the next 10 years and what is it doing now that causes concern in our community?

To answer those questions, it is helpful to look back at the past and to see where local government has come from in this country.

Originally, communities banded together to provide essential works such as roads, bridges, refuse collection and disposal, water supplies, sewerage reticulation and land drainage. ...

From there, local government developed on the centralist principle of the all - caring, powerful, collective being better able to care for individuals than those individuals would possibly manage for themselves.

Then, in 1989, local government was reformed.

But we still have people in local government who operate on the 'big brother' principle.

These are the councils which ... have committed to the discredited concept of big spending, large government. They are characterised by grand schemes, an almost religious fervour in their strategic planning, and environmental crusades. ...

History tells us that the most likely outcome will be a shameful waste of money. ...

Local government should begin asking the question, what is best for New Zealand and New Zealanders?

The answer may be that there are better delivery mechanisms for works, services and regulatory functions. ...

Indeed, it may be that those services can be delivered better and cheaper outside of local government, thereby removing a layer of cost and bureaucracy from the lives of ordinary New Zealanders.

Contrary to what you might be thinking, that is not an extract from a Business Roundtable speech. It comes from an article by the mayor of Papakura, David Hawkins, which appeared in the *Herald* last year. Mr Hawkins has written to us saying he agrees with our general approach on local government but believes it doesn't go far enough. He has questioned whether New Zealand will ultimately need local government at all.

Another council that is regarded as a leader in local government is the Rodney District Council. It has been one of the first to prepare a 10-year financial strategy under the new local government legislation. A section of its document reads as follows:

Some local authorities in New Zealand involve themselves in a very wide range of activities on behalf of their local communities - including things like health and welfare, social and economic issues, subsidised and senior citizen's houses, child care, unemployment, as advocates for children, youth entertainment, art galleries, public relations offices, the provision of convention centres, economic development and marketing, the promotion of local festivals and events, arts and culture, and so forth.

The Rodney District Council has received the very clear message that ... this is *most definitely not* what people want here.

The District Council will continue to confine its work to a very narrow range of activities. It believes that its core business is:

- ***TO PROVIDE LEADERSHIP*** for the District (especially by way of advocating the District's interests to Central and Regional Government) and to coordinate/empower/support/encourage/facilitate local people and national and local organisations to work together in the local community interest; and
- ***TO MAKE PROVISION*** for the operation, maintenance and upgrading of local roads, sewerage systems, water supplies, stormwater systems and some recreation and civic amenities; to plan for and administer controls on the adverse effects of land uses in its district; and to exercise a limited number of other regulatory responsibilities.

That approach is broadly in line with our thinking and, I believe, that of most other business organisations. To say that local government should focus on such core functions is not to say that the other activities listed by Rodney are unimportant. It is simply to say that local government is not the best institution to undertake them, and that by over-reaching itself it will be less effective in discharging its core responsibilities. Indeed the best contribution local government can make on issues such as unemployment and economic development is to achieve lower rates, reduce regulatory burdens, and organise efficient infrastructural services so as to encourage private investment and job creation.

A common objection to this line of argument by some in local government who defend a 'big government' role is to say they have popular support. This misses the point. We all want local governments to be democratic, but we also want their policies to be sound. Sir Robert Muldoon's policies enjoyed democratic legitimacy, but they ran the country into the ground. Economic directions changed democratically in New Zealand because the arguments about the failings of Muldoonism ultimately prevailed. Debate about public policies must be based on sound public policy criteria: the fact that a particular course of action enjoys temporary popular backing does not necessarily make it sound.

Another objection to a constrained vision for local government is that councils have to step in to 'fill a gap' or 'meet an unmet need'. As John Roughan put it recently in the *Herald* in a related context:

... you can still find innumerable people who want the government to finance a possum fur industry if nobody else will.

The argument is similar to those which would have businesses assuming all kinds of social responsibilities or schools taking on non-educational roles. If acceded to, the likelihood is that the core functions of all these institutions will not be performed well, activities of marginal social value will be picked up, substitutes for them will be crowded out, and those who should be assuming the relevant responsibilities are let off the hook.

The proper business of local government is not hard to define conceptually. Local government is part of the public sector. By definition it should be involved in organising the provision of public goods. It should not be involved in the provision of private goods. Most goods are private goods: they are bought and sold in the market place, or - in the case of many sporting, recreational and charitable activities - organised voluntarily. A public good satisfies two main criteria. First, is it possible to charge for it? If not, it may be a public good. Second, can people be excluded from using it? If it is not possible to exclude non-payers, it is less likely that the service will be provided commercially. Open-access parks, footpaths and stormwater drainage are standard examples of public goods at the local government level.

Public goods whose provision must be organised by local government are quite rare. Many councils are now rightly reviewing the services they provide to determine where user charges or part charges are justified. The public good component of services, however, will usually need to be financed from rates.

The vast majority of the assets tied up in local government - roads, water and sewerage, power supply, ports, airports, forests, bus companies, parking buildings and so forth - are used to produce private goods. Roads, for example, are largely funded by user charges and (pedestrians aside) non-payers are excluded. Together with local government regulation, these are the activities that have the largest impact on the business sector and hence on economic growth. For this reason the interest of the business sector in local government is mainly focused on these activities. By contrast, I think business organisations are relatively relaxed about whether councils provide things like community or information services on a modest scale. Especially in small communities, this may well be a sensible role.

Because the 'big ticket' items account for the lion's share of councils' assets and spending, they should obviously account for most of their decision-making time. And because they are largely private goods, questions are clearly raised as to whether councils should remain involved with them. My view is that in most cases there is no longer a need for local government involvement, at least in its present form. Power companies, ports and airports are increasingly being run by the private sector around the world, and there is now substantial private sector involvement in roading and water supply.

The evidence in favour of private ownership and/or management of business enterprises is now abundant and does not need to be rehearsed here. There is a convenient summary in the Treasury's briefing to the incoming government. Given the generally superior performance of businesses under private ownership, there needs to be very strong public policy reasons for keeping them in the public sector. It is not sufficient just to run SOEs or LATEs on business-like lines; typically there are further large productivity gains with privatisation. Nor is it sufficient to point to the fact that some private businesses fail, and that some SOEs and LATEs have achieved good returns. The relevant point for public policy is that on average and over time the performance of private firms is superior, and politicians should not bet against the odds. It is simply ludicrous for Manukau City, for example, to put ratepayers' money at risk by undertaking a grass-mowing operation in Brisbane.

There is little doubt that New Zealand's economic growth will be stunted in the absence of further privatisation at both the central and local government levels. Some councils are moving in that direction; others which are almost wholly commercial operations, like the Auckland Regional Services Trust, seem reluctant to give up their role.

Some extraordinary arguments are still made about privatisation. A classic was a recent *Otago Daily Times* editorial which concluded that if the Dunedin City Council sold its electricity and forestry assets, rates would be 20 or 30 percent higher. Can you imagine anyone seriously suggesting that if central government sold its electricity or forestry assets, taxes would go up? The future value of the income streams of government assets is capitalised at the time of sale; their present value is typically higher under private ownership because of the expectation that the businesses will be managed more

efficiently; the financial position of central or local government is improved as a result; and there is the potential for taxes or rates to go down, not up.

Another objection to privatisation that is sometimes raised is that business simply wants to get its hands on assets and reap the benefits. This overlooks the fact that buyers have to pay full value for assets sold by councils in competitive sales, and that the main beneficiaries of privatisation are consumers and ratepayers. Moreover, while competitive sales are usually the best means of privatisation, we have argued that a good alternative for a council is simply to issue shares in its businesses to their true owners, the ratepayers. Letting them decide whether to remain investors is surely the most democratic of democratic procedures. So forget about so-called 'greedy' businesses: what is the objection to this approach?

Where councils need to ensure that services of a largely public good nature are provided, it is equally well established that there are usually major gains from contracting them out by competitive tender to the private sector. A recent case in point concerns bus services in Auckland. Around 50 percent are now operated on a commercial basis, and the subsidy required in those sectors which went to tender has dropped from \$22 million a year to \$13 million. Wellington City Council is moving to competitive tendering for a wide range of services. Central Hawkes Bay, which has a population of 12,500, makes the greatest use of contracting out in the country and has reduced its staff to 25. If other councils were to achieve the same ratio of staff to population, employment in local government would fall from 38,000 to 7,000, although many of these people would find jobs with private contractors. It is not difficult to understand why Tony Simpson and the PSA defend inefficiency and oppose local government reform. One can also see why excessive local government costs put pressure on the real exchange rate and the traded goods sector.

Yet resistance to such productivity gains is entrenched in some elements of local government. Stuart Macaskill, chairman of the Wellington Regional Council and former president of the then Local Government Association, is one who has repeatedly come up with spurious arguments against privatisation and contracting out. He has even argued that the regional council, which has no comparative expertise in managing forests, can get a better return on its forestry investment by hanging on to it rather than selling it. The logic of the argument would suggest that the Wellington Regional Council should own the

entire national forestry estate. Recently Mr Macaskill has opposed the decision by the Wellington City Council to tender out maintenance of its water supply and argued that his council should be given a regional monopoly. Fortunately, the replies by the mayor and other Wellington City councillors were robust: the regional council had been slow to fix leaking pipes, it had done "a lousy job", and "he is trying to protect his patch".

Papakura District Council is moving to franchise its entire water supply and sewage disposal services to a private operator. Stuart Macaskill's last line of argument against such proposals is that 'the public would not wear it'. Yet only eight public submissions were received on Papakura's proposal, and five of them urged the Council to take the next step of full privatisation. This is in line with experience elsewhere with water industry reforms wherever political leadership has been shown. Commenting on Australian experience with user charges for water, the *Australian Financial Review* noted in an editorial last year that "the politics of paying for water ... has never been a significant issue." The average weekly cost of water to a New Zealand household amounts to less than it spends on Lotto and other forms of gaming, and there would be large efficiency improvements with a more commercial approach to water supply.

An interesting question is whether local government should be required by central government to divest its commercial operations and contract out services. The Auckland Regional Services Trust is required by legislation to sell most of its assets, and compulsory competitive tendering has been applied widely in Australia and to roading in New Zealand. *The Economist* noted recently that compulsory tendering in Britain has made it easier for council leaders to push through difficult but desirable decisions in the face of opposition from staff and unions. To date, the Business Roundtable has seen such issues as a matter for local decision, but the coalition agreement proposes restrictions on sales of certain council assets and Stuart Macaskill has proposed even stricter restrictions - a 60 percent level of support in a poll of voters - on the sale of water companies. If, contrary to the trend of policy in recent years, Mr Macaskill is leading a move in local government towards seeking greater control by central government, perhaps this is an issue that ought to be debated openly at the national level.

Let me sum up. Local government has been a lagging sector in New Zealand's economic reform programme. It is pleasing that some councils are now quite

vigorously changing the way they do things and may even be showing the way to central government.

Nevertheless, there is still a serious lack of focus and massive under-performance in the sector. Just in the last two months there have been media reports of the Auckland Regional Services Trust losing \$7.5 million on a recycling station, the Hutt City Council valuing a carparking building that cost \$22 million at \$6.3 million, and the Wellington City Council selling a works depot at a loss of \$11 million dollars, to pick just three random examples. Wellington deserves credit for exiting its works business, but it should never have been in it in the first place. Last year increases in charges for central and local government services consistently outstripped inflation in the private sector and made the Reserve Bank's job more difficult. Whereas central government reduced taxes and should be able to make further reductions in the near future, only a handful of local authorities have started to reduce their rates.

If New Zealand is to achieve sustainable non-inflationary growth at the levels targeted by the coalition partners, a much greater effort by local government will be required. At around \$27 billion in 1993/94 values, ratepayers' equity invested in local government is around half the market capitalisation of all the companies listed on the New Zealand Stock Exchange. Higher returns on these massive investments, whether they are retained in public ownership or shifted to the private sector, must clearly be part of any significant improvement in living standards.

The new financial management legislation is a welcome stimulus to better decision making in local government. In particular, it will throw a much clearer spotlight on the genuine public goods functions of councils, promote more efficient pricing and provide a better long-term perspective on trends in councils' spending, revenue, debt and net worth. It is disappointing that fewer than 15 percent of councils are ready to adopt the new framework this year. The business sector will be placing a good deal of weight on it in its submissions on forthcoming plans.

Finally, the government has signalled some initiatives in the coalition agreement which will affect local government. The document emphasises efficiency in local government and makes specific mention of the numbers of elected politicians, charging policies and levels, the separation of regulatory

and service provision functions, competitive tendering and contracting out, and the Resource Management Act. All these are relevant from a business sector perspective. Given the pressures facing farming and other export industries at present, the business sector will be looking for strong leadership from central government and within the local government sector this year to create an environment more conducive to business expansion and economic growth.