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**NEW ZEALAND FOREST OWNERS' ASSOCIATION  
SEMINAR 'THE COMPETITIVE GAP'**

**WHY LOCAL GOVERNMENT NEEDS A BOMB  
UNDER IT**

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## **WHY LOCAL GOVERNMENT NEEDS A BOMB UNDER IT**

The New Zealand economy is nowhere near as competitive as it should be. Indeed we are losing ground after the achievements of the first half of the 1990s. The politics of 'muddle through' at both central and local government level are costing us dearly.

The most comprehensive survey of relative international competitiveness tells a clear story. The IMD World Competitiveness Report put New Zealand in 18th position in 1991. Following the fiscal and labour market reforms of that year, which gave the overall reform programme a coherence it had previously lacked, New Zealand had moved up to 8th position by 1995. It slipped to 11th position in 1996 and slipped a further two notches to 13th position in 1997. We have been on a journey from mediocrity to excellence and back again.

Anyone with a modicum of economic literacy has long since worked out that competitiveness is about far more than the value of the dollar. If a depreciating currency were an answer to exporters' prayers, Brazil, Russia and New Zealand in earlier years would have been world champions in exports, growth and job creation. Instead they were dogs.

What matters for international competitiveness – for the so-called real exchange rate – is a much more fundamental set of economic influences. Essentially the real exchange rate is the relationship between prices in the traded and non-traded goods sectors of the economy. Prices in the traded goods sector are set in international markets – they are largely beyond New Zealand's control. What we have to do is to keep our eyes firmly fastened on

the prices we can influence in the non-traded goods sector of the economy. If they rise faster than the prices of traded goods the real exchange rate rises and the export and import competing sectors are squeezed.

That is exactly what has been happening in recent years. In the year to the September quarter of 1997, prices in the traded goods sector did not rise at all. Meanwhile non-tradeables inflation ran at an annual rate of 3.8 percent. These movements – which are a continuation of earlier trends – have been an important contributor to weak export profitability and the expanding current account deficit.

There are many dimensions to international competitiveness. Firms have a major role to play. They must continually strive to reduce costs, improve productivity, innovate and establish a reputation for quality, service and reliability. But firms in general will only succeed in an environment which is business-friendly. Governments have a major role in creating that environment.

The lesson of the first phase of New Zealand's economic reforms in the 1980s was that, despite many far-reaching initiatives, a consistent economic framework and hence a business-friendly environment was never achieved. In the second phase, fiscal control was established in the 1991 budget, the pressure came off financial markets and the currency, and the Employment Contracts Act led to major improvements in work practices and firm-level productivity. The outcome was a strong, export-led economic recovery.

Since the mid-1990s, there has been slippage on several fronts. The most important has been the massive blow-out in government spending, which has pushed up domestic costs and put monetary policy under strain again. While

the exchange rate has fallen in recent months, this reflects in part a loss of international confidence in New Zealand. Unlike in 1991, it is not due to a fiscal correction: government spending net of finance costs is expected to rise by a further 7 percent in the year to June 1998, more than twice the likely rate of economic growth.

In addition, the government has allowed the Employment Court to re-regulate the labour market, and microeconomic reform – other than the 1996 tax cuts and the privatisation of the Forestry Corporation – has virtually come to a standstill in recent years. Meanwhile other countries have been pressing ahead with privatisation and other structural reforms. This is the story behind New Zealand's fall down the world competitiveness ladder.

The government seems to have finally recognised the gravity of this slippage, and we must hope that the prime minister's recent 'springtime' address and the forthcoming change of leadership signal a real determination to take the kind of initiatives that the business community has been calling for. A glaring omission in Mr Bolger's speech, however, was any mention of plans to reverse the trends in government spending, and at this stage the 'laundry list' of microeconomic reforms on the government's work programme are just that – a list, with no clear indication of the government's intent. For example, there are a dozen ways of introducing competition into ACC, and most of them just involve tinkering rather than the fundamental change that is needed. The new administration must set out its intentions in much clearer terms.

In his speech the prime minister affirmed the need to foster export-led growth by improving the climate for business and said the government's strategy was to remove roadblocks and distortions. In respect of local

government, the topic you have asked me to focus on, it is interesting to note the number of issues listed by Mr Bolger which involve that sector. They included retail electricity distribution, the Resource Management Act, roading, a review of the role and functions of local government, the future of the Auckland Regional Services Trust, and privatisation initiatives such as airports. Clearly the government sees the local government sector as a major source of blockages to growth.

The business sector certainly shares that perception. David Hawkins, the mayor of Papakura, put it bluntly when he told Federated Farmers recently that local government "needs a bomb under it".

Certainly local government as a whole made a lot of progress after the 1989 reforms, and a few councils are maintaining the momentum. But like central government, the sector in general has been coasting again. Increases in local authority rates and the cost of regulatory activities have pushed up prices in the non-tradeables sector and contributed to the loss of international competitiveness.

Local government is clearly a major player in the economy. Its expenditure exceeds 3 percent of GDP. It has infrastructural assets valued at over \$20 billion. The ARST alone is New Zealand's fifth largest business. There are two local authority employees for every three full-time farmers. And the sector's regulatory role, through the Resource Management Act and the Building Act in particular, has a major impact on the private sector.

Inefficiencies in local government therefore affect the economy as a whole. And it is clear that inefficiencies are still rampant in the sector. To give just two recent examples: this year the Horowhenua District Council contracted

out the bulk of its works and services with cost savings in the range of 30 to 40 percent and the Wellington City Council is achieving cost savings of 18 percent and 36 percent in parks management and roading maintenance respectively through competitive tendering. These initiatives are thoroughly commendable, but the questions they raise are why were they not taken years ago and how many other councils are carrying such fat? I have been told recently by an authoritative source that savings of 25 percent could probably be made if local government's professional services work, which amounts to \$125-150 million annually, were put out to competitive tender.

Consider another comparison. When the Papakura District Council has completed contracting out all its regulatory services, it will have a staff of under 30 for a population of 40,000. Christchurch, with a population of 300,000, has a staffing level of 2000 (plus another 1000 in Local Authority Trading Enterprises). If it had the same staffing ratio as Papakura, the number would fall to about 225. In general, local government has achieved nothing like the kind of operating efficiencies that we have seen in former government organisations such as Telecom and New Zealand Rail.

In recent years the Business Roundtable has been making detailed submissions on the draft annual plans of the majority of the councils in the main centres. Simply by virtue of their size, they have the largest impact on the business sector. This involvement has given us a reasonable basis for assessing their performance, and the picture that emerges is a pretty depressing one.

In brief summary, we have given up on Dunedin: it seems the least interested in creating a business-friendly environment. Christchurch has adopted a strategy which was characterised by *North and South* as 'Think Big Buck' – like

Muldoon it has undertaken an extraordinary series of spending projects, imposed draconian controls on land use which have pushed up property prices, run up a large debt burden, set its face against disengaging from commercial activities, and it completely lacks a focus on its core role.

The consequences for the South Island centres are clear: Christchurch's population is projected to grow by 13 percent over the next 25 years and Dunedin's by a mere 3 percent, whereas Auckland City is expected to grow by 36 percent and other parts of the Auckland region by higher rates. Regions that are struggling to attract resources and grow should be doing the most to make their environment business-friendly – to offset competitive disadvantages by striving for excellence in local government policies.

In the North Island, we consider the Wellington City Council has gone backward in recent years, that the Auckland City Council has lacked a sense of direction, and that both have maintained rating policies that are blatantly discriminatory against the business sector. The Wellington Regional Council and the Auckland Regional Services Trust (ARST) are major holders of assets, and both have been resolutely opposed to the overwhelming arguments for exiting from business activities in favour of the private sector.

What is also striking about many council plans is the poor quality of the policy analysis: arguments are put forward which would be regarded as an embarrassment by anyone in central government circles today. For example, we have had a long-running battle (still unresolved) with the Wellington City Council which seems to think the tax treatment of rates concessionally favours the business sector. Wellington managed to decide this year that when someone borrows a book from the public library 75 percent of the benefits of the service go to someone else. Christchurch has put forward

spurious arguments to the effect that selling its business operations would cause rates to go up. The chairmen of the Wellington Regional Council and the ARST steadfastly refuse to accept that privatisation generally means major efficiency improvements in businesses and benefits to consumers, despite the mountain of international evidence on this score. The latest argument against privatisation from the chairman of the Auckland Regional Council is that it would short-change the generations who built up community assets. It is as though National Mutual, Colonial, AMP and other mutual companies which have been crystallising their ownership through share issues have been ripping off past generations of policyholders!

Whether resistance to privatisation is due to patch protection or an inability to grasp the arguments I do not know, but either way the implications are scary. Manukau City has a contracting business which is mowing lawns in Brisbane, and Sir Barry Curtis wants to hold on to shares in Auckland International Airport Limited because he thinks it is a good investment. A London Council, Hammersmith and Fulham, recently decided to invest £6 billion in the swap market and ran up losses of £400 million (which ultimately it did not incur as the whole operation was deemed illegal). Airports are only less risky businesses by an order of magnitude. The Marlborough port company will obviously suffer a major loss in value if the Clifford Bay terminal goes ahead. When will we ever learn?

Most New Zealand councils would agree that it would be irresponsible to risk ratepayers' money in a casino or on unhedged swaps and other derivatives. They would also agree that it makes no sense to take money from ratepayers to put into risk-free government stock. On what possible logic therefore does it make sense for them to put ratepayers' money into investments of intermediate risk like airports?

What should be done about this state of affairs? If the government is serious about promoting export-led growth, reducing unemployment and raising living standards, a new 'spring offensive' involving local government is clearly needed. There are a number of fairly obvious opportunities.

First, the government is about to consider proposals on roading. There are sound arguments for moving roading operation away from political control and into a corporatised framework. As a utility business, roading should be run on normal commercial lines – there is no reason to opt for cooperative, non-profit structures with weak performance incentives as some are advocating. Soundly-based roading reform would be of huge benefit to the forestry industry.

Similarly the government has the opportunity to take early decisions about the ARST. By far the best solution would be to wind up the Trust and issue shares in its businesses to ratepayers. This was the primary approach to privatisation followed in the Czech Republic and has been followed elsewhere, including in New Zealand. Czech prime minister Vaclav Klaus took the view that socialist apologists should be taken at their word when they insisted that government businesses and properties "belonged to the people", and shares were issued in them. The Pam Corkerys of the world should be challenged to put their money where their mouth is, or to reveal their real agenda as being to maintain their own political power and control.

One of the major ARST businesses is Ports of Auckland Limited. Its chairman, Sir Richard Carter, recently made it clear that in the board's view the interests of port shareholders would be better served by privatisation. The chairman of the ARST appears to have finally acknowledged this point.

The same argument applies to other ports. The chairman of the Wellington port company has also argued for the sale of a business that has probably lost value over the last two years, but the chairman of its owner, the Wellington Regional Council, has been one of the most determined anti-privatisers in local government. No industry is more conscious of the benefits of port reform than forestry, and it should press the government and councils to expedite privatisation.

The issues with water and sewage are similar to those with roading and other utility businesses. Last month the Kennett government in Victoria announced a water reform package which will abolish water and sewage rates and introduce a user-pays approach to water pricing. This is expected to clear the way for privatisation after the next state election in 2000. There would be major gains for household and business users from similar moves in New Zealand, which has been lagging well behind overseas developments in the water industry.

The recent local government legislation which will come fully into effect next year requires councils to justify their involvement in any activity. It should lead to substantial divestments of non-core activities, greater contracting out and a focus on their core public goods roles. If this does not happen, the government may need to apply mandatory requirements in the overall national interest.

In the regulatory area, the evidence is mounting that the Resource Management Act is leading to huge costs and delays with many developments. The minister for the environment has been acknowledging this problem but has yet to take any effective action. He has been placing the blame on councils for their poor performance in administering the act, but this is only part of the problem. A bill with some modest but useful

amendments to the RMA has been languishing in the House for nearly two years. Another obvious step would be to allow independent certifiers to issue consents, along the lines of the Building Act. In my view, the time is fast approaching when a more fundamental review of the flawed framework of the Act is needed, with a view to promoting greater use of market mechanisms such as efficient pricing, tradeable permits and compensation where property rights are affected.

More generally on regulation, there is a case for developing an over-arching regulatory statute which would set out the principles and processes that should be followed when regulatory interventions are considered. The government is currently looking at the idea of such a Regulatory Responsibility Act along the lines of the Fiscal Responsibility Act. Just as this act has its counterpart in the new financial management legislation applying to local government, a regulatory statute should apply to that sector as well. Local government's accountability for its regulatory performance is currently very weak.

If steps such as these were followed, there would be scope for a large downsizing of local government, with commensurate savings in costs to the community. If councils focused on their core public goods functions, they could be much smaller in size, few full-time councillors would be needed, and council bureaucracies could be drastically pruned back. It is absurd that there are currently three quarters as many politicians in Auckland City alone (counting community board representatives) as there are members of parliament nationally. The divestment of functions such as roading, water and sewage could lead to a further round of reorganisation, particularly among the smaller local authorities. David Hawkins has even questioned whether we would need local government at all in 20 years' time.

In summary, my message is that export competitiveness is not fundamentally about the Reserve Bank and foreign exchange markets but about the real exchange rate. This is above all a matter of our domestic cost structure. Recent trends have been going in the wrong direction and need to be reversed. The government must urgently revitalise its reform agenda if it is to achieve the kind of annual growth rates of 3.5 – 5 percent or even higher that it has talked about.

An important part of that agenda must be the local government sector. Local government does indeed need a bomb under it. The Business Roundtable and the New Zealand Forest Owners' Association are involved with other business organisations in the Local Government Forum to promote the kind of reforms I have been talking about. We must ensure that the spurious arguments underlying many councils' policies are exposed and rebutted. And beyond councils themselves, we must look to the new minister of local government, to other relevant ministers and to the courts to ensure that local government faces disciplines in its decision making which will improve the environment for business and better serve the interests of the community as a whole.