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**POLITICS AND WATER DON'T MIX**

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# **POLITICS AND WATER DON'T MIX**

## **Introduction**

I want to argue in this paper that the time has come for central government to step in and direct reform of the water industry in New Zealand. It is hard to escape the conclusion that local government is so confused about its roles, weak on analysis and bogged down by petty politics that in most cases councils are incapable of sorting themselves out on their own. To date a permissive approach has been taken by central government – an approach which allows councils to implement changes themselves. But significant reforms have not happened despite changes to legislation. The few councils like Papakura that have wholeheartedly reformed their operations are now delivering better services at lower costs to their ratepayers. Others like the Auckland and Wellington city councils that have implemented some water reforms are now proposing to undo them. Most have done little or nothing.

The overwhelming lack of progress in getting councils to focus on their core activities and exit the rest suggests that the government needs to initiate reform of the water industry just as it has done with airports and ports and is proposing for roads. Many of the issues are the same. All of these industries are large and capital intensive. Underperformance in any of them is a drag on the business sector and the overall economy. The New Zealand Water and Wastes Association has said it believes "huge efficiencies" could be available in the sector.

Instead of seeing water supply issues as giving ratepayers value for money, too many councils close their minds to alternative delivery mechanisms. They seem incapable of even acknowledging the evidence of superior performance from competitive commercial environments or the reality of the trend to privatisation worldwide. Their only response to those who raise these issues appears to be ideological. Local Government New Zealand advocates an approach to water industry issues within a "framework that includes reason and rigour." We endorse that approach, but it is followed only by a handful of councils. One is the Rodney District Council, which has stated in its latest draft annual plan that the problems in the sector raise the question of:

... whether water supply and sewerage systems are best owned and managed by local authorities or if better results could be obtained if they were sold or leased to private enterprise.

Commendably, its policy approach is:

To keep an open mind about possible alternative options for future ownership and management of all the public sewerage and water supply assets but, for the foreseeable future, to continue to own and manage them itself.

By contrast, the Wellington Regional Council is completely closed-minded about alternatives to public ownership and operation.<sup>1</sup> It even excluded the option of private ownership from the terms of reference for Ernst and Young's recent review and has categorically ruled it out without examination in its latest draft annual plan. Similarly, the mayor of Wellington recently shut down discussion on a Local Authority Trading Enterprise (LATE) option in the Wellington region.

Local authorities appear unable to cope with their conflicting objectives. As regulators they should ensure that public water supplies meet health standards. The record shows that many fail to do so. As suppliers they should search for arrangements which provide consumers with the best value for money; instead they invoke anti-market ideologies to protect their own operations from market disciplines. As politicians they routinely interfere with pricing, investment and funding decisions to serve the interests of particular interest groups rather than all citizens. Non-transparent, non-arm's length operations maximise their flexibility.

Because councils tend to confuse their governance and management roles and many councillors have made council business close to a full-time occupation, councils are increasingly run by retired people, beneficiaries, failed business people and others who do not have the qualifications to govern multi-million dollar businesses. The combined value of New Zealand's water and wastewater assets exceeds \$6 billion. Annual operating expenditure is over \$600 million. No one would dream of letting politicians loose today to run similar large utilities like telecommunications or gas – despite the fact we used to do so only 10 years or so ago. Why should we put up with the way politics bedevils in the water industry?

Anthony Wilson, one of the few movers and shakers in the industry, recently declared that "New Zealand's water industry appears doomed to be trapped in a time-warp."<sup>2</sup> The level of service in

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1 WRC chairman Stuart Macaskill recently described the Business Roundtable as being "at the very far end of the political spectrum" in response to a speech by NZBR member Douglas Myers advocating privatisation of local authority businesses including water. Contrary to the approach advocated by Local Government New Zealand, Mr Macaskill has consistently resorted to political polemic rather than reasoned argument in debate on water issues. Mr Myers was speaking on behalf of the 60 chief executive members of the Business Roundtable whose firms account for around 10 percent of the Wellington economy. Mr Macaskill's views on what constitutes an extreme policy can be contrasted with the policies of governments in France and Britain (supported by all the main political parties in those countries) in favour of private water operations, those of many state governments in the United States and Australia, and a growing number of governments of all political persuasions in other industrial and developing countries. His attachment to political control should rather be seen in the same light as the policies of those few governments that continue to resist privatisation such as Castro's Cuba. Mr Macaskill's socialistic beliefs could be disregarded as quaint and eccentric were it not for the fact that policies based on them have a similar effect on the cost and quality of service provision and community living standards as socialist policies elsewhere.

2 Anthony Wilson, "Too many local bodies add up to poor water and sewerage service", *The Independent*, 15 April 1998.

many parts of the industry is a disgrace. In last weekend's *Herald*, Carroll du Chateau and Jan Corbett reported that Auckland city's main sewers overflow 85 times a year, tons of raw sewage flow on to beaches and the Viaduct Basin is infested with filth-feeding rats: they ask whether sewerage is the next big infrastructure disaster waiting to hit Auckland. Cryptosporidium appears to be a growing threat in a number of systems. Significant amounts of deferred maintenance have been built up. Auckland's Metrowater discovered it did not know what sewerage pipes were in the ground, where they were and when they had been laid. Last year the Dunedin City Council discovered it had 500 kilometres less sewerage pipes than it believed it owned.

We have had over a hundred years of political control of the water industry and it has failed us. It is time to look for new solutions.

In this paper I first examine the progress that has been made in reforming local authority businesses. The key lesson from this discussion is that reform has seldom occurred until it has been encouraged or mandated by central government. Overseas experience reinforces this finding.

The paper then looks more specifically at experience in New Zealand since central government initiated the major reforms of 1989. One of the key points made by Carol Stigley, chief executive of Local Government New Zealand, in a recent paper is that "substantial efficiencies have been achieved over this period with many activities being run as corporatised entities, with others having been divested/privatised." In other words, the efficiency gains from private sector involvement are freely and officially acknowledged in the sector.

Some specific impediments to reform of the water industry in New Zealand are considered next, in particular the unacceptable performance of the Department of Internal Affairs and the Ministry of Health in addressing legislative issues.

Finally, I want to consider a few of the frequently raised concerns about commercialisation of the industry and discuss why requiring a return on capital is essential for sensible decision making.<sup>3</sup> I conclude that full-scale privatisation of the industry within a sound regulatory environment is the option that would offer greatest benefits, although discussion of this option accounted for only five

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3 For a fuller discussion of these issues, see CS First Boston New Zealand Limited (1995), *Reform of the Water Industry*, New Zealand Business Roundtable; Kerr, R L, 'Reform of New Zealand's Water Utilities: The Snail's Pace of Progress', AIC 1997 New Zealand Water Management conference, Auckland, 24 March 1997; Kerr R L, 'The Water Ideologues', New Zealand Water and Wastes Association annual conference, Rotorua, 29 August 1997; and Kerr, R L, 'Corporatisation and Privatisation of Water Supply', AIC Conferences 6th Annual NZ Water Summit, Auckland, 26 February 1998.

pages of the 150-page report on water industry reform which the Business Roundtable published in 1995. There are many intermediate options and complementary reforms that can be considered.

### **Some lessons from local government reform**

Since the Local Government Act was passed in 1989 the standard of local authority decision making has improved. The first set of reforms led to the amalgamation of many local authorities and changed the way councils managed some of their commercial activities, especially ports and airports. Some have established their businesses as local authority trading enterprises (LATEs) that must provide a return on capital. Around 97 percent of all roading work now goes through a competitive tendering process. The performance of many councils, however, particularly in the main centres, is still well below its potential.

The more recent Local Government Amendment (No 3) Act 1996 was intended to promote prudent, effective and efficient financial management by local authorities.<sup>4</sup> It establishes principles for funding expenditure. One of them is that the costs of any activities should be recovered from those who benefit from them. The Act requires improved financial planning and a more transparent analysis of who benefits from local government activities.

Disappointingly, the legislation seems as yet to be having little effect on funding policies. For example, in its latest draft Annual Plan exercise, Dunedin found that the provision of water to domestic users provided a 100 percent private benefit. This seems a reasonable conclusion, and contrasts with the Wellington City Council's finding last year that 75 percent of the benefit from the supply of potable water was public. One of the public benefits it identified was "improved bodily aroma in confined public spaces." It is not clear how the Wellington City Council plans to monitor the regularity of ratepayers' showers to determine the size of this public benefit. However, Dunedin's identification of a 100 percent private benefit was too sensible to survive local politics for long. The draft annual plan notes that "further to recent council debate and decision following the water review, a step two modifier is introduced on the grounds of lawful Council policy, to enable this function to be publicly funded by rate mechanism." In plain English, Dunedin intends to ignore sensible economic analysis and to continue to regard domestic water supply as a pure public good.

New Zealand's approach to local government reform since 1989 has been to give local authorities the opportunity to make efficiency gains at their own pace. This approach has failed to make the progress that is necessary if New Zealand is to improve its economic performance and raise living standards. Signalling dissatisfaction with local authority activities is extremely difficult. Councillors often point

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4 Local Government Amendment Act (No 3) 1996, s.3.

to public consultation processes as lending support to their policies, but these political methods of providing councils with feedback are fraught with problems. Local Government New Zealand recognises this problem: Carol Stigley has stated that "Consulting the community is a strong guide but not a substitute for reasoned decision-making." The process of making submissions on annual plans is time-consuming. Often the numbers of submissions supporting particular views are given more weight than the quality of the analysis in them, or than the sections of the community represented by submissions. Some councils give the impression that the only way they could decide that two plus two equals four is by majority vote. Elected representatives should accept a responsibility to ratepayers to analyse issues carefully and make decisions based on careful analysis, not on simplistic number-counting exercises.

Since 1990 the consumer price index has risen by 18 percent. Over the same period, local authority rates rose by 35 percent. This dramatic increase in costs looks set to continue unless central government takes the lead in mandating further local government reform. Other countries are well ahead of New Zealand in this respect. Some governments have mandated change out of despair at local authority management. Early in its term, the Kennett government in Victoria put in a commissioner to take over and run the city of Melbourne while local government was reorganised, and major gains were realised. There is no reason why this option could not be considered for, say, Auckland. Other governments have opted for private sector participation.

In New Zealand, local government has generally needed direction from central government to change the way it operates its businesses. When Transit New Zealand was established, local authorities were required to set up their road maintenance operations as LATEs. They were also required to contract out all roading maintenance. Few would have taken this step by themselves. All now agree that this reform has been very successful – so much so that some councils now argue that no more reform of roading is required. Of course, substantial further gains could be achieved from roading reform, particularly through adopting more commercial approaches. This is an initiative once again being promoted by central government. It could serve as a model for reforms to the water industry – which is many ways a more straightforward case than roading.

### **Local government involvement in the water industry**

Papakura District Council's water franchising agreement demonstrates the potential cost savings that can be achieved in water supply. United Water was granted a 30-year franchise to operate Papakura's water network, with a right of renewal for a further 20 years. The efficiency gains have already been dramatic. Rates have gone down by an average of 28 percent. Some of this decrease has been offset by United Water's bills to customers for water and sewerage, but overall a 10 percent cost saving has been passed on to ratepayers. Under the terms of the franchising agreement, Papakura's prices for

water and wastewater are fixed for the first two years. After that, the prices cannot exceed the average Auckland price.

United Water is responsible for ensuring that water quality meets the standards required by the Ministry of Health. It has developed a network model that identifies current weaknesses in the network of pipes and establishes priorities for network maintenance and expansion. The model enables engineers to test the impact of different assumptions about demand for water in terms of the effect on water quality and pressure for existing customers. The ability to identify and manage risks has increased significantly. It is noteworthy that an area as small as Papakura has been able to access such sophisticated planning techniques through the association with United Water and its extensive expertise in water supply operations worldwide.

Papakura's reforms haven't been problem-free. One complaint when United Water started operating was from customers who objected to paying for sewerage. Until then, sewerage charges had been included in general rates, so there was a perception that prices had increased. Council officials comment that the biggest issue in gaining acceptance of the changes has been educating customers on changes to charging structures.

Although franchising offers substantial efficiency gains, significant problems can arise in writing a franchise contract to cover uncertain future conditions. Franchise contracts can be difficult to enforce. If franchises are renewable, the cost savings from franchising may not be sustainable. Incumbent franchisees may have a substantial advantage over competitors when the contract is re-tendered. Franchising is seldom used in the electricity and gas industries around the world – industries similar to water and wastewater where problems of specifying the quality of the product and monitoring the condition of the assets are likely to arise.

In my view even greater gains could be achieved by full privatisation. The ongoing possibility of political interference by local authorities would be removed, as would the risks to ratepayers of owning the assets. By exposing the owners of the assets to the discipline of capital markets, the current difficulties of monitoring the performance of council-owned businesses would be reduced. A private water company would have to satisfy investors that it was focusing on customers' needs and maintaining and expanding the asset base efficiently. The constraints on funding capital expenditure from rates which have led to the backlog of maintenance would be removed.

One of the most common criticisms of private sector participation in the water industry is that water is an essential good and that water businesses must therefore be publicly owned. Strangely, proponents of public ownership of water supply seldom argue that all New Zealanders should hold shares in businesses supplying potatoes or rice, or that the government should nationalise all bread factories.

Privatisation of infrastructure assets need not mean that ratepayers relinquish ownership of the assets. The most obvious way to give ratepayers ownership and control over their assets is to allocate shares to ratepayers so that they can choose whether to hold or sell them. If some ratepayers value community ownership, a trust could be established. Ratepayers who wanted to continue with community ownership could choose to assign their shares to the trust.

Demutualisation in the insurance industry illustrates the advantages of giving the true owners of the businesses better control over their assets. When the case for corporatisation and sharemarket listing has been spelled out to policyholders and ballots held, support for demutualisation has usually been close to 100 percent. Some policy holders decided to sell their shares immediately but most have held on to them. Similarly, share giveaways have been used extensively in Eastern Europe to promote private ownership.

Privately owned water companies would be more likely to introduce efficient pricing, including prices that covered the future costs of investment. This contrasts with the incentives that operate with council ownership. The difficulties councils have in moving to usage-based charging are illustrated by Metrowater's problems in charging prices to reflect costs and the Wellington City Council's retreat from a uniform annual charge. Watercare is also undercharging for water.

The net result of these price distortions is a waste of money and harmful environmental effects. Rates disguise the cost of delivery of water to households and business. Over-consumption is encouraged, water resources are more rapidly used to capacity and the need for new investment is brought forward. A uniform charge for water is unfair because it penalises poorer households which generally do not use as much water as wealthier ones. Even the Alliance believes that water should be charged for on the basis of what people use, but few major councils have implemented this straightforward policy.

### **Other impediments to reform of the water industry**

In addition to problems of conflicting interests, confused analysis and leadership failure, a number of specific impediments have hindered local authorities' efforts at reform.

#### **– *Fragmented ownership***

One feature of the New Zealand industry that stands out is the large number of entities involved in water and wastewater supply. There are over 70 councils operating significant water and wastewater networks. About 75 percent of local authorities serve fewer than 50,000 customers. Even prior to its reforms, there were only about twice that number of water entities in Britain: some 100 water boards, 50 local authorities and 29 privately owned statutory water companies. The 1973 Water Act set up

the 10 water authorities that were privatised in 1989. In Scotland, there are three water authorities for 6 million people. In Adelaide, one company provides water and wastewater services for over a million people.

New Zealand's current industry structure, in which each local authority is responsible for a small area of network, leads to significant duplication of resources. Construction standards vary from area to area, and contractors work to different specifications for different councils. Fifty-six councils serve fewer than 50,000 people and 26 have fewer than 20,000 people. World Bank research suggests that the minimum efficient size of operation for water businesses is a customer base of about 500,000. It is difficult to determine how many water companies would be optimal in New Zealand. Most industry people I talk to suggest the number would be in single figures.

How could industry rationalisation be achieved? One option is to move immediately to private ownership, which would allow restructuring of the water industry to take place. If all council water assets were privately owned, the industry structure could be determined in the market, as is occurring in a partial way with electricity distribution. This could be initiated via a share distribution to ratepayers. An alternative would be for central government to mandate a more rational structure along the lines proposed for roading, with local authorities retaining shareholdings in a small number of water companies, at least as an interim step. Subsequently there could be share giveaways to ratepayers.

– ***Taxation***

The tax treatment of local authority trading enterprises means that councils have been reluctant to move businesses out of direct council control (where business income is not taxed) to a more commercial and taxable LATE structure. Progressively from 1 April 1999 the tax-exempt status of LATEs will be removed and they will pay tax on profits just as privately owned businesses do. However, councils themselves remain tax exempt, so there remains a financial cost to them of corporatisation even though the underlying economic costs of supplying the service are unaffected by the tax treatment. The fact that a number of councils have chosen to create LATEs despite the tax bias suggests that the benefits of a more commercial structure are significant.

From a council's perspective, income tax is an avoidable transfer of funds to central government. However, most ratepayers are also taxpayers. From a taxpayer/ratepayer perspective, what matters is the total quantum of central and local government spending and revenue-gathering. Arrangements which reduce local government payments to central government simply raise the central government tax burden on taxpayers through other mechanisms. Councils may think they are doing water users or ratepayers who do not pay central government taxes a favour, but they cannot know where the

ultimate burden of the increased central government taxation of other parties falls. From a ratepayer and national interest perspective, the more critical point is that councils which use the tax issue as an excuse for inaction are perpetuating a cost-plus structure with conflicting objectives.

A related point is that central government must raise sufficient revenue from income taxes and GST to fund its expenditures. If water prices do not incorporate the tax element in the same way as other goods and services, water will be overconsumed relative to the consumption of other products. Loopholes of this type in a tax structure cause welfare-reducing price distortions.

Central government has been far too slow to eliminate this tax loophole and local authorities have been far too self-serving in their use of this issue to delay reform.

– ***Bureaucratic inertia***

In 1993 the Department of Internal Affairs began a review of local authorities' powers and responsibilities to provide water and wastewater services. Five years on, little or no progress has been made. Meanwhile, a number of serious regulatory problems that need addressing continue to be ignored. Public health legislation, which is the responsibility of the Ministry of Health, is outdated and confused. Providers of water and wastewater services have to comply with a multitude of acts and regulations governing drinking water and sewage. The regulations vary according to location and make different assumptions about whether services will be publicly or privately provided. It is unclear who is responsible for the quality of drinking water, and whether there are standards for pressure or minimum flow. Customers have no supply contracts and no idea of what they can expect from their water provider for the price they pay. There is no shortage of issues for officials to address, yet little is being achieved. In terms of the State Sector Act, the chief executives of the agencies concerned should be held accountable for their lack of performance by the State Services Commission.

**The cost of capital**

– ***The importance of opportunity cost***

Historically, councils and large-scale investment projects have been a disastrous mix. Many councillors simply fail to understand the most basic concept in economics – opportunity cost. The profit forgone when ratepayer capital is invested in a water project is a cost which society incurs as a result of that project. It is a cost regardless of accounting treatments. It is a cost regardless of medieval and socialist prejudices about usury and profiteering. It is a cost regardless of organisational form – business unit, LATE, non-profit or for-profit. It is a cost regardless of whether dividends are distributed or retained. It is a cost regardless of whether water is priced so as to make a reported

profit. Some councils report a zero cost of capital for projects. Economically literate ratepayers no doubt fear that this book-keeping illusion also drives council attitudes when they spend ratepayers' money. The cost of capital is real and it does not disappear just by reporting it as zero. The funds could be used in other projects to earn a return. Thus there is an opportunity cost of investment regardless of whether the project is undertaken in the public or private sector.

The failure to understand the concept of opportunity cost underlies the common confusion in many councils over cost and price. Organisations cannot supply goods at lower cost to the community simply because they do not have to pay tax or achieve a profit. Eliminating either simply means that others in the community have to pay more tax or subsidise the cost of capital employed by the council. This was the fallacy in the belief in the former Soviet Union that "eliminating the profit element" benefited consumers through lower prices. All it did was ensure an inefficient allocation and use of resources and make the country poorer. Councils should stay focused on policies which minimise the total cost burden and ensure efficient pricing since these are the basis of wealth creation. Any other approach merely redistributes costs and ultimately incomes in inefficient ways.

In similar vein, councils sometimes declare that a new spending proposal will not cost ratepayers anything because it will be financed out of retained earnings. But those retained earnings could be distributed as dividends and used to reduce rates. The opportunity cost of the decision not to distribute dividends to ratepayers is the value that ratepayers would have derived if they had been able to spend the money for themselves, plus the costs to society which arise from the way rates distort behaviour at the margin.

The failure to acknowledge that capital is costly may also create the illusion that an uneconomic project is attractive. When used for reporting business returns, it can make investments appear successful and well managed. In the private sector, businesses report their net profits along with funds invested so that investors can assess the adequacy of the reported rate of return. Rules about reported valuations of assets and the 'reality' check of the relationship between the book value of the firm's net assets and the value of its shares help make the assessment more honest. Such comparisons are harder to produce for council operations because of valuation problems, non-arm's length relationships and politically distorted pricing. This relative lack of transparency and accountability in local government is, of course, one of the reasons why it should rid itself of the production of private goods such as water.

Requiring an adequate return on capital is essential to ensure that councils (and any other investors) make sensible investment decisions. Ignoring the benefits that could be generated by alternative uses of ratepayers' money biases decisions in two ways.

First, local government projects may displace private investment that would generate greater benefits to society. Given the choice, ratepayers might prefer to put the extra money towards paying off their mortgages, expanding their businesses or simply putting the money in the bank.

Secondly, ignorance of the fact that forgone profit is a cost means that cost-based prices will be set too low. This will stimulate overconsumption and either congestion and rationing or premature expansions in capacity. The investment distortion is potentially very serious for capital intensive industries such as water and roading. The same illusion will stop councillors from being aware that the investment in additional capacity is uneconomic. If the net benefits of a project are assessed using a cost of capital that is too low, projects will appear to satisfy investment criteria – such as having a positive net present value – before they really do.

Councillors who are alert to these biases should also be aware that they cannot readily be detected under continuing local government ownership because of measurement problems. For example, the cost of capital is an expected return which is not directly observable. The actual return on capital is the profit that the business makes. It will not match the expected return on capital every year, but over time it needs to cover the cost of capital if ratepayers are not to subsidise users of the service unwittingly. Requiring council businesses to earn sufficient returns to cover the cost of capital, ie to make profits, improves the incentives for managers to find the combination of services and prices that maximise community welfare.

### ***Fear of price consequences***

Those opposed to the commercialisation and privatisation of water argue that the requirement to make profits will cause prices to rise and hurt consumers, especially low income households. There are several confusions here.

First, there is a confusion between price and the burden on the community or on low income groups. Again, ignorance of the concept of opportunity cost lies at the heart of this confusion. The burden to the community from current arrangements arises from the opportunity cost of the resources they are absorbing. For a given opportunity cost, the price charged simply affects the balance between user-pays and ratepayer burdens. Someone must pay, and any opposition to a higher price is really advocacy of higher rates.

Secondly, the opposition to a commercial approach fails to acknowledge the overwhelming evidence, most recently from the experience of Papakura, that making an activity commercial and contestable will lower costs so that prices overall are more likely to fall than rise. Even if prices were to rise, however – perhaps because they were previously kept at politically distorted levels, or because of the

increasing scarcity of water supplies – the result would still be a net gain to society. What matters for economic welfare is efficient prices, not artificially low ones.

Thirdly, it presumes that transparent assistance to low income groups is not desirable. If current arrangements effectively cross-subsidise some users, it is highly desirable in a democratic system that price rises occur to remove such cross-subsidies, thus forcing politicians to make subsidies explicit if they wish to continue with them. Given the power of interest group politics, the political clout of the middle class and the low amount of water used by low income groups, it would be surprising if in practice current arrangements and pricing policies favour low income groups.

## **Conclusion**

What are the lessons from experience to date with local authority reform? The clearest is that most councils will make little or no progress by themselves. They have too many conflicting roles and are paralysed by factions, interest group pressures and anti-market prejudices. The potential benefits from reform and the dismal performance of most local authorities justify a much more pro-active stance by central government.

In short, the government needs to mandate change. It should make the water industry a major priority in its microeconomic reform programme. Government officials must progress the necessary work with much greater urgency. The Department of Internal Affairs is far removed from commerce and is not up to the task. You wouldn't ask someone who doesn't understand animals to design a zoo and we should not look to the department to work out how to put a water network into a commercial framework. Instead the responsibility should be passed to the Ministry of Commerce which is responsible for other network industries.

It is clear that those few councils that have taken the initiative to reform their water operations have made substantial gains. A 10 percent cost saving, as obtained by Papakura, applied across the whole industry could yield annual savings in operating costs of the order of \$60 million. This estimate takes no account of the – probably larger – efficiency gains from setting the right prices for water and ensuring that investments are undertaken at the right time.

The most straightforward approaches for achieving an efficient and better structured industry would be the privatisation of existing operations (perhaps through share giveaways) followed by market-driven rationalisation, or by the setting up of a small number of (initially) council-owned companies, along the lines of the proposed roading reforms. Central government should mandate such initiatives, in the interests of achieving the best outcomes for the community. Failing bold moves of this kind,

significant gains could be obtained through corporatisation, franchising and other types of contract involving the private sector.

Unfortunately, central government is far from immune to the same conflicts of objectives, outdated ideologies and interest group pressures that confound local government. Unless it proves able to overcome its own policy paralysis and revitalise its microeconomic reform programme, New Zealand will muddle along until the next national crisis occurs. In the absence of leadership by central government, industry professionals and entrepreneurial political leaders in local government bear more of the burden of effecting change. The wonder in all this morass is not that there is so much paralysis and confusion in local government. Rather it is that there are some competent and energetic people who stay long enough in the sector to make a difference. Who will be the next to follow those who drove the changes in Papakura?