

EMBARGOED UNTIL 2.00 PM TUESDAY 4 AUGUST 1998

NZ FINANCIAL PLANNING COMPANY

THE PROBLEM WITH PEOPLES' REPUBLICS

ROGER KERR EXECUTIVE DIRECTOR NEW ZEALAND BUSINESS ROUNDTABLE
--

CHRISTCHURCH 4 AUGUST 1998

THE PROBLEM WITH PEOPLES' REPUBLICS

A few months ago I read a report that more people were on Prozac in Christchurch than anywhere else in New Zealand. I wondered what the explanation could be for this unhappy state of affairs. Obviously it had to be some factor specific to Christchurch. I came to the conclusion that it must be the performance of the Christchurch City Council that's making people so depressed.

Just joking, of course. Christchurch is in many ways a great place; I spent my university years here, and it's one of my favourite New Zealand cities. There's much that is excellent about business, education, culture, sport and the general environment in Christchurch.

Down the years, Christchurch councils have also done much for Christchurch. The city fathers, as we used to call them, recognised the importance of fine parks and other civic amenities, were cautious spenders and kept rates low. More recently, the council has done other things to add vibrancy to the city although it's not alone in this: programmes such as 'Absolutely Positively Wellington' by councils with different outlooks have had similar results.

But Christchurch has also got plenty to worry about. The whole country is struggling at present as both central and local governments have failed to strive for continuous improvements in New Zealand's economic and social environment, and have dissipated many of the earlier gains with high spending. Canterbury is struggling more than most other regions. Less than two years ago its unemployment rate was 5.6 percent, one of the lowest in the country. In the March quarter of this year it was 45 percent higher at 8.1 percent, well above the national average. In a longer-term perspective, the government statistician projects Christchurch's population to grow by just 13 percent over the next 25 years, whereas Auckland city and other parts of the Auckland region are expected to grow around three times faster.

Centres that are lagging find it difficult to attract and retain bright young people, create new businesses and maintain social infrastructure. They should be doing the most to make their environments business-friendly – to offset competitive disadvantages by striving for excellence in local government policies.

In April of this year Douglas Myers gave a speech on local government on behalf of the Business Roundtable. He argued that the benefits of the 1989 reforms had run out, that many councils had lost their way, and that central government needed to initiate a new wave of reform – building on its plans for roading – and refocus councils on their core public goods functions.

The speech was widely reported; the *National Business Review* said it should be mailed to every New Zealander. It agreed with Mr Myers's assessment that the evidence of council underperformance is compelling and added:

Councils continue to tax well beyond the rate of inflation. They penalise commercial and industrial ratepayers to stay sweet with domestic ratepayers. Councils believe they can run commercial activities better than the private sector when most evidence suggests the contrary. They remain the last bastions of socialism, providing livelihoods for bureaucrats and councillors who would not otherwise be gainfully employed. They shamelessly use legislation (such as the Resource Management Act) to tax, stop or retard development. They have little sense of direction in a modern economy where the private sector rather than the state is the dynamic force.

Recently the New Zealand Employers Federation reported similar views following a survey of barriers to growth around the country, and I sense there is a groundswell of opinion now building up in favour of change.

Douglas Myers's reference in his speech to the PRC – the People's Republic of Christchurch – obviously struck something in these parts: I'm unsure whether it was a nerve or a chord, or perhaps both. In recent years Christchurch has been perceived as an outlier within local government for its expansive policies. *North and South* carried an

article entitled 'Think Big Buck', and the mayor was clearly happy with the 'People's Republic' accolade.

Reactions to Mr Myers's comments varied. *The Press* said that Christchurch was "not quite China", but added that the view that the council should stick to core services deserved attention and that it favoured the sale of council shares in Southpower and the Lyttelton Port Company. One councillor wrote to Mr Myers that "some councillors, including myself, agree with you but sadly – at this time – we are in the voting minority." Some letters to newspapers endorsed the concerns about "spendthrift" council policies while others displayed the usual paranoia, lambasting the Business Roundtable for having "greedy designs on assets" and decrying the evils of private enterprise.

My purpose in this talk is to tease out some of the themes in this debate, and a useful starting point is the reactions of Mayor Vicki Buck. I should preface my remarks by saying that, contrary to the mayor's beliefs, the Business Roundtable does not "hate" Christchurch: most of the major firms that make up our membership operate here, and we want Christchurch to be a thriving part of the national economy. Nor do we disagree on all issues: for example, we are on the same side as the mayor in regarding the government's electricity reforms as an unfortunate move towards re-regulation, contrary to the previous trend of government disengagement from the industry.

One reaction from the mayor was as follows:

We get told off by BOMA [the Building Owners and Managers Association] and the Business Roundtable. ... But they are the extreme right wing. They believe councils should be involved in nothing. They believe individuals make the best decisions, there should be no rates and no taxes, and we'll all live happily ever after.

Now this is nonsense on stilts. On the right-wing label, I can report that I visited the real People's Republic a couple of months ago and that the mayor would be appalled by current thinking and attitudes in that country. China is desperately trying to privatise its state enterprises. Government spending accounts for about 10 percent of the

economy (or perhaps twice that figure if you count quasi-government enterprises) compared with around 40 percent in New Zealand. People like Margaret Thatcher, Milton Friedman and Bill Gates are admired and popular figures in China. That this is not the case in New Zealand says far more about this country than it does about irrelevant political labels like 'left' and 'right'. And as far as I can see, nothing that the Business Roundtable or BOMA is saying about the Council is very different from the views of the Canterbury Manufacturers Association, the Canterbury Employers Chamber of Commerce and other business organisations. We were one of eight organisations, including Grey Power and the Merivale Precinct Society, that made a joint submission on the Council's Revenue Study.

Moreover, nowhere have we argued that "councils should be involved in nothing", although the mayor of Papakura, David Hawkins, has questioned whether councils will be needed in the long run. We are not anti-government; to the contrary, we want governments to perform their necessary functions, and to perform them better than they typically do when their energies are dissipated on extraneous activities. Government implies taxes and rates. And the issue is not whether individuals make the best decisions: individuals in a democracy make *all* decisions, whether through the political process, the marketplace, or voluntary community organisations. The issue from the point of view of individual citizens is which vehicle is best suited to meeting which needs.

Mayor Buck was somewhat more coherent in an article replying to Douglas Myers in *The Press*. Indeed she got off to an excellent start: she said local government is "about doing those things collectively which we can't achieve on our own." She ought to have also recognised that there are many things we do collectively without the intervention of governments – through families, clubs, voluntary associations, cooperatives and the like – but she is right in saying we need governments to do the things that can't be done as well in the marketplace or through civil society.

In saying this she is also in line with government policy toward local government over the last decade. Labour and National governments and the present coalition have been

encouraging councils to focus on their core public goods activities: the provision of goods and services that cannot easily be produced and charged for privately. The *public* sector is about ensuring the provision of *public* goods; it should not be about the provision of *private* goods, which should be left to the *private* sector. All organisations (public and private) need to determine their proper role and not be jacks of all trades and masters of none.

In her article Mayor Buck proceeded immediately to give a good example of a genuine public good, namely crime prevention. Leaving aside various forms of private security, we all want governments to ensure the security of their citizens: that is their most basic role. She failed to note that crime prevention is essentially a central government role – we hardly want competing police services – but she was right to talk about councils' responsibilities for safe streets and alleyways and public lighting. Also councils often talk about their advocacy role: I hope the Christchurch City Council has made a submission on the current and very inadequate police review, as we have.

There are other local public goods that we need councils to provide, such as open access parks, stormwater and environmental regulation, but the list is not a particularly long one – it does not justify big local government. And there are services with mixed public and private good characteristics, such as sports grounds, where the Local Government Amendment Act (No 3) requires councils to determine the split and apply user charges to cover the private element of benefits. Hopes were held that this legislation would push councils towards a clearer focus on their public good roles but experience to date has been disappointing. Most have used the escape clauses in the legislation to carry on much the same as before. All too often councils appear to be using *ad hoc* cost allocations and spurious arguments to benefit some interest groups at the expense of others, such as non-voting business ratepayers. When those who benefit from services expect others to pay disproportionately, councils will always be under pressure to provide services whose benefits to the 'average' ratepayer are less than the costs.

By contrast with its legitimate public good activities, there is a whole raft of Christchurch City Council functions that cannot be justified on the basis of the mayor's

criterion that the council should be "doing those things collectively which we can't achieve on our own." Port companies, airports, power companies, passenger transport firms, road maintenance operations, forestry plantations and so forth are providing private goods. All their outputs can be paid for by those who use them; they do not need to be funded from taxation. All such businesses are to be found in the private sector in New Zealand or around the world, and governments worldwide are exiting from them. The conceit that governments are competent to run businesses leads councils to ride roughshod over the preferences of ratepayers who would rather spend their own money themselves. Christchurch stands out even in New Zealand as a council with an extraordinary range of trading enterprises.

I still hear arguments about privatisation in Christchurch which were discarded in other places years ago. People point to the failures of Equiticorp and Chase, which is about as relevant an argument as pointing to the failures of the BNZ and the DFC. Business without failure is like religion without sin. Losses and bankruptcies, and even the threat of them, concentrate the minds of those whose own money or jobs are at stake on prudent behaviour. Councils are not so motivated and should not be running businesses, which are invariably risky, with other people's money. Christchurch's loss-making tram, which was promoted by the mayor as a profitable venture, is a classic example of political folly. People should be allowed to decide for themselves whether to risk money in commercial ventures. Businesses in political control are not subject to the same disciplines as privately owned businesses, and as a result they underperform on average. And it is this inferior *average* pattern of performance in government-owned enterprises around the world that has been the basis for government policies of privatisation.

Christchurch city councillors like David Close have argued that the Council should hold on to assets which generate income because without them rates would have to rise. We have pointed out that this argument is fallacious. Because a business is likely to be operated more efficiently under private ownership, buyers of a council-owned business in a competitive sale process will be prepared to pay more for it than it is worth to a council. As a result the council's financial position improves, and there is scope for

rates to go down, not up, just as central government debt and taxes have fallen with privatisation. Councillor Close has accepted that this argument holds insofar as the sale proceeds offset the loss of a council's dividend stream, but he believes it overlooks capital appreciation. I pointed out in a letter to him some weeks ago that he is mistaken as the argument relates to gross returns – dividends plus capital appreciation – and I am still awaiting his reply.

Moreover, from an investment strategy perspective, the Council's ownership of businesses is highly undiversified from a global perspective and therefore risky and inefficient. As financial planners, how many of you would advise your clients to put their money into a handful of utility companies in one geographical location? Given the poor performance of the New Zealand dollar and the New Zealand sharemarket over the last year or two, the Council as an investor has clearly destroyed a large amount of ratepayer wealth by having its investments tied up in local assets rather than in a diversified global portfolio. It cannot even argue that these are relatively safe investments: the Council faces obvious commercial risks in the port industry, for example, as well as the kind of regulatory risks we have recently seen in the electricity industry. Even if it had any justifiable role as an investor – which it doesn't – it is following a very poor investment strategy.

In passing, I might note that those who are worried about 'greedy outsiders' getting their hands on Christchurch assets ought to relax. For a start, I am not aware of any Business Roundtable member company that is interested in any of them. Much more importantly, as a matter of logic there is nothing intrinsically attractive to an investor about government- or council-owned assets anywhere. Investment is a value-for-money issue. Investors can choose from the vast portfolio of investment opportunities available worldwide. Given a competitive sale process, buyers cannot expect to make more than competitive returns on any of them. After the event, those expectations will be realised in some cases, and in others investors will find they have paid too much or done better than they expected. We have seen all these outcomes in New Zealand. Those who think government or council assets are routinely sold too cheaply should club together at the time of the next sale and put their money where their mouth is.

There might be grounds for concern about the motives of those advocating privatisation if councils were to sell assets uncompetitively. However, for its part the Business Roundtable has long favoured competitive tender processes, open to all bidders. Only where the proceeds are best distributed to ratepayers may it be more efficient to privatise a local government entity by some form of 'popular capitalism' – eg by giving ratepayers title to shares in the company.

Finally, it is often said (in Christchurch and elsewhere) that ratepayers want to retain ownership of their assets: that that is the 'democratic will'. There are a number of points to be made about that proposition.

First, the real test of people's opinions occurs when they actually have the choice of holding a share in an enterprise or taking a known amount of money. Polls fail to provide the necessary information about these options or to give people anything more than a hypothetical choice. There is no need for polls because there is nothing to stop councils giving the shares in the assets directly to ratepayers. Rather than accepting the claims of politicians about preferences for community ownership, ratepayers should be allowed to decide for themselves whether to hold shares in, say, a port company or to put their money into, say, their house, a superannuation fund or a hip operation. If it is really believed that some people get extra satisfaction from community ownership, a community trust could be set up to which they could assign their shares. It was interesting that when these ideas were proposed for the Auckland Regional Services Trust, Auckland local body politicians ran a mile. It turned out that what they were interested in was not ratepayer control but political control. Similar submissions by the Business Roundtable and BOMA in Christchurch have been met with a deafening silence.

Secondly, there is no obvious public policy reason why a majority should be permitted to stop a minority from achieving its preferred option. A share giveaway respects the preferences of all ratepayers. There is no sound basis for making decisions through the ballot box about private commercial transactions. As Mayor Buck says, the political

process should be reserved for those things that we have to decide collectively, like law and order. Some people seem to regard the democratic process as suitable for deciding anything; their attitude brings to mind the episode on Sesame Street where the Muppets decide to vote on whether to spend \$3 to buy crayons or juice. Rosita says:

You count the people who want crayons. Then you count the people who want juice. If more people want juice, it's juice for everyone. If more people want crayons, it's crayons.

Telly replies:

Sounds crazy but it might just work!

Well, we know from the experience of countries that tried to decide things this way that it was crazy and it didn't work. Those who think that decisions on a vast range of issues can reasonably be forced on people by a 51 percent majority vote have a stunted concept of a free and democratic society. If they thought about it for a moment, few of them would agree that a 51 percent majority vote would be an adequate justification for scrapping the Treaty of Waitangi or decreeing that all houses should be painted blue. There is more to democracy and a free and civilised society than majoritarian politics.

Thirdly, voting is no way to approach issues that should be judged in the first place on the basis of logic and evidence. Two plus two will not equal five, no matter how many people may say otherwise in a poll. As one analyst put it recently:

Consensus and majorities in straw polls are equally invalid as a basis for making sound economic decisions. A present example is the oft-repeated statement that "a majority of the population is against privatisation." Even if this were the case it is no sound basis for retaining public ownership of assets when all the economic evidence indicates otherwise. Many of the major advances made by human society have, from the outset, been made through sound analytical thinking which was contrary to public opinion and consensus.

Voters are too busy and have too many competing priorities to want to invest in the detailed information necessary to make a well-informed decision about each and every council matter. Having elected councillors they expect them to master that information

and make sensible decisions on their behalf. Local Government New Zealand has stressed that community consultation is not a substitute for reasoned decision making. Councillors owe electors their judgment on the merits of policy choices. As Edmund Burke put it in his classic statement on the concept of representative government:

Your representative owes you, not his industry only, but his judgment; and he betrays, instead of serving you, if he sacrifices it to your opinion.

Does this mean councils should go ahead and sell assets regardless of public opinion? Not necessarily, but it does mean that elected politicians in a system of representative government have a duty to inform themselves about policies which offer greater benefits to the community and present information and analysis to voters. There is plenty of evidence that people change their minds when presented with sound facts and arguments. Otherwise we may as well dispense with the expensive apparatus of councils and rely on straw polls instead.

In the final analysis, communities need to understand the trade-offs. They can have inefficient policies like public ownership or they can have higher incomes and more jobs but they can't have both. Those who are concerned about poverty and social problems should not complain when they get worse if they consciously support policies which reduce living standards, destroy job opportunities and create unnecessary social problems in their communities. As Douglas Myers put it, Christchurch is free to decide it is culturally different, but it is not free to repeal the laws of economics.

The key point I have been making is that if we want sound social decisions to be made – decisions which will make our communities more prosperous, safe, cohesive and environmentally agreeable – we must choose the right decision-making mechanisms. Decisions about the different things people want are best made in different ways. Some are best made through the political process, others through transactions in the marketplace, and others in the voluntary sector.

The boundary between the public and private sectors needs to be closely patrolled. Each has a different role to play. And within the public sector, there needs to be a clear demarcation between the responsibilities of central government and those of local government.

The problem with Peoples' Republics is that these important distinctions get hopelessly blurred. The public sector expands, the private sector is crowded out, governments become over-extended and core functions are performed badly. One of the reasons for the present problems in Asia is that politicians and business people were not clear about where politics ended and business began. *The Press* is right to say Christchurch is not quite China, but the council has become seriously confused about its proper roles. Its core roles do not include social welfare, education and law and order: those are the business of central government. Nor do they include the provision of marketable goods and services: that is the role of the private sector. They do include things like environmental regulation which the Council is handling poorly and where it may fail to survive challenges to its city plan in the Environment Court.

Think Big strategies were disastrous at the national level, and their long-run effects at the local level are no different. Without a change of direction, I fear that the use of Prozac in Christchurch will continue to rise. If Christchurch is to promote a healthy economy, reduce its unemployment rate and compete successfully with the rest of the country, the next council needs to think smaller about its role, its rate levels and the burden of regulation it places on business. If it needs help, the present inhabitants of the Great Hall of the People in Beijing could surely teach it a thing or two.