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THE BUSINESS NETWORK

**TOWARD MORE EFFICIENT AND
DEMOCRATIC LOCAL GOVERNMENT**

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TOWARD MORE EFFICIENT AND DEMOCRATIC LOCAL GOVERNMENT

The OECD's recent report on the New Zealand economy makes salutary reading. It says that the overall economic strategy that has been evolving since the 1980s "appears to be on the right course". On the other hand, it correctly notes that economic outcomes have not improved as much as hoped. Its key message is the need for "constant attention and an ongoing – rather than a stop-and-go – reform effort". It calls for "follow through on microeconomic reforms" in certain areas including local government, where "reform has not been as extensive as elsewhere".

The New Zealand Business Roundtable has expressed similar concerns. It endorses the OECD's call for further reform of local government. The efficiency of the sector must be raised substantially, and more transparency and accountability are required to make it more democratic.

Some people like to claim that the Business Roundtable is opposed to democracy and will not rest until every conceivable issue is left to the market. Nothing could be further from the truth. We have always recognised that some issues need to be resolved collectively through the political system. Our founding statement of purpose affirms that:

An important role for the government is seen in providing a sound framework of laws and a macroeconomic environment which facilitate private sector decision making, and in undertaking certain activities which are best catered for within an efficient public sector. The government also has responsibility for necessary action to modify market outcomes in the distribution of wealth or income, and to pursue other social equity objectives in a well-considered and cost effective way.

Both the market or, more correctly, voluntary exchange, and democratic government have limitations as mechanisms for enabling people to get what they want. Cases of market failure are known to any economics student. They can occur with public goods, where non-payers cannot be excluded from benefiting from goods or services; with externalities, where significant costs and benefits fall on parties other than those directly involved in a transaction; and with monopoly, where there can

be abuse of a dominant position. Market failures may justify government intervention.

On the other hand, government failure is commonplace and in many ways more difficult to remedy than market failure. Winston Churchill stated that "democracy is the worst form of government except all those other forms that have been tried from time to time." Voters have little incentive to become informed because a single vote carries little weight. They have to vote for a package of policies, many of which they may not like. Politicians are like people in other walks of life: they tend to be self-interested. They often act in ways that enhance their position or their party's interests, rather than in the public interest. As a consequence, organised groups lobby for policies which benefit them in return for supporting a politician or party, and unorganised groups such as consumers, taxpayers and ratepayers end up meeting the costs. The political system is much less efficient at revealing information than the market. It is virtually impossible to determine the real preferences of people unless they freely exchange one thing, for instance an amount of money, for another. Politics is a highly imperfect mechanism for making social choices.

The choice between imperfect political decision making and imperfect markets therefore depends on which does the best job in a particular circumstance of maximising overall community well-being. If markets were perfect we would not need governments, and vice versa. Both mechanisms have to be used, but we need to be aware of the comparative advantages and disadvantages of each.

Consistent with this view, the Business Roundtable holds that local government has a vital role to play but its role (and that of other levels of government) is not all-encompassing. It needs to be established on a principled basis and properly circumscribed. Our argument is not for no government or minimal government but for government of the right shape and size. The core business of local government should be funding and – in justifiable circumstances – providing local public good services which cannot be better provided by firms, households and non-profit organisations. Local government also has a role administering necessary local regulations.

Councils serving rural areas, such as Opotiki and the Taranaki Regional Council, are generally focused on their core business, although some like the Far North District Council have had flights of fancy. However, with few exceptions, such as Papakura and Rodney, and more recently Hutt City, councils in the main urban areas continue to engage in a wide range of activities that should be left to the private sector or central government. Christchurch has had a particularly unfocused council in recent years. Some have neglected their traditional activities, such as roading, sewage disposal and drainage, to such an extent that inadequate services are limiting growth and development. The economic costs of the mismanagement of the roading infrastructure in Auckland are huge.

Since 1984 most legislative changes affecting local government have been of the enabling type, conferring wide discretion on local authorities. However, no major reforms affecting local government have been initiated and led by the sector. Councils have generally opposed greater private sector participation in key areas such as water supply, drainage and sewage disposal, despite substantial evidence of the benefits.

Local authorities have seldom taken a principled approach to reviewing their activities. Sound economic principles were reflected in the government's initial proposals on financial management. The local government sector was responsible for gutting them. Local Government New Zealand successfully lobbied to water down the principles and gave councils the opportunity to ignore them. Not surprisingly, the results to date of the Local Government Amendment Act (No 3) 1996, which contains the financial management regime that was eventually adopted, have been disappointing.

These developments suggest that central government needs to revisit the legislative framework for local government. The role and functions of local government need to be more closely specified. In setting up reviews of roading and water services, central government has recognised that it must drive rationalisation in the sector, and these should lead to a wider review of local government's other functions.

The roading and water reforms are likely to reduce the activities of local government, particularly district councils, over the medium term. Not surprisingly,

some in local government are now trying to stimulate a debate on the devolution of functions from central to local government. They are doing so under the rubric of local democracy.

Carol Stigley, the chief executive of Local Government New Zealand, has put forward such an argument for devolution. In February 1999 she noted that local government spending in New Zealand accounted for 10 percent of total government spending and was much lower than in countries such as Finland, Norway and Denmark, where the ratio is between 28 and 52 percent. But unlike a number of European countries, New Zealand does not deliver health, education and welfare services through local government. This goes a long way towards explaining the lower ratio in New Zealand.

The distribution of functions between central and local government should not be designed to achieve some arbitrary split of total government spending. Three main principles should determine whether the funding and/or supply of particular public goods and services should be the responsibility of central or local government.

The first relates to informed decision making. The information required to make decisions is costly to obtain. Thus the level of government that is most likely to possess the required information should generally be given responsibility for related decisions. Central government, for instance, is likely to be much better informed about national defence than local government. In contrast, a local authority should be better placed to make decisions about local parks.

The second principle concerns balanced decision making. Decisions should be made at the level of government where both the benefits and the related costs fall. The people of, say, Hamilton have a direct interest in the operations of its council and little or no interest in those of councils on the west coast of the South Island, but they are affected like all New Zealanders by the decisions of central government. It makes sense for ratepayers in Hamilton City and Westland District to bear the costs of their own councillors and for the costs of members of parliament to be borne by all taxpayers. Trouble is sure to arise when one level of government is responsible for spending decisions while another is charged with raising the required revenue.

The third principle relates to cost effective decision making. Where the costs of making decisions are high and individual preferences are relatively uniform, national policies may be efficient. On the other hand, where preferences differ, local decision making may enable the diverse preferences of people to be better reflected. People who strongly favour, say, extreme environmental policies can locate in an area that reflects their preferences while others can locate elsewhere.

As things stand, the application of these principles on a case-by-case basis is unlikely to lead to any major reallocation of functions between central and local government. A generally sound distribution of functions is already in place. There is no general support for major devolution and calls for new forms of local taxation have died away.

Proponents of devolution sometimes attempt to link their arguments with those of market advocates of decentralisation and federalism. The Nobel laureate James Buchanan, for example, has written about federalism in the context of the United States. It hardly needs pointing out, however, that the United States is a country with over 70 times the population of New Zealand.

Federalism is intended to operate in much the same way that competition in a market encourages firms to act in the interests of consumers. If citizens can leave their country or state, the prospect of doing so will constrain a government from extending its control over them. The economic cost of moving to another state may be lower than that of migrating to a foreign country with different institutions and customs. Constitutionalist like Buchanan advocate the division of political authority between levels of government, such as between federal and state governments in the United States and between the European Union and its sovereign states. Buchanan's overriding concern, however, is to limit the role of government at all levels. As he put it in concluding a 1993 paper entitled 'The Liberal Constitution':

I have not addressed issues such as republican versus parliamentary forms of government; proportional representation versus two-party structures; [and] effective federalism versus political centralisation. But my neglect of such issues has been quite deliberate. All such organisational-procedural matters fade into insignificance by comparison with the constitutional challenge of placing constraints on the authority of government over the operation of the economy.

Similarly, we should not allow a debate about devolution to divert attention from the overriding goal of refocusing local government on its proper role.

Another strand in the debate on local democracy relates to whether local government is more democratic and responsive than central government. Carol Stigley argues that:

The current emphasis in public policy on the transfer of responsibility for former public services from the 'mandarins' within the bureaucracy to 'mandarins' within the private and corporatised public sectors does little to increase diversity or the capacity of communities for self-government.

The resulting democratic deficit is seen by many in the communities local government represents as eroding civic life, removing decision making from the public sphere, and placing it in the hands of new structures, which are equally distant and unresponsive.

'Government' may be becoming smaller. But to many of the ratepayers and residents our branch of the public sector works with, it seems like more decisions being made by centralised agencies, and fewer opportunities to influence policy and services.

These comments do not acknowledge that there are valid limits to the role of the government. Taking any activity out of the public sector appears to be seen as undesirable, regardless of whether it should have been in the private sector in the first place. Constitutional advocates of limited government would view a reduction in the production of private goods by the public sector as a desirable advancement in freedom and efficiency. Carol Stigley confuses a reduction in socialism – less public ownership of businesses – with a reduction in democracy.

The implication that the government is becoming smaller is also mistaken. The best measure of the size of government is the level of its spending relative to gross domestic product (GDP). Total spending by governments – central and local – in New Zealand is estimated by the OECD to reach 41.4 percent of GDP this year, up from a low point of 38.5 percent in 1997. At a time when we are seeing double digit rate rises, not even Local Government New Zealand would be so brazen as to suggest that local government spending is shrinking.

In a research paper prepared for Local Government New Zealand, Peter McKinlay reported that "in many areas, local authorities are now seeing themselves as, at the very least, advocates on behalf of their communities." He noted that in areas that have traditionally been the responsibility of central government and where local authorities may have no financial obligations, they are "increasingly claiming a right on behalf of their communities to be partners in the process of working through options."

According to Local Government New Zealand, an opinion survey shows that local government is "more accessible, more willing to listen and more responsive to public opinion than central government." The results of the survey should, however, be regarded as deeply disturbing. Only 25 percent of respondents considered that the average person has considerable influence on local government (and a still smaller percentage thought that they had a similar influence on central government).

In the understatement of the year, Local Government New Zealand reported that "the significant number of respondents who disagreed with [the statement that the average person] has considerable influence on local government shows there is still a big gap between perception and reality." But arguably the vast majority of respondents (up to 75 percent) have it right and it is Local Government New Zealand that is detached from reality.

Local government often poorly reflects the views of the community. In a candid observation, the mayor of Hutt City, John Terris, said that a fifth of his city's population comprised Maori, Pacific Islanders and Asians but "there wasn't a single brown face" on the council. There is minimal public participation in most consultative exercises undertaken by local authorities. A survey by the Department of Internal Affairs found that councils on average received only 160 submissions on their annual plans in 1994/95. Fewer than 20 submissions were received on the draft annual plan of the Auckland Regional Services Trust, a billion dollar business, in 1997. Mayors privately admit that consultations on plans are a charade, involving largely a parade of vested interests seeking additional spending on their pet projects. Groups representing the business sector, which has little voting power, are rarely listened to. For that reason we have decided that a detailed examination of city plans for 1999/00 is a waste of effort.

Last year the Business Roundtable argued that the citizens of the Auckland region should be allowed to decide by referendum whether assets such as shares in Ports of Auckland Limited held by the Auckland Regional Services Trust should be distributed to ratepayers. Local body politicians in Auckland campaigned vigorously and successfully to ensure that their citizens did not get such an opportunity. One might ask which party is more committed to democracy.

The problems of local government stem from weak accountability. There is a low turnout at elections, usually no more than 50 percent, despite postal voting. Few voters can identify more than a handful of candidates on ballot papers. Often candidates do not have a party affiliation, so there is not even a party platform to help voters make their choice. Mayors and chairpersons do not necessarily lead the political party or parties with a majority on a council or command the support of a majority of councillors. As a result they are sometimes unable to implement the manifestos on which they were elected. Governance and management roles on councils are often confused. Media coverage of local government affairs tends to be sparse and unquestioning relative to that of central government. The operations of many councils are not transparent, and they are difficult to monitor because of the vast range of activities councils engage in.

At the staff level, many council officers are not competent to provide quality public policy advice to councils. More attention is paid to the quantity of submissions for or against a project than to the quality of the arguments. In the case of the Christchurch City Council, for example, those responsible for financial management have consistently got basic aspects of financial analysis wrong. Staff on the Wellington Regional Council use outdated economics to justify subsidies to public transport. The Controller and Auditor-General's Report on the management of Auckland's Britomart project, which includes the construction of a bus and train terminal, confirmed that the transport aspects of what could become the biggest local body project ever undertaken in New Zealand had not been subjected to a comprehensive cost and benefit analysis. Not only was this finding not sufficient to lead to the view that the management process was flawed, it passed virtually unnoticed when the report was released. The mayor of Auckland City, Christine Fletcher, examined the performance agreement of the council's chief executive on her first day in office. She reported that the agreement "had 52 clauses in it and that

it was indicative of the whole place. Fabulous people, everyone really well-meaning, but nobody focused."

The politics of local government have been perfectly illustrated over the past 12 months. Last year, an election year, rate increases were typically low. This year many councils are proposing double digit rate increases. How many candidates standing for councils last year did you hear saying 'Vote for me and I will put your rates up by 10 or 20 percent'?

Some councillors have blamed the proposed rate increases on a legislative requirement to provide for depreciation. That is a feeble excuse. If councils had acted responsibly in the past and made provision for depreciation like any well-run business, the implementation of the new legislative provisions would have made no difference. It was the failure of some councils to provide for depreciation in accordance with accrual accounting rules introduced in 1990/91 that led to legislation explicitly requiring councils to provide for depreciation. That legislation was passed three years ago. The whole saga is evidence of the chronic problems of much of the local government sector.

Council spending is excessive and is increasing. It is a major reason why some councils, such as Auckland and Wellington, are putting up rates. Few ratepayers can possibly believe that the quality and quantity of services they receive have increased commensurately. The Wellington Regional Chamber of Commerce is so exasperated with the performance of the Wellington City Council that it is calling for a commissioner to be appointed to take over and run it.

As the OECD indicated, the problems of local government are a serious national issue. A new round of policy initiatives is required. They must be initiated and driven by central government as in 1989, when central government acted decisively after years of tinkering with the problem had come to nought.

Activities such as the provision of water and roading infrastructure should be commercialised. Local authorities should be required to focus on the public good activities that are the proper business of government at the local level, and prohibited from engaging in the provision of private goods and services. The Local

Government Amendment Act (No 3) 1996 should be revisited to ensure that councils apply sound economic principles in deciding what activities to engage in and how their spending should be funded. The flawed Resource Management Act should be examined afresh.

Large councils that are remote from ratepayers are a major part of the problem. Thus simply amalgamating territorial authorities is not a basic solution. However, following the roading reforms, some small district councils may need to merge with neighbouring ones to remain viable. The need to retain separate regional councils should be examined, and special purpose authorities, like Infrastructure Auckland, that have no valid purpose and are not accountable to ratepayers, should be abolished.

These steps would reduce the size of council activities substantially, make their activities more transparent, facilitate better monitoring by ratepayers, and result in lower rates and regulatory burdens. They would make councils more democratic. Central government should also take a much more active role in monitoring the performance of local government.

The current fundamental weaknesses must be addressed in the interests of moving towards a more efficient and democratic local government sector. Until this happens, New Zealand's economic and social performance will continue to fall well short of its potential.

