

2 June 2000

The Corporate Secretary
Infrastructure Auckland
P O Box 105-048
AUCKLAND

Dear Secretary

Submission on the Draft Annual Plan 2000-2001

On behalf of the New Zealand Business Roundtable, I enclose a submission on Infrastructure Auckland's draft annual plan 2000-2001, long term funding plan 2000-2010 and statement of corporate intent 2000-2003.

We would appreciate the opportunity to appear before the directors in support of the submission.

Yours faithfully

R L Kerr
EXECUTIVE DIRECTOR

NEW ZEALAND BUSINESS ROUNDTABLE

**SUBMISSION ON INFRASTRUCTURE
AUCKLAND'S
DRAFT ANNUAL PLAN 2000-2001
LONG TERM FUNDING PLAN 2000-2010
AND STATEMENT OF CORPORATE INTENT
2000-2003**

JUNE 2000

INFRASTRUCTURE AUCKLAND'S DRAFT ANNUAL PLAN, LONG TERM FUNDING PLAN AND STATEMENT OF CORPORATE INTENT

1 Overview

1.1 This submission on Infrastructure Auckland's draft annual plan 2000-2001, long term funding plan 2000-2010 and statement of corporate intent 2000-2003 (the Plan) is made by the New Zealand Business Roundtable (NZBR). The NZBR is an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall New Zealand interests.

1.2 In last year's submission the NZBR observed that it was:

... vital that Infrastructure Auckland establishes a valid and consistent view of its role and function that conforms fully with its governing legislation. Infrastructure Auckland has not adequately distinguished its responsibilities and activities from those of other agencies and it has given insufficient attention to its statutory obligation to fund public (not private) good activities.

It is not apparent from the Plan that progress has been made on these matters.

1.3 The Plan does not focus on funding public good activities. All passenger transport projects for which grant applications have been received since 1998 and are reported to have passed "legislative filters" are unambiguously private good activities. The benefits arising from those projects accrue to clearly identified individuals or group of people, namely the users of such services. Any grants for the passenger transport projects listed in the Plan, including rapid transit systems, are arguably *ultra vires*.

1.4 Infrastructure Auckland's notional allocation of its fund over the next five years is hopelessly out of balance with the distribution that would arise from a proper focus on public good activities and a rigorous public policy analysis. Over 60 percent of the fund is allocated to passenger transport. Bus, rail (rapid or otherwise), ferry and taxi services are private good activities. Moreover, such services account for a tiny proportion of Auckland's transport market and will

not make any noticeable contribution to the amelioration of congestion on the region's roads.

- 1.5 Infrastructure Auckland should, in our view, concentrate on funding the upgrade of stormwater treatment and disposal on the isthmus. The notional allocation provides just 15 percent of total funds for such projects. Stormwater disposal and treatment, most notably in relation to footpaths, roads and open access parks, are public good activities. Infrastructure Auckland should focus on large projects that may be difficult for territorial authorities to fund from existing sources of revenue.
- 1.6 Infrastructure Auckland should exit from its investment in the Ports of Auckland Limited, Northern Disposal Systems Limited and the America's Cup Village Limited (ACVL). Infrastructure Auckland should invest its capital in a diversified portfolio of low risk securities. The public should be consulted on this investment strategy as required by the Act. Infrastructure Auckland should provide a high quality analysis to inform such consultations.
- 1.7 Local body politicians in the Auckland region have had nearly two years to demonstrate that they were justified in lobbying for the creation of Infrastructure Auckland. There is no compelling evidence from the operations of Infrastructure Auckland to date or the Plan that Infrastructure Auckland is fulfilling a valid role. The future of Infrastructure Auckland should be examined afresh by the government.
- 1.8 The balance of this submission is presented in two sections. The principal function of Infrastructure Auckland is discussed in the next section (section 2). Its investment activities are examined in section 3.

2 The principal function of Infrastructure Auckland

- 2.1 Section 707ZZK(1) of the Act states:

The principal function of Infrastructure Auckland is to contribute funds, by way of grants, in respect of projects or parts of projects, undertaken in the Auckland region for the purposes of providing –

- (a) Land transport; or
- (b) Any passenger service; or

- (c) Any passenger transport operation; or
 (d) Stormwater infrastructure, –
where the project or parts of projects generate benefits to the community generally in addition to any benefits that accrue to any identifiable persons or groups of persons (emphasis added).

Goods and services that provide benefits to people or groups of people that cannot feasibly be identified are known as public goods. Thus Infrastructure Auckland's principal function relates to the making of grants in respect of public good transport and stormwater projects. Infrastructure Auckland also has some functions in respect of facilities used for the America's Cup regatta and other investments.

- 2.2 Instead of focusing on its principal function as defined in the Act, Infrastructure Auckland's Plan envisages a wider role and function that may lead it to engage in activities that are arguably *ultra vires*. Infrastructure Auckland's vision, for instance, is that:

The people of the Auckland region enjoy a superior quality of life within a vibrant, harmonious, safe and economically successful region, based on a healthy environment.

Infrastructure Auckland does not have responsibility for quality of life, harmony, safety, economic success or environmental matters. The responsibilities of local authorities in the region extend to aspects of these matters but even they do not have sole or prime responsibility for all but one of them (environmental regulation). Infrastructure Auckland should not have a vision statement that cannot be advanced or achieved by pursuing its lawful activities. It should revise its vision statement to reflect its statutory functions.

- 2.3 The role adopted by Infrastructure Auckland is not consistent with its principal statutory function. Infrastructure Auckland has defined its role as follows:

Infrastructure Auckland is the custodian of a fund of regional investments and will manage the investments entrusted to it, using sound business practice. This will provide tangible benefits for the community, principally through grants to transport and stormwater projects.

Infrastructure Auckland's principal purpose is not to make grants that provide "tangible benefits for the community" but to make grants that *generate benefits to the community generally in addition to any benefits that accrue to any identifiable*

persons or groups of persons. This qualification is the critical element that distinguishes private and public goods.

- 2.4 The Plan does not focus on the funding of public good activities. Unlike public goods such as city parks and street lighting, passenger transport services such as buses, trains, ferries and taxis are provided by private operators and charged for in the normal way. There are no free-rider problems arising from the inability to exclude non-payers from benefiting. In addition, the use of passenger transport services by one person detracts from their enjoyment by other people.¹ The streetlight illuminates the footpath regardless of how many people pass by. In contrast, once a seat on the bus is taken it is not available for other commuters and the identifiable beneficiary is the person sitting in the seat.
- 2.5 All passenger transport projects for which grant applications have been made since 1998 and which are reported to have passed "legislative filters" are private good activities. The installation of GPS passenger information systems on ferries and piers, bus priority measures and transport services for drivers who have been drinking are examples. The benefits arising from those projects accrue to clearly identified individuals or groups of people, namely the users of such services. Who but a ferry user could possibly benefit from GPS passenger information systems installed on board the ferry? Any grants for the passenger transport projects listed in the Plan, including rapid transit systems, are arguably *ultra vires*.
- 2.6 The inadequate focus on public good activities is highlighted by Infrastructure Auckland's notional allocation of its fund over the next five years (see table below). The proposed allocation is hopelessly out of balance with the distribution that would arise from concentrating on public good activities and a rigorous public policy analysis of proposals, both consistent with Infrastructure Auckland's governing legislation. The lion's share of the fund (61 percent) is allocated to passenger transport. Public transport proposals could also be approved as innovative programmes to relieve congestion. In comparison, just 15 percent of the funds are allocated for stormwater projects.

¹ This is the second criterion of pure public goods. It is not reflected in section 707ZZK.

3 Notional Allocation of Fund

3	Category	3	Smillion	3	Percent
3	Passenger transport	3	410	3	61
3	Innovative ways to relieve congestion and improve transport	3	75	3	11
3	Road network	3	90	3	13
3	Stormwater	3	100	3	15
3	<i>Total</i>	3	<i>675</i>	3	<i>100</i>

2.7 Public transport accounts for a tiny proportion of the transport market in Auckland and it can only solve a fraction of Auckland's serious traffic problems. A recent report by the Energy Efficiency and Conservation Authority notes that only 7.3 percent of Aucklanders used public transport to travel to work in 1996, down from 7.6 percent in 1991. This is despite the substantial subsidies provided to public transport. In contrast 87 percent of Auckland commuters chose private transport, an increase of 2 percentage points between 1991 and 1996. Similar trends away from passenger transport and to private transport have been reported in other comparable countries.

2.8 Government agencies are poorly placed to make informed judgments about peoples' preferences because they have no reliable way of measuring them. It is only in situations where people face actual choices that their preferences are revealed and only when people decide to exchange one thing for another (for example an amount of money for, say, an unsubsidised bus trip) that relative weights can be properly assigned to their preferences. Thus research which shows that "a high proportion of Aucklanders believe that passenger transport is a key tool" to address "the region's transport problems" is no justification for allocating \$410 million to passenger transport. Respondents to surveys may encourage local authorities to expand mass passenger transport services in the hope that other people will use and pay for such services and leave the roads less congested for their use. The revealed preferences of Aucklanders clearly show that the vast majority choose to commute by car. Private transport is preferred because it is more convenient and for other reasons.

2.9 The choice faced by people is not a simple one between the use of a private motorcar and mass passenger transport. A host of factors, such as where one

chooses to live, work and shop, which school children attend and whether one rents a video or goes to the movies, affect the demand for transport services. The implementation of more efficient prices for road services, such as tolls, which is supported by some local authorities in the region, and appropriate new investment in roading is required to address congestion. Such prices should apply to all road users, including bus operators. These matters are examined in greater detail in our submission on the Draft Auckland Regional Land Transport Strategy, which is attached.

- 2.10 The mistaken view that the government has a significant role in funding and/or providing passenger transport operations and infrastructure is reflected in the policies and activities of the Auckland Regional Council, the region's territorial authorities and Infrastructure Auckland. Disproportionate efforts and resources are being committed to passenger transport projects by local government. The Auckland Regional Council's draft plan provides \$58 million in subsidies for mass passenger transport services in the region. Territorial authorities provide additional subsidies. Mass passenger transport services are unlikely to make any noticeable contribution to easing Auckland's transport difficulties which are now recognised to be among the largest problems facing the region. Modelling work undertaken by the Auckland Regional Council, for instance, is reported to show that only road pricing has a significant effect on the demand for roading services.
- 2.11 While the capacity of the roading network needs to be expanded to meet growing demand, we agree with the statement in the Plan that this should not be the main priority for Infrastructure Auckland. Roading should be put on a more commercial basis and steps should be taken to introduce more efficient prices for such services.
- 2.12 Infrastructure Auckland should, in our view, concentrate on funding stormwater treatment and disposal projects on the isthmus. Such projects are far more likely than passenger transport projects to satisfy the public good criterion reflected in section 707ZZK of the Act. Stormwater disposal and treatment, most notably in relation to footpaths, roads and open access parks, are public good activities. A similar conclusion might apply in respect of stormwater from private properties if it is not feasible to apply efficient prices.

- 2.13 Serious questions must be raised about the relative priority of small to modest projects, such as Auckland City Council's application relating to the installation of a "minor pollutant trap" in Bowden Road, Mt Wellington, at a cost of \$0.25 million. If such expenditure cannot be funded from within Auckland City Council's proposed capital expenditure of \$141 million in 2000/01, it is hard to accept that it is a high priority. Infrastructure Auckland notes that it will focus on projects which (among other criteria) would not otherwise be funded from any other source. Presumably, this criterion is not intended to convey a willingness to fund low priority projects that local authorities and other applicants should fund themselves. There is a risk that funds will be frittered away on small low priority projects and the major projects that were claimed by local authority politicians to justify the establishment of Infrastructure Auckland will not be able to be funded.
- 2.14 The grant allocation process emphasises the multi criteria evaluation (MCE) methodology. As observed in last year's submission, that methodology cannot possibly permit conflicts among the various criteria to be resolved on a sound basis. Infrastructure Auckland has a clear statutory function that emphasises the funding of certain public good projects. The problem arises from the lack of focus on public goods, the flawed and unduly complicated MCE methodology, and the confused conceptual framework reflected in clause 5.2 of the Infrastructure Auckland Deed. The Deed adds several criteria that are not contained in the Act and provides no basis for resolving conflicts among them. The Deed should be revisited. A standard public policy analysis of proposals, consistent with the relevant statutory provisions, should replace the MCE methodology.
- 2.15 The highest ranked project among those for which grants have been approved by Infrastructure Auckland involved a private good activity, namely improvements to land surrounding park and ride facilities at the Swanson railway station. A grant of \$0.2 million was provided for the project. A survey conducted over a month in 1997 found that on average 341 and 429 people got on and off trains respectively at Swanson station during each day Monday to Friday. It is unlikely that subsequent growth has exceeded 7 percent.² Thus

² The Auckland Regional Council supplied the survey findings and indicative growth rate.

patronage today may amount to about 365 (on) and 460 (off) users on each workday. The grant per average workday train trip is about \$249.³ It is not known how far the people travelled on the train. The use of train services to and from Swanson can be put into perspective by noting that some 150,000 vehicles a day cross the harbour bridge and 195,000 vehicles a day use the busiest section of the motorway (Gillies Avenue to Khyber Pass). It is obvious that the Swanson railway project will do nothing to relieve congestion. It is hard to escape the impression that no worthwhile projects from an overall community perspective have been put to Infrastructure Auckland and public funds are being spent simply because they are available.

3 Investment activities

- 3.1 In last year's plan Infrastructure Auckland reported that it would review its investment strategy during 1999/00. There is no indication in the Plan that a principled review has been undertaken.
- 3.2 Ports of Auckland Limited, ACVL and Northern Disposal Systems Limited all engage in private good activities. Infrastructure Auckland is not required to retain its interests in them. However, it is required (with some exceptions) to adopt the special consultative procedure in relation to any proposal to sell or dispose of its shares or interests in those ventures.
- 3.3 Infrastructure Auckland does not need to invest in the Ports of Auckland Limited and Northern Disposal Systems Limited to undertake its principal function. Standard financial analysis indicates that Infrastructure Auckland can optimise its return for a given level of risk by holding a diversified portfolio of securities. Its present portfolio, 62 percent of which is invested in Ports of Auckland Limited, requires the inhabitants of the region to bear undiversified risk. This is imprudent and not necessary.
- 3.4 The Plan states that "Infrastructure Auckland has no plans or current intention to sell or otherwise dispose of any of [its] shares in Ports of Auckland Limited". No reason is given for this policy stance.

³ Calculated as $\$205,000 / (365 + 460)$.

- 3.5 There is compelling evidence that public agencies are generally poor managers of business enterprises. They are subject to weak accountability arrangements. Infrastructure Auckland is an example. Political considerations bias commercial decisions. For instance, the rationalisation of industries through vertical and horizontal integration, such as a possible merger of the Ports of Auckland Limited with other domestic or offshore ports, may be impeded. Ports of Auckland Limited argued in 1998 that substantial efficiency benefits would accrue if it were freed from majority public ownership. Efficient port operations are vital to the business sector and the country. They are being impeded by public ownership.
- 3.6 Infrastructure Auckland should focus on its principal function of making grants that conform with the relevant statutory provisions. Consistent with this view, it should dispose of its investment in Ports of Auckland Limited, Northern Disposal Systems Limited and ACVL. Its capital should be invested in a diversified low risk portfolio of securities.
- 3.7 A principled case for adopting such a strategy should be put to the public in accordance with the Act as soon as possible. Infrastructure Auckland should inform the public by providing a high quality analysis of the issues involved.
- 3.8 The draft long term funding plan provides for grants of between \$125 million and \$145 million a year between 2000/01 and 2004/05, and \$45 million a year thereafter. Infrastructure Auckland cannot implement this programme in 2004/05 and beyond without realising its investment in subsidiaries or incurring debt. Thus, if the grant programme is realistic (bearing in mind that cumulated grant commitments to June 2000 are forecast to be \$5 million), the issue of Infrastructure Auckland's investments must be confronted in the next year or two.
- 3.9 The Auckland Regional Services Trust claimed that it was taking a sound commercial approach to its investigation of the provision of facilities for the America's Cup regatta. The cost borne by residents through Infrastructure Auckland and its predecessor escalated from \$20-30 million as noted in the Trust's draft 1996-97 annual plan to \$86 million as reported in Infrastructure Auckland's annual plan for 1999-2000. Infrastructure Auckland's investment in

ACVL had been written down to \$61 million by 30 June 1999 and further reductions in value are forecast for 1999/00 (to \$56 million) and 2001/02 (to \$42 million).⁴ While the forecast reductions comprise repatriation of funds to Infrastructure Auckland in 2001/02, undisclosed losses incurred in 1999/00 may be included in the forecast writedown in that year. The experience with ACVL illustrates the public sector's capacity to make poor investments with no reporting on what went wrong and why, and little accountability.

3.10 ACVL is now described as a property management and development company. The key financial objective set for ACVL is inconsistent with the requirement that it operate as a successful business. The objective states that "For the three year period 1 July 2000 to 30 June 2003, the average return achieves a positive EVA." It seems that an average EVA of one cent over three years on a written down investment of \$56 million will be regarded as satisfactory. This is totally inconsistent with the objective of operating as a successful business.

3.11 Infrastructure Auckland's statutory mandate in respect of the America's Cup event, which is defined in the Act as the "yachting event ... that is to take place in the years 1999 and 2000", is now limited as the Plan notes. The Plan should have included a discussion on the future of ACVL and, as a minimum, outlined what steps Infrastructure Auckland intends to take to meet its responsibility to see that ACVL is a successful business.

3.12 Finally, local body politicians in the Auckland region have had nearly two years to demonstrate that they were justified in lobbying for the creation of Infrastructure Auckland. The validation of their claims require the following conditions to be met:

- that the assets of the former Auckland Regional Services Trust are required to fund public good activities that would yield a higher return to the community than other uses for the resources, including personal spending;
- that such projects could not be funded by local authorities from their sources of revenue; and

⁴ The value of Infrastructure Auckland's investment in ACVL is forecast to remain unchanged in 2000/01.

- that a separate public body was needed to undertake such funding.

3.13 There is no compelling evidence from the operations of Infrastructure Auckland to date or the Plan that these conditions are being met or are likely to be met in the near future. The future of Infrastructure Auckland should be examined afresh by the government. In addition, the Business Roundtable has asked the Auditor-General to examine whether Infrastructure Auckland's plan is consistent with the public goods focus of the legislation under which it operates.