

# **LOCAL GOVERNMENT FORUM**

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## **SUBMISSION ON THE REVIEW OF THE LOCAL GOVERNMENT ACT 1974**

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## EXECUTIVE SUMMARY

- The serious deficiencies of the Local Government Act 1974 (the Act) are widely recognised. A thorough revision of the Act is warranted. The new act must, however, be based on sound principles.
- One of the most disturbing features of *Reviewing the Local Government Act 1974: Have Your Say* (the Consultation Document) is the absence of principled argument and analysis.
- Unless the government strengthens New Zealand's institutional and policy framework and implements a proven growth strategy there is no prospect that a sustainable improvement in growth and social indicators, relative to that of other OECD countries, will be realised.
- The proposals contained in the Consultation Document, by broadening the mandate for local government and by seeking to overturn longstanding constitutional and legal constraints on council activities, would weaken rather than strengthen the existing framework. More effective checks and balances on the activities of local authorities are required.
- The role of government at any level needs to be established on the basis of a proper public policy analysis. There are two primary functions of the government. They have been called the protective and productive states.
- The protective state refers to the establishment and maintenance of the general framework within which all social interactions take place. It entails the enforcement of rules against theft, fraud and the like, and the monopoly use of force to protect citizens from each other and from outsiders.
- Beyond the protective state the government might be able to enhance the wealth of its citizens by undertaking or funding productive activities that cannot be organised efficiently through voluntary exchange in the commercial or household sectors. Such activities involve the production of public goods and services.
- Local government may be the most efficient level of government to undertake the

role of the protective and productive states where local knowledge is required, where the costs and benefits of government action accrue locally, and where appropriate incentives apply at the local level.

- Local government has some responsibilities in respect of law and order (eg public nuisance) and its regulatory and taxing activities affect private property rights. The core function of local government, however, relates to the funding or provision of local public goods that cannot be produced efficiently by individuals, firms and voluntary organisations.
- On this criterion, the range of council activities is already excessive. The vast majority relate to the provision of private goods and services.
- The best possible contribution that local government can make to the advancement of the overall wellbeing of its citizens and thus to the achievement of the government's broad goals is to confine its activities to local protective and public good roles and undertake them as efficiently as possible.
- Any role beyond those will impair welfare by reducing individual autonomy and choice, and discouraging wealth creation and other activities that are undertaken by individuals, private firms and voluntary organisations.
- Councils should be required to privatise their private good businesses and be prohibited from owning such businesses in the future. There are no valid grounds for councils owning such businesses. Elected public bodies are likely to be relatively inefficient owners.
- The proposals contained in the Consultation Document place unwarranted faith in the efficacy of democratic processes at the local level. Those processes are weak. There is a low turnout at elections, voters have little information about who, or what, they are voting for, governance and management roles are confused and media coverage is more limited and less questioning than comparable reporting on central government.
- New Zealand's constitutional arrangements do not envisage local democracy limited only by popular vote. Councils may only exercise the powers that are conferred by parliament. Moreover, those powers are limited by common law.

Limited government is required to protect liberty and promote prosperity.

- The activities that councils may engage in should be tightly circumscribed and enumerated in the act. The deliberate specification of limited powers is a vital constraint on local government. It would prevent local government from expanding into activities that use economic resources poorly and reduce community welfare.
- A power of general competence is inconsistent with New Zealand's long-standing constitutional arrangements and the common law, and is a threat to personal and economic freedom. There are no sound public policy reasons for introducing uncertainty, by attempting to change the *ultra vires* doctrine that has applied for over a century, for no demonstrated benefit.
- A substantial expansion of council activities is envisaged in the Consultative Document without a contemporaneous examination of how such services are to be funded.
- The objectives of the review should focus on the appropriate institutional and policy framework rather than on the drafting of a new act. The objective of promoting a partnership approach between local government, central government and communities to improve each community's wellbeing is mistaken.
- The proposed purpose of local government is undesirable because it does not recognise that there should be a clear demarcation between those activities that should properly be the domain of local government and those that should be the responsibility of either central government or civil society (which includes the business sector).
- The purpose of local government is also stated in terms of process, namely to enable collective decision making, rather than in terms of functions or desired objectives or outcomes. The aim in the Consultative Document is not, as it should be, the paramount one of promoting the highest possible welfare of the community; it is merely the process one of enabling councils to make decisions on behalf of their citizens.

- The discussion on the proposed general principles reflects many of the weaknesses of the entire Consultation Document. Existing provisions are not acknowledged, the strengths and weaknesses of such provisions are not identified, options for improvement are not developed and evaluated against standard criteria and proposals are suggested that are often substantially inferior to the present provisions or are inconsistent with those that are to be retained.
- A fundamental examination of the structure of local government is warranted. If local government focuses on its core role there is unlikely to be a need for both regional and territorial councils.
- No council or community board should have more than, say, 10-12 members. The criteria for establishing the size of councils within the range prescribed should be included in the legislation.
- The implications of the Treaty of Waitangi for local government are a significant policy issue that should be examined carefully. The brief discussion in the Consultation Document does not provide a sound basis for advancing legislative proposals that could go beyond arrangements that apply to other government agencies or in other areas, and does nothing to advance community understanding. Most importantly, as a significant constitutional issue, any proposal should be the subject of a referendum; otherwise it has the potential to be very divisive.
- The failure to adequately differentiate between the roles that elected members of councils should perform and those that should be undertaken by the chief executive (and his or her staff) is one of the key weaknesses in the governance of councils. Compared to most company boards, many councils adopt an excessively hands-on approach to management.
- Councils should not be able to establish subordinate entities with members directly elected by residents. This confuses lines of accountability. Moreover, the need for committees, workshops and advisory groups appointed by councils would be much reduced if councils are restricted to public good activities and if operational matters, including the provision of advice, are the responsibility of the executive.

- Long-term council plans should be confined to the activities of the council (and its agencies). The proposed extension of such plans is not a sufficient reason to weaken annual plans as proposed.
- Many council decisions under the Act and the proposals in the Consultative Document do not give sufficient attention to the proper principles that should apply in funding council spending. Those principles need to be properly specified in the new act.
- Because the Consultation Document is of such poor quality and so patchy in its coverage, the government faces a massive task in bridging the gap between the proposals contained in it and the development of an effective new act.
- The deficiencies of the Consultation Document should be addressed by appointing an expert group to review submissions and to develop detailed proposals for further consultation before a bill is introduced. This work should not be rushed. Unless local government reforms are based on sound and widely agreed principles they will not command political consensus and will be overturned with changes in government. Such instability is not in the best interests of local government or New Zealand.



# THE REVIEW OF THE LOCAL GOVERNMENT ACT 1974

If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable government to control the governed; and in the next place oblige it to control itself. A dependence on the people is, no doubt, the primary control on the government; but experience has taught mankind the necessity of auxiliary precautions.

James Madison<sup>1</sup>

## 1 Overview

- 1.1 This submission on the review of the Local Government Act 1974 is made by the Local Government Forum (the Forum). The Forum comprises mainly business organisations that have a vital interest in local government (see appendix). The members of those organisations are among the largest ratepayers in the country and they are affected directly by the activities of local government. Businesses pay about 50% of all rates.
- 1.2 The serious deficiencies of the Local Government Act 1974 (the Act) are widely recognised. They were highlighted in the Forum's report *Refocusing the Role of Local Government*.<sup>2</sup> The Act is complex and in many places it is excessively detailed and poorly drafted. A thorough revision of the Act is warranted.
- 1.3 The new act must, however, be based on sound principles. One of the most disturbing features of *Reviewing the Local Government Act 1974: Have Your Say* (the Consultation Document) is the absence of principled argument and

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<sup>1</sup> Cited by Dorn, James A (1988), 'Public Choice and the Constitution: A Madisonian Perspective', in Gwartney, James D and Wagner, Richard E (eds), *Public Choice and Constitutional Economics*, Political Economy and Public Policy, vol 6, JAI Press, London, p 61.

<sup>2</sup> Local Government Forum (1999), *Refocusing the Role of Local Government*, Local Government Forum, Wellington.

analysis. Fundamental issues such as the nature of constitutional democracy at the local government level, the protection of the freedoms of citizens and the rights of minorities, and the proper role of local government are at stake. It is incumbent on the government to apply a contemporary public policy analysis to such issues.

- 1.4 In line with the Forum's view, the Ministerial Panel on Business Compliance Costs recommended in its recent report that the government "Treat with urgency the review of the role and regulatory powers of local government from a first principles perspective."<sup>3</sup> The Panel apparently understood that such an examination was being undertaken as part of the review of the Act. This has not occurred. Further and more fundamental analysis will be necessary to implement the Panel's recommendation.
- 1.5 Unless New Zealand's institutional and policy framework is strengthened, the government has little hope of achieving the ambitious economic and social goals that it has set, namely of restoring New Zealand to the top half of the OECD rankings. The proposals contained in the Consultation Document, by seeking to overturn longstanding constitutional constraints on council activities and by broadening the mandate for local government, would weaken that framework. They would impede the achievement of the government's broad economic and social goals.
- 1.6 Local government has a vital role in advancing the overall wellbeing of all New Zealanders. However, its role is not all-encompassing. It needs to be established on a principled basis and properly circumscribed. Local government has a role to play in establishing and maintaining the general framework that protects lives, liberties and properties. However, the core business of local authorities should be the funding and – in justifiable circumstances – the provision of local public goods and services that cannot be better provided by firms, households and non-profit organisations, and the administration of appropriate regulations. The Forum submits that

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<sup>3</sup> Ministerial Panel on Business Compliance Costs (2001), *Finding the Balance: Maximum Compliance at Minimum Cost*, Ministry of Economic Development, Wellington, p 24.

such powers should be tightly defined and explicitly enumerated in the new act. Councils should be prohibited from engaging in other activities.

- 1.7 Because the Consultation Document is of such poor quality, the government faces a massive task in bridging the chasm between the proposals contained in it and an effective new act. No government

committed to genuine consultation, the implementation of sound policy and the presentation of quality legislation to parliament would proceed from the present consultative exercise directly to the introduction of a major bill in parliament.

- 1.8 The deficiencies of the Consultation Document should be addressed by appointing an expert group to review submissions and to develop detailed proposals for further consultation, including a draft bill, before a bill is placed before parliament.
- 1.9 The activities of local government will be affected by separate reviews on rating, transport, waste management and issues that relate to Auckland. There is also a bill before parliament that would amend the Resource Management Act. A review of the water industry was initiated some years ago and handed over to Local Government New Zealand. There has been no discernible progress. High quality outcomes in all areas are essential. These exercises should be coordinated and based on sound and widely agreed principles.
- 1.10 The balance of this submission is presented in three parts. Part I presents our general comments. It comprises sections 2 to 7. The next section (section 2) comments on the consultative process. Section 3 notes the government's broad economic and social objectives and assesses whether the proposals contained in the Consultation Document will assist the government to achieve them. Section 4 discusses the role of the government while section 5 comments critically on democratic processes. Section 6 analyses the proposal to confer a power of general competence on local authorities. The main deficiencies of the proposals contained in the Consultation Document are summarised in section 7.
- 1.11 Part II presents detailed comments on most proposals contained in the Consultation Document. It comprises sections 8 to 17. Section 8 examines the government's objectives for the review of the Act. The purposes, powers and principles of local government are analysed in section 9. The structure and membership of local authorities are discussed in sections 10

and 11 respectively. Issues relating to the Treaty of Waitangi are examined in section 12. The non-resident ratepayer franchise is discussed in section 13. Governance is discussed in section 14. Section 15 focuses on planning, consultations and reporting. Sections 16 and 17 address financial management and funding decisions respectively.

1.12 Part III, comprising section 18, presents our main conclusions.

## **PART I GENERAL COMMENTS**

### **2 Consultative process**

2.1 In the foreword to the Consultation Document the minister of local government states that it was "developed in a collaborative way by officials of the Department of Internal Affairs working closely with other Departments and people from the local government sector." The prime minister reported that every cabinet paper relating to the present review was commented on by Local Government New Zealand before the cabinet considered it.<sup>4</sup> In marked contrast, the views of users and ratepayers – the parties most directly affected by local government – have been largely ignored up to this point.

2.2 Public meetings on the review were poorly promoted and there were more hui than meetings for the public generally. While it may be difficult to encourage the public to focus on the review, widespread community support should be a precondition for the fundamental changes in the mandate of local government that are envisaged.

2.3 The Forum expects full and genuine consultation at all further stages of the review, consistent with the prime minister's undertaking that the government would do more to listen to business concerns. Genuine consultation means a process that involves the following steps:

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<sup>4</sup> Clark, Helen (2001a), 'Conference of Local Government New Zealand: Address by Rt Hon Helen Clark, Prime Minister', press release by New Zealand government, 16 July, [www.newsroom.co.nz](http://www.newsroom.co.nz).

- the gathering of information to test policy proposals;
- the advancement of proposals for discussion that are not pre-determined;

- informing interested parties of all relevant information on which the proposals are based;
- the seeking of analysis and opinion on the proposals;
- examining with an open mind the views of interested parties and being prepared to alter the original proposal in the light of information and argument advanced; and
- providing feedback to interested parties both during the consultation process and after the decisions have been taken.

The Forum notes that all relevant information on the proposals has not been included in the Consultation Document. In particular, principled argument for the proposal to introduce a power of general competence has not been provided and no assessment of the costs and benefits of the proposals has been presented.

- 2.4 A number of court decisions show that local authorities are not entitled to implement their election manifestos come what may. Courts have made it clear that an election manifesto is not to be taken as gospel and it is not to be regarded as a bond, signed, sealed and delivered. The cost of policies and countervailing considerations are required to be taken into account.<sup>5</sup> The Forum submits that the government should apply a similar approach in deciding whether to implement its election policy on local government including its proposal to introduce a power of general competence.

### **3 The government's broad objectives**

#### **3.1 Economic transformation**

- 3.1.1 In the speech from the throne of 21 December 1999, the governor general stated on behalf of the government that:

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<sup>5</sup> See cases cited by Palmer, Kenneth A (1993), *Local Government Law in New Zealand*, The Law Book Company Limited, Sydney, p 60-62.

It is crucial that government policies ensure that New Zealand transforms the base of its economy much faster than has been the case in recent years. The future must be one of a high skills, high employment, high value added economy. We need to be innovative and adaptive to changing international demands.<sup>6</sup>

- 3.1.2 The prime minister elaborated on the government's commitment to economic transformation in a statement to parliament in February 2001:

If we embrace innovation wholeheartedly, we can be in the top half of the OECD, not falling to the bottom. Our falling unemployment rate places us among the top half of OECD performers on that indicator. Why should we not aim to be in the top half on other key indicators too?<sup>7</sup>

The prime minister also said:

This government has a passion for economic transformation.<sup>8</sup>

- 3.1.3 The prime minister returned to these themes in her address to Local Government New Zealand's conference in July 2001:

Our government is ambitious for New Zealand. We have set our sights firmly on returning New Zealand to the top half of the OECD across a wide range of economic and social indicators.<sup>9</sup>

- 3.1.4 New Zealand's economic performance is falling massively short of the level required to achieve the government's goals. Our rate of economic growth, although better than before the reforms began in 1984, is mediocre. The Treasury forecasts real GDP to grow at about 2% to 3% a year over the medium term and projects a paltry growth rate of 1.6% a year in the longer term.<sup>10</sup>

- 3.1.5 *Unless the government strengthens New Zealand's institutional and policy framework and implements a proven growth strategy there is no prospect that a sustainable improvement in growth and social indicators, relative to that of other OECD countries, will be realised.*

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<sup>6</sup> Hardie-Boys, Michael (1999), 'Speech from the Throne: Opening of Parliament', 21 December, [www.newsroom.co.nz](http://www.newsroom.co.nz).

<sup>7</sup> Clark, Helen (2001b), 'Prime Minister's Statement to Parliament', press release by New Zealand government, 13 February, [www.newsroom.co.nz](http://www.newsroom.co.nz).

<sup>8</sup> *Ibid.*

<sup>9</sup> Clark (2001a), *op cit.*

<sup>10</sup> See 'Fiscal Strategy Report', Budget 2001, [www.treasury.govt.nz](http://www.treasury.govt.nz), p 33.



3.1.6 A country's institutional framework comprises the underlying, enforceable rules that motivate and coordinate people's decisions. Simple, universal, consistent and stable rules that protect individual freedom and promote self-responsibility are required to order economic, civil and political action effectively. Important among these are the upholding of individual autonomy and private property rights. Institutions such as these encourage people to cooperate on an impersonal basis and to innovate with confidence. An economy with effective institutions and with a high level of trust enjoys low transaction costs and will grow.

3.1.7 By contrast, people who are subject to complicated, arbitrary and outcome-specific rules tend to cooperate on the basis of personal relationships which are a more costly way of coordinating activity. When rules are hard to know or poorly enforced, people become confused and often lack the motivation to explore economic improvements. Entrepreneurial energies are then diverted from cultivating commercial and technical prowess and wealth creation to lobbying, income redistribution and other non-productive pursuits.

3.1.8 According to Wolfgang Kasper, emeritus professor at the University of New South Wales, New Zealand's institutional framework has never been very robust. He observed that our overriding constitutional rules "are, by and large, implicit and weak."<sup>11</sup>

## **3.2 Will the proposals help?**

3.2.1 The proposals contained in the Consultation Document would weaken rather than strengthen New Zealand's institutional framework and thus harm growth and social advancement. The proposals to broaden the purpose of local authorities and to confer on them a power of general competence, for instance, are a threat to individual liberty and would reduce certainty and thereby raise transaction costs. They could authorise councils to tread all over the domain that should belong exclusively to civil

society, namely individuals, firms and other voluntary organisations. Councils would be able to achieve through ownership objectives that they cannot attain through national regulation (eg unjustified prohibitions on private development on coastal land in the Auckland region). As legal scholar Richard Epstein has noted, "every advance of government power necessarily shrinks rights that are left to individuals."<sup>12</sup>

3.2.2 The government has not yet implemented a strategy that will enable its economic goals to be achieved, as the Treasury forecasts confirm. The majority of its initiatives to date have been directed at the redistribution of wealth rather than wealth creation. All future initiatives must be tested against its new emphasis on dramatically raising the growth rate of the economy.

3.2.3 *A vast improvement in the contribution of local government to the wellbeing of all New Zealanders must be a top priority in an effective growth strategy. Local government spending amounts to almost 4% of GDP. The assets of the sector, net of debt, amount to about \$42 billion. The broadly comparable net asset value of all companies listed on the New Zealand Stock Exchange is about \$27 billion.<sup>13</sup> With this proportion of resources devoted to a sector of the economy that is not primarily focused on wealth creation, it is hardly surprising that the economy is struggling to progress.*

3.2.4 Unless the resources used by local government yield a return to the community at least equal to that which could be earned elsewhere, potential national income is forgone. The return to the community is after

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<sup>11</sup> Kasper, Wolfgang (2000), *Gambles with the Economic Constitution: The Re-regulation of Labour in New Zealand*, The Centre for Independent Studies, St Leonards, p 28.

<sup>12</sup> Epstein, Richard A (2000), 'Assault with Blunt History', *Reason Online*, May, p 2, [www.reason.com](http://www.reason.com).

<sup>13</sup> The Consultation Document puts the annual revenue and assets of the local government sector at \$4.1 billion and \$46 billion respectively. It also states that the sector's equity to debt ratio is \$10.20 to \$1 which implies that its net equity is about \$42 billion. The market capitalisation of companies listed on the stock exchange is about \$44 billion. Information supplied by Credit Suisse First Boston suggests that the equity of companies listed on the stock exchange amounts to about \$26.7 billion. GDP for the year to March 2001 was \$104.7 billion according to Statistics New Zealand.

taking account of the economic or deadweight costs of rates that are applied to fund such activities. It is implausible that marginal council spending provides anywhere near the level of return required.

3.2.5 Auckland City's Waitemata interchange project, or Britomart as it is better known, illustrates this point. The Waitemata waterfront interchange is reported to be the largest single project ever to be proposed by a council. It is estimated to cost about \$194 million in present cost terms. The cost benefit study belatedly prepared for Auckland City Council by Beca Carter Hollings & Ferner Limited shows that community costs will exceed related benefits by \$103 million in present value terms.<sup>14</sup> The study implied that about \$7 of community benefits accrue to non-users for each \$1 that accrues to users. This ratio would need to double to \$14 to \$1 for the project to be economic (other things being equal). Moreover, community costs are understated because the capital costs of additional buses and trains required for commuters who are assumed to transfer from cars to public transport were omitted even though the related benefits, such as less congestion, were taken into account. Despite the quantitative evidence that the project would reduce community welfare, it was included in the preferred transport option adopted by representatives from all councils in the Auckland region at a workshop in July and has since been supported by the government.<sup>15</sup> <sup>16</sup> Like the uneconomic Think Big schemes, it is a wealth-reducing project.<sup>17</sup> Economic growth rates will not be raised by decisions of this kind which are endemic in the local government sector.

3.2.6 With few exceptions 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. Some have neglected their traditional activities, such as

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<sup>14</sup> Beca Carter Hollings & Ferner Limited (2001), *Waitemata Waterfront Interchange – Benefit Cost Assessment: Report Prepared for Auckland City Council*, Beca Carter Hollings & Ferner Limited, Auckland.

<sup>15</sup> Paterson, Les (2001), 'Light Rail in the West: Conventional Rail in the South', media release, 6 July, [www.newsroom.co.nz](http://www.newsroom.co.nz).

<sup>16</sup> Tizard, Judith (2001), 'Urgency Needed for Infrastructure Auckland on Auckland's Transport Issues', press release by New Zealand government, 30 July, [www.newsroom.co.nz](http://www.newsroom.co.nz).

roading, sewerage disposal and drainage, to such an extent that inadequate services may well limit growth and development. The parliamentary commissioner for the environment's consultation document, aptly entitled *Aging Pipes and Murky Waters*, highlighted the poor state of many water supply systems.<sup>18</sup> Roads in the Auckland region are becoming increasingly congested with delays common. Improvements to the capacity of the roading network are being held up as councils focus disproportionate effort and spending on passenger transport projects. Auckland City pours untreated sewerage into the Waitemata Harbour from outfalls not far from Queen Street. Wellington City spent 20 years examining sewerage schemes and then opted for an exorbitantly expensive one.

- 3.2.7 There is little contracting for services by councils, except where councils are compelled to do so by central government (for instance in respect of roading). There is, however, evidence that contracting typically produces cost savings in the order of 20-40 percent.
- 3.2.8 Most councils have been slow to apply user charges where feasible, notwithstanding the importance accorded to the principle of economic efficiency in part VIIA of the Act which was inserted by the Local Government Amendment Act (No 3) 1996. Many have implausibly concluded that services provided by libraries and art galleries benefit non-users more than users. Rather than undertake a principled analysis of their long-term financial strategies as implied by the Act, councils such as Auckland and Wellington cities and many district councils (for instance Rotorua District Council) appear to have sought to justify existing revenue policies. There is no regular monitoring of council compliance with part VIIA of the Act.
- 3.2.9 Rates revenue has increased at a disturbing pace. There is little evidence that the quantity and quality of services have increased commensurately. Ever-increasing rates threaten the competitiveness of export and import

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<sup>17</sup> The estimated capital cost of the project was recently reduced, but the reduction does not alter the thrust of the comments presented.

<sup>18</sup> Williams, J Morgan (2000), *Aging Pipes and Murky Waters: Urban Water System Issues for the 21st Century*, Office of the Parliamentary Commissioner for the Environment, Wellington.

competing firms, and put pressure on monetary policy and interest rates. Councils such as Auckland, Christchurch and Wellington cities and most district councils have sought to protect residential ratepayers from the full impact of their spending by imposing an unjust share of the rate burden on businesses, including farms. This outcome reflects vote-gathering behaviour by self-interested politicians as most electors are residential ratepayers rather than businesses (including farms).

3.2.10 Local authorities also have a pervasive effect on individuals, firms and other voluntary organisations through their extensive regulatory activities. Councils largely administer important national regulation, for example that relating to resource management, buildings and hazardous substances, at the regional and territorial levels. They also have powers to make regulations on matters such as health and safety, roads, recreation, animals and public order. Unless their regulatory activities are efficient, overall welfare is reduced.

3.2.11 There is ample evidence that some regulatory activities of local authorities are an unwarranted obstacle to growth and development. The Resource Management Act imposes large costs and delays on developers and gives too much scope for frivolous and vexatious objections to proposals, as the government's business compliance cost review has confirmed.<sup>19</sup> In a special deal, the government cut through the red tape to allow a development by Sovereign Yachts on the former defence land at Hobsonville to be approved in five or six months rather than the customary five to 10 years. As John Roughan of the *New Zealand Herald* correctly asked, if it could be done for one project why not for all?<sup>20</sup>

3.2.12 A thorough review of local government would have identified shortcomings in the performance of local government and structural problems with much of the regulation that it administers. It would have focused on the contribution that local government should make to the

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<sup>19</sup> Ministerial Panel on Business Compliance Costs (2001), *op cit*.

<sup>20</sup> Roughan, John (2001), 'Nothing Stands in Way of Anderton's Favours', *New Zealand Herald*, 19-20 May, p A23.

achievement of the government's economic and social goals. Instead the Consultation Document focuses on selective aspects of the Act. Important policy issues, such as a principled examination of the role of local government, were not discussed.

- 3.2.13 Unless the institutional and policy framework within which local government operates is substantially superior to that envisaged in the Consultation Document, the local government sector will be a brake on the achievement of the government's broad economic and social objectives. Only the best possible framework will provide any hope of achieving the goals set by the government.

## **4 The role of government**

- 4.1 The role of government at any level needs to be established on the basis of a proper public policy analysis. The demand for services will generally be excessive from the perspective of the level and growth of national income because people and groups that lobby for particular services do not face the marginal social costs of the services that they demand. Tightly focused groups are able to obtain services that they value by imposing costs thinly over the majority of ratepayers who face excessive costs in representing their views. The absence of information on the real value to ratepayers of particular services makes it impossible for councils to accurately assess the preferences of ratepayers. Furthermore, ratepayers are compelled to bear the costs that are imposed on them. Their opportunities to move to a more fiscally attractive territory are constrained.

- 4.2 There are two primary functions of the government. They are to maintain order and to provide public goods and services. They have been called the protective and productive states. The former refers to the establishment and the maintenance of a general framework within which all social interactions take place. This protective state entails the enforcement of rules against theft, fraud and the like, and the monopoly use of force to protect citizens from each other and from outsiders. The crucial elements include the enforcement of contracts and the avoidance of regulations,

restrictions and excessive taxation that would unjustifiably restrain voluntary exchange.

4.3 When the government performs its protective function well, individuals can have a high level of confidence that they will not be cheated and the wealth that they create will not be taken from them by intruders, or by the government through high taxes or inflation. On the other hand, if private property rights are not clearly defined and enforced, some people will be encouraged to engage in harmful activities toward others. Resources will be used inefficiently, such as the excessive exploitation of fish in international waters and the under-utilisation of resources owned in common.

4.4 Beyond the maintenance of order the government might be able to enhance the wealth of its citizens by undertaking or funding productive activities that cannot be organised efficiently through voluntary exchange. Such activities involve the production of public goods and services. A 'pure' public good has both of the following characteristics:

- Non-rivalry in consumption. A good is 'non-rival' when an individual can consume a unit of it without detracting from the consumption opportunities available to other people. Examples of non-rival goods are atmospheric quality and disease eradication programmes.
- Non-excludability of benefits. Goods or services generate non-excludable benefits if it is too costly to prevent access to their benefits by people who do not pay. Examples are defence, flood control and cleaner air arising from pollution control devices.

Very few goods or services exhibit both characteristics.

4.5 Public goods and services can often be produced privately. Private firms may produce what at first sight appear to be public goods by charging for them with complementary products. An example commonly cited in the economic literature is that of lighthouses. The benefits of lighthouses are

non-rival and non-excludable. It is, however, possible to charge for their services along with port dues. A more relevant example is the provision of lighting in shopping malls. The cost involved is recovered from shoppers through the rents charged to traders.

- 4.6 The non-rival property does not automatically mean that government action is necessary. Many services traded in markets are non-rival in that extra users could be accommodated at little or no additional cost. Surplus capacities at concerts, sporting events and on airlines are possible examples. Firms use a number of techniques to use the capacity available. In particular, they often differentiate levels of associated services and set different prices for each market segment.
- 4.7 The technical definition of public goods is essential to a proper analysis of the role of government. The term 'public good' is commonly used very loosely, for example to imply that a service is of general value to a community. Often local government services are described as public goods or a widespread pattern of benefits is alleged when a careful analysis would reveal that the services have few or no public good characteristics. There are inconsistencies in the classification of similar services as public or private goods by particular councils. Used loosely, the term public good becomes no more than an assertion that a particular function should be publicly provided, funded, or both.
- 4.8 The discussion to this point has not distinguished between the functions of central and local government. There are circumstances where the role of the protective and productive states can most efficiently be undertaken by central government rather than local government, and *vice versa*. Probably the most common circumstances where local government is likely to be more efficient than central government are where local knowledge is required, where the costs and benefits of government action accrue locally, and where appropriate incentives apply at the local level.
- 4.9 Most activities that fall within the protective state are properly undertaken by central government in New Zealand. It has responsibility for defence,



police, the criminal and commercial laws, and the courts. Local government has some responsibilities in respect of law and order (eg public nuisances) and its regulatory and taxing activities affect private property rights.

- 4.10 The core function of local government, however, relates to the funding or provision of local public goods. These comprise activities related to democratic, governance and representative processes, civil defence, street lighting and footpaths, open-access parks and reserves, and public health.
- 4.11 On this criterion, the range of council activities is already excessive. The vast majority relate to the provision of private goods and services. Private goods are the polar opposite of public goods. They include the supply of water; refuse, sewerage and waste water collection, treatment and disposal from private properties; libraries; art galleries; museums; recreational facilities where access can be restricted such as swimming pools and halls; and car parking facilities.
- 4.12 There should be no presumption that council funding, provision, or both, is justified simply because particular goods or services have public good characteristics and are authorised in the Act. Local government is just one of many agencies which can facilitate the provision, funding, or both, of such goods and services and it should not step in to assist when other arrangements might be more efficient and equitable. A careful assessment of the costs and benefits of government action is required. This approach is consistent with the government's *Statement of Policy Direction for Review of Local Government Act 1974*. It recognised that the provision of local public goods should be a matter of choice for councils.<sup>21</sup>
- 4.13 The best possible contribution that local government can make to the advancement of the overall wellbeing of its ratepayers and thus to the achievement of the government's broad goals is to undertake its protective and public good roles as efficiently as possible. Any role beyond those will impair overall welfare by reducing individual autonomy and choice and

discouraging wealth creation and other activities that are undertaken by individuals, private firms and voluntary organisations. The government's goal of improving the performance of the economy would be put at risk.

- 4.14 Local authorities should only be permitted to engage in those activities that fall within the protective and productive states discussed above (and other activities that are incidental to such activities) and that should be the responsibility of local rather than central government. Such activities should be enumerated in the legislation consistent with our constitutional arrangements and the common law.

## 5 Democratic processes

- 5.1 The proposals contained in the Consultation Document place unwarranted faith in the efficacy of democratic processes at the local level. They assume that local collective decision making over a vast range of activities relating to social, economic, cultural and environmental matters is desirable. The proposals are intended to restore "localness" to local government and to enhance its ability to recognise and respond to community aspirations. They are also intended to encourage increased participation of citizens and communities in local government.
- 5.2 The underlying notion is that democratically elected representatives can be expected to act in the interests of ratepayers and citizens and, if they fail to do so, they will be replaced at the next election. This is a naïve view of political decision making as the quotation at the start of this submission implies. It fails, for instance, to recognise the vast literature on the need to restrict the activities of government to preserve liberty and to increase prosperity. Madison argued that:

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<sup>21</sup> Department of Internal Affairs (2000), *Statement of Policy Direction for Review of Local Government Act 1974*, Department of Internal Affairs, Wellington.

... a pure democracy, by which I mean a society consisting of a small number of citizens, who assemble and administer the government in person, can admit of no cure for the mischiefs of faction.<sup>22</sup>

How much worse is that problem when government is larger and citizens are represented by elected councillors?

### 5.3 Democratic processes at the local government level are weak:

- There is a low turnout at elections, despite postal voting which was introduced in 1989 to increase participation. Between 51% and 61% percent of people enrolled voted in the 1998 election.<sup>23</sup> This contrasts with many countries in the European Union where between 60 and 93 percent of electors vote in sub-national elections and with New Zealand's 1999 parliamentary elections where the turnout was 84.7%.<sup>24</sup>
- In exercising their right to vote, electors are required to choose between candidates (or party candidates) offering a package of policies which may well include some policies that they support and some that they do not. An electoral mandate does not necessarily mean that most voters support the particular policies that are promoted by elected representatives or the governing parties.
- Voters have little information about who, or what, they are voting for. In part this reflects the limited role of party affiliations.
- Mayors and chairpersons do not necessarily lead the political party or parties with a majority on council or command the support of the majority of councillors. Thus they may be unable to implement their election manifestos.

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<sup>22</sup> Madison, James (1961), 'No 10: Madison' in Rossiter, Clinton (ed), *The Federalist Papers: Alexander Hamilton James Madison John Jay*, Penguin, New York, p 81.

<sup>23</sup> The Department of Internal Affairs advised that there were 2,508,210 electors on the roll at the 1998 local government elections. The voter turnout was 53% for regional councils, 51% for city councils, 61% for district councils and 51% for community boards.

<sup>24</sup> Stewart, John (1996), 'Democracy and Local Government', in Hirst, Paul and Khilnani, Sunil (eds), *Reinventing Democracy*, Blackwell Publishers, Oxford, pp 41-42 and information supplied by the Electoral Office.

- Governance and management roles are confused. Cabinet ministers are advised by a largely independent public service that is expected to provide frank advice. There is no similar tradition in local government where there is insufficient separation between the governance function of elected representatives and the operational responsibilities of local government officials.
- Media coverage of local government activities, elected representatives and candidates is more limited and less questioning than comparable reporting of central government.
- The costs borne by individuals in monitoring the activities of local government (for instance the opportunity cost of their time) are large relative to the expected benefits. There is minimal public participation in consultative exercises such as those related to draft annual plans. Moreover, public submissions seem to make little difference to many plans. The Controller and Auditor-General reported that there is a perception that the consultative process is a sham.<sup>25</sup>
- The adoption of differential rating has enabled councils to impose the costs of their spending programmes on certain classes of ratepayers such as businesses that are entitled to fewer votes than if voting rights reflected the amount of rates paid.

5.4 Many people are disillusioned with politics at all levels, and want to have as little as possible to do with the political process. As a result activists and special interest groups unduly influence council policies. A 1998 opinion poll that included questions supplied by Local Government New Zealand found that only 17% of people agreed that the average person has a great deal of influence on local government decisions whereas 76% disagreed with the statement. Moreover, 69% agreed that the public has little control

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<sup>25</sup> Controller and Auditor-General (1988), *Public Consultation and Decision-Making in Local Government*, Office of the Controller and Auditor-General, Wellington, p 9.

over what politicians do in office compared with 25% who disagreed.<sup>26</sup> There are no proposals in the Consultation Document that give confidence that the widespread disillusionment with politics will reduce. Yet the thrust of the proposals is to extend the mandate of councils.

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<sup>26</sup> Local Government New Zealand (1999), 'New Zealand Values Survey', 8 March, [www.localgovt.co.nz](http://www.localgovt.co.nz).

- 5.5 The reality is that most of the goals and preferences of citizens are best achieved by private means – not by political means as the Consultation Document often seems to imply. The individual who chooses between candidate A and B in the polling booth is the same as the individual who chooses between apples and oranges. However, voluntary exchange provides a better indication of people's true preferences than voting because individuals are required to trade one thing (for instance a sum of money) for another (apples). The relevant difference between political and voluntary exchange decision mechanisms does not lie in the kinds of values and interests that people pursue, but in the means by which they are able to pursue their various interests.
- 5.6 The challenge is to establish an institutional framework that enables government at any level to operate efficiently where it is necessary to advance overall welfare but beyond that to maintain the maximum possible opportunity for individuals to pursue their interests. *Reliance on majority rule is not sufficient.*
- 5.7 Central government is responsible for setting and evaluating the framework within which local government operates. The framework should be improved in the new act. More effective checks and balances are required.
- 5.8 New Zealand's constitutional arrangements do not envisage local democracy limited only by popular vote. Local authorities in New Zealand have never been empowered to undertake whatever activities a majority of voters or elected representatives might like councils to do. Councils may only exercise the powers that are conferred by parliament. Moreover, those powers are limited further by common law (see below). For instance, no council (or individual) can impose taxes or unilaterally alter private property rights without statutory authority to do so.
- 5.9 Limited government is required to protect liberty. For the good of society individuals cede some of their rights to the government. It is not for the

government to take whatever rights it might like and leave the rest to individuals as the democratic theory advanced by some seems to imply.

5.10 The powers of local authorities must be conferred by statute or be incidental to such powers. Consistent with this approach the activities that councils may engage in should be enumerated and tightly circumscribed as suggested above. The deliberate specification of such limited powers is a vital constraint on local government just as the enumerated powers in the constitution of the United States limit the powers of the federal government. Any other formulation such as a true power of general competence or broad and ill-defined powers is a threat to liberty and economic development and inconsistent with our constitutional arrangements.

5.11 The key solution to the shortcomings of local democracy is to depoliticise activities that do not need to be undertaken collectively. This would enable the number of local authorities to be reduced and for those that remain to be tightly focused on valid public good and regulatory activities. Beyond this robust checks and balances on the activities of councils are required.

## **6 Power of general competence**

### **6.1 The proposal**

6.1.1 The Consultation Document states that:

So local authorities can clearly deliver on the new purpose of local government, it is proposed that the new legislation will establish, clear and, broadly based powers of general competence for local authorities [*sic*]. This is an acknowledgment of the greater flexibility local authorities will need to respond effectively to the needs of their communities in the future.

It then suggests that the capacity and powers clause might be drafted as follows:

(1) A territorial authority or regional council has –

- (a) full capacity to carry on or undertake any business or activity, do any act, or enter into any transaction; and
- (b) for the purposes of paragraph (a), full rights, powers and privileges;

(2) Subsection (1) applies subject to –

- (a) This Act and any other enactment; and
- (b) The general law.<sup>27</sup>

6.1.2 The Consultation Document states that these general powers will allow councils to do all things necessary to achieve the purpose of local government, provided that the activity is consistent with the new act, the council has consulted meaningfully with its community and the council complies with the law, including specific provisions in the new act as well as with other statutes.

## 6.2 Analysis of the proposal

6.2.1 The prevalence of the power of general competence in countries of the European Union reflects sub-national levels of government that were created by constitutions rather than statute.<sup>28</sup> In contrast, local authorities in New Zealand, like those in Britain, are creatures of statute and are subordinate to central government.<sup>29</sup>

6.2.2 The proposed power appears to be an attempt to change the existing law by diminishing the impact on councils of the *ultra vires* doctrine. That doctrine arose from mid nineteenth century decisions of the courts concerning the scope of the powers of new joint stock railway companies. It was apparently applied to local authorities because they happened to be incorporated bodies operating under statute.<sup>30</sup>

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<sup>27</sup> The proposed subsection 2(b) is redundant.

<sup>28</sup> Stewart (1996), *op cit*, pp 41-42.

<sup>29</sup> Historically, corporations created by royal charter were assumed to have general powers of competence. However, no charter corporations of local authorities exist in New Zealand.

<sup>30</sup> Loughlin, Martin (1997), 'Ultra Vires: Hail and Farewell', in Kitchin, Hillary (ed), *A Framework for the Future: An Agenda for Councils in a Changing World*, Local Government Information Unit, London.



6.2.3 The effect of the doctrine is to make unlawful the expenditure of money by a local authority on any object or purpose other than those that are expressly or impliedly authorised by statute. As Palmer observed:

Understandably the courts were concerned to safeguard commercial and private property rights, and to curb an over-zealous exercise of powers. The courts assumed that Parliament did not intend subordinate bodies or authorities to possess plenary powers or unlimited discretions as to activities, where affecting the rights of other persons and property.<sup>31</sup>

6.2.4 Commenting in the context of the Britain, Loughlin wrote:

The *ultra vires* doctrine, which provides the cornerstone of our modern local government law, is now under threat. Many have come to view the doctrine as expressive of the restrictive nature of contemporary arrangements of local government and have indicated that its removal and replacement with a power of general competence provides the key to the rejuvenation of local government.<sup>32</sup>

A commission for local democracy, the Labour Party and a House of Lords committee on the relationship between central and local government were reported to have come to this conclusion. Although the concept of general competence seemed to have acquired the "symbolic status of a universal, principled, cost-free, progressive policy stance", Loughlin warned that it must not be assumed that those who embrace the reform have a clear grasp of its nature and significance.<sup>33</sup>

6.2.5 Loughlin's warning is relevant to New Zealand. Despite the proposed removal of the doctrine, which is also the cornerstone of New Zealand's local government law, the Consultation Document contains no substantive analysis of the reasons for the change or its likely effects. It does not identify even a solitary product, service or activity that one of the 86 regional, territorial or unitary councils or 148 community boards would like to supply or undertake and is a valid activity for local government but is prohibited from doing so by the present law.

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<sup>31</sup> Palmer (1993), *op cit*, p 46.

<sup>32</sup> Loughlin (1997), *op cit*, p 1.

<sup>33</sup> *Ibid*, pp 1-2.

- 6.2.6 Stewart's conclusion, that the view that statutory restrictions were constraining local authorities in Britain was a myth, may also hold for New Zealand.<sup>34</sup> *However, unlike New Zealand, local government spending in Britain is subject to an expenditure cap.* No consideration is given in the Consultation Document to constraining the proposed power of general competence by an expenditure cap.<sup>35</sup>
- 6.2.7 Loughlin notes that that English boroughs created under charter were "persons" at common law. Yet in interpreting the Municipal Corporations Act 1882, the courts held that boroughs could exercise the powers of an ordinary person only in so far as expenditure from the borough fund was not involved. Moreover, nothing in their status as persons authorised them to interfere with private property rights.
- 6.2.8 Even if the *ultra vires* doctrine had not been devised, the intrinsic powers of local government would still be limited because such limits are a consequence of Britain's basic constitutional arrangements. According to Loughlin, this is highlighted by distinguishing between *powers* and *privileges*:

... no person – whether an incorporated body or an ordinary person has any privileges other than those which are accorded by the operation of the law.<sup>36</sup>

Jennings is reported to have made the point in 1931 in the following terms:

Neither a railway company nor I may commit nuisances without express statutory authority. Neither a local authority nor I may tax inhabitants of a given area except with the consent of Parliament, even though our object be to bring untold benefits to those inhabitants. A local authority has no right to use rates to start a new

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<sup>34</sup> Stewart, J D (1983), *Local Government: The Conditions of Local Choice*, London, cited by Loughlin (1997), *op cit*, p 8.

<sup>35</sup> In terms of the Rating Powers Act 1988 a territorial council may not levy a general rate in excess of 1.25 cents in the dollar of capital value (or the equivalent level in the case of land value) or 18 cents in the dollar of annual value. The limit on the maximum rate has been omitted from the Local Government (Rating) Bill. Controls on the activities of councils should focus on their functions and spending rather than the level of rates.

<sup>36</sup> Loughlin (1997), *op cit*, p 5.

service unless it can show statutory sanction. And this rule is not a nineteenth century innovation. It is almost as old as Parliament.<sup>37</sup>

This vital principle seems to have been overlooked in the debate in New Zealand.<sup>38</sup> However, the guidelines on legislation produced by the Legislative Advisory Committee acknowledge the role of the common law and the courts in protecting individual freedom and property rights.<sup>39</sup>

6.2.9 The power of councils under section 37L(4) of the Act appears to reflect many of the aims of the power of general competence proposed in the Consultation Document:

Every council and every territorial authority shall be a body corporate with perpetual succession and a common seal, and, subject to this and any other Act, shall be capable of acquiring, holding, and disposing of real and personal property, of entering into contracts, of suing and being sued, and of doing and suffering all such other things as bodies corporate may do and suffer.

The empowering words of the subsection are qualified by the clause "subject to this and any other Act" which is the same as that proposed in the Consultation Document. As Palmer notes:

... the preferred conventional legal view is that the section is enabling only. Accordingly, the substantive powers of a local authority to carry out works and engage in functions and activities should be found in other provisions. The ultra vires doctrine remains applicable.<sup>40</sup>

6.2.10 Crawford concluded that if the power of general competence were conferred on local authorities:

The most that would change is the presumption of legality, and it is not a fundamentally different concept. Indeed, ... in relation to Scandinavian jurisdictions, while operating within the principle of

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<sup>37</sup> Jennings, W I (1931), *Local Government in the Modern Constitution*, London, cited by Loughlin (1997), *op cit*, p 5.

<sup>38</sup> See Jansen, Ross (2000), 'Local Government and the Power of General Competence', paper presented at the Building the Constitution conference, 7-8 April, Institute of Policy Studies, Wellington and Hewison, Grant (forthcoming), *A Power of General Competence – Should it be Granted to Local Government in New Zealand?* TNT Publications, Oneroa.

<sup>39</sup> Legislative Advisory Committee (2001), 'Guidelines on Process and Content of Legislation', 2001 edition, Ministry of Justice, Wellington, [www.justice.govt.nz/lac/index.html](http://www.justice.govt.nz/lac/index.html).

<sup>40</sup> Palmer (1993), *op cit*, p 18.

the power of general competence it is possible to have very tight restrictions.<sup>41</sup>

The courts could also be expected to circumscribe a power of general competence. Councils would be required to act in good faith and reasonably in exercising their discretionary powers as they are required to act today. These requirements arise from the common law.

6.2.11 The inclusion of a power of general competence in the Consultation Document is somewhat surprising. There is no explicit mention of it in the government's *Statement of Policy Direction for Review of Local Government Act 1974*. That statement appeared to rule the proposal out on sound constitutional grounds:

New Zealand does not have a written constitution which sets out the place of local government. Some recent commentary on the reform of local government law has identified options involving fundamental constitutional reform to include recognition of the place of local government. That is not proposed. The roles, responsibilities, powers and accountabilities of local government will continue to be defined in legislation enacted by Parliament. The provisions of the legislation will continue to define both the powers of local authorities, and the powers of Ministers in relation to local government.<sup>42</sup>

6.2.12 Furthermore, the government's statement of policy direction noted that factors that were relevant in developing the powers needed by local government included the following:

- the powers are to be commensurate with what is reasonably necessary to carry out the range of activities local authorities are to be able to undertake (fit for the purpose);
- the powers are not to be so vague and broad as to allow unreasonable intrusions on the individual and property rights; and
- appropriate rights of appeal and review are to be provided.

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<sup>41</sup> Crawford, C (1992), 'European Influence on Local Self-Government, LGS, vol 18 (1), cited by Loughlin (1997), *op cit*, p 6.

<sup>42</sup> Department of Internal Affairs (2000), *op cit*.

A true power of general competence is inconsistent with this approach. What is more, the proper acknowledgment of the threat to individual autonomy and property rights is not reflected anywhere in the Consultation Document.

### **6.3 Developments in Britain**

6.3.1 Despite the apparent support of the Labour Party and some official commissions for the introduction of a power of general competence, no such power has been adopted in Britain.<sup>43</sup> However, that did not stop Dr Bob Chilton, director of the United Kingdom Audit Commission, from telling the Local Government New Zealand conference that:

... the UK model preferred to focus on outcomes (well-being) rather than means (competence). In the UK we define power of general competence as the power to promote or improve economic and social or environmental well-being.<sup>44</sup>

6.3.2 The powers of British local authorities were extended in the Local Government Act 2000 by the introduction of a discretionary power to take steps which, in their view, promote the economic, social and environmental wellbeing of those who live in, work in, or visit the local area. Local authorities were also empowered to work with other local organisations in responding to the needs of their communities. Unlike an existing legislative provision that may have been relied upon to undertake such activities, the new powers are not subject to a spending cap. They are, however, subject to statutory prohibitions. Local authorities, for example, are not permitted to use their new power to impose taxes.

6.3.3 The British government intended to introduce a duty rather than a general power to promote wellbeing. However, the government moved away from

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<sup>43</sup> Martin Loughlin, professor of public law, London School of Economics, personal communication, 21 July 2001.

<sup>44</sup> Local Government New Zealand (2001), 'Local Government Act Review Provides Power for Councils to Grow Up!' press release, Local Government New Zealand, 27 July, [www.localgovt.co.nz](http://www.localgovt.co.nz).

that proposal ostensibly because it did not want to expose local authorities to possible legal challenges for breach of duty.<sup>45</sup>

- 6.3.4 The activities of the London Borough of Hammersmith and Fulham provide a stark example of the potential cost to ratepayers if the government were successful in conferring the full powers and privileges of a natural person on local authorities. From December 1983 the Borough entered into numerous interest swap contracts with banks. It subsequently lost about £200 million (or about NZ\$650 million at today's exchange rate). Not surprisingly, legal action involving the Borough, its auditor and the banks followed to determine which entity should bear the losses. The House of Lords held that the local authority had no power to speculate with the public's money and it could not therefore lawfully trade in interest rate swaps, whether for speculative or debt management purposes. As a result of its decision, the ratepayers of the Borough escaped liability for a loss that amounted to over NZ\$4,000 a head.<sup>46 47</sup>

## 6.4 New Zealand experience

- 6.4.1 Elected representatives are responsible for liquor licensing trusts although they are not local authorities. Those trusts have broad powers and are subject to weak accountability arrangements. Liquor licensing trusts have a history of poor earnings and financial difficulties. Subject to the objects specified, such trusts have all the rights, powers and privileges of natural

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<sup>45</sup> Martin Loughlin, professor of public law, London School of Economics, personal communication, 21 July 2001.

<sup>46</sup> Davies, Rachel (1991), 'Council's Swaps are Unlawful', FT Law Reports, *Financial Times*, 29 January, and Loughlin (1997), *op cit*, p 11.

<sup>47</sup> Local authorities in New Zealand are permitted by section 122ZB of the Act to enter into an "incidental arrangement" in New Zealand currency to manage, reduce, share, limit, assume, offset or hedge financial risks and liabilities in relation to any investment (or investments) or loan (or loans). However, an authority could not lawfully engage in transactions similar to those undertaken by the Borough of Hammersmith and Fulham.

persons. Some licensing trusts have engaged in activities other than their core business of the sale and supply of liquor and related activities like the provision of accommodation, food and refreshments. Their non-core businesses include travel services, tourism promotion, redevelopment of property (providing a service station, video outlet, retail shops and car parks) and investment in breweries. Particularly unsuccessful ventures funded wholly or partly by licensing trusts are understood to include attempts to obtain radio, television and casino licences. At least one trust borrowed in foreign currency, thereby assuming unnecessary risks. The funds wasted by affected trusts should have been distributed for educational, cultural and recreational purposes.<sup>48</sup>

6.4.2 The Hammersmith and Fulham case provides a clear warning to the government of the risks involved in conferring a power of general competence on councils apparently to fulfil an election promise. New Zealand's experience with liquor licensing trusts also points to the risks entailed. The government should give very careful consideration to the overall effects of the proposal and its costs and benefits.

## 6.5 Concluding comment

6.5.1 The paramount issue is the extent of statutory powers and privileges that are conferred on local authorities. As argued above, the protection of liberty and the promotion of efficiency require that councils undertake only those public order, public good and regulatory activities that should be properly performed by government at the local level. The new legislation should make that restriction unequivocal by enumerating the public goods that they may fund or provide. Councils should be required to identify spending on each public good activity in their reports to ratepayers. A power of general competence is inconsistent with the suggested approach.

6.5.2 There are no sound public policy reasons for introducing uncertainty, by attempting to change the *ultra vires* doctrine that has applied for over a

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<sup>48</sup> Sale of Liquor Act 1989, part IX.

century, for no demonstrated benefit. Furthermore, the change is being proposed without examining what other changes to governance arrangements might be necessary to compensate for any relaxation in controls over council activities. *For these reason, the Forum is opposed to the introduction of a power of general competence.*

## 7 Deficiencies of the Consultation Document

7.1 The quality of policy analysis in the Consultation Document is poor. The main deficiencies include the following:

- There is no principled discussion of the proper role of local government. This is fundamental to reaching an informed and contemporary view on the activities that councils should undertake. Since 1989, the thrust of policy on local government has been to encourage local authorities to focus on their core activities and to exit from other activities. The financial management provisions of the Act reflected this view. The proposals contained in the Consultation Document represent an about-turn on the flimsiest of justifications.

Much of the recent debate in local government circles is predicated on the assumption that local government is under pressure to expand its role by taking on new functions devolved by central government. However, over the past century there has been very little change in the relative responsibilities of central and local government for the supply of goods and services. The most recent major changes involved the transfer of the responsibility for urban fire and some health services from local government to central government. However, these changes have had a limited effect on councils because they were not responsible for such services.<sup>49</sup> Local authorities arguably now have a somewhat larger role in the administration of regulation as a consequence of new and expanded regulation in areas such as resource management and hazardous substances, but that



does not require local authorities to be given a broader purpose or additional powers as the necessary powers are contained in the relevant statutes that are not included in the present review.<sup>50</sup> Parts VIIA and VIIB of the Act imposed additional reporting, consultation and other requirements on councils. They are intended to improve the accountability of councils and did not expand their roles.

The main impetus to assume new roles has come from local government itself. It is local authorities that want to assume broader responsibilities in areas such as social policy, economic development and as advocates for their communities. McKinlay reported that in areas that have traditionally been the responsibility of central government and where local authorities may have no financial obligation they are "increasingly claiming a right on behalf of their communities to be partners in the process of working through options."<sup>51</sup> A 1998 opinion poll that included questions asked on behalf of Local Government New Zealand showed that substantially more New Zealanders believe that central government rather than local government has responsibility for matters such as unemployment and income distribution.<sup>52</sup> Moreover, councils have resisted vigorously suggestions that they should exit private good activities, privatise their commercial businesses, corporatise other activities and regulate the demand for services by applying user charges where appropriate and feasible.

The thrust of the Consultation Document is that there should be few effective limits on councils in respect of the provision and funding of goods and services, income transfers and ownership of businesses.

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<sup>49</sup> Fire and health services were the responsibility of fire and area health boards respectively.

<sup>50</sup> See Local Government New Zealand (2000), *Devolution – Fact or Fiction: A Report on the Extent of New Functions and Costs Acquired by Local Government Since Reform in 1989*, Local Government New Zealand, Wellington.

<sup>51</sup> McKinlay, Peter (1998), *Local Government Reform: What Was Ordered and What Has Been Delivered*, Part Two, Research Monograph Series, paper 7, Local Government New Zealand, Wellington, p 52.

<sup>52</sup> Local Government New Zealand (1999), *op cit*.

This is reflected in proposals to broaden the mandate of councils to include the advancement of the social, economic, cultural and environmental wellbeing of local communities, to confer a power of general competence on councils and to authorise them to operate outside of their territories and regions.

The overwhelming direction of government policy in developed and developing countries is toward a more tightly focused government sector and the removal of obstacles to wealth creation by the private sector. The trend is not based on ideology – centre/left governments as well as other governments have been moving in this direction. The broad direction of policy reflects the weight of analysis and evidence.<sup>53</sup> The Consultation Document is out of step with policy in other countries and is inconsistent with the policies that are required if the government's economic and social objectives are to be achieved.

- As noted earlier, there is no analysis of the present problems with local government and no proper examination of policies that might overcome any shortcomings. There is, for instance, no review and assessment of the present dichotomy between regional and territorial councils and between territorial councils and community boards. If regional councils are allowed to undertake activities that currently fall within the responsibilities of territorial councils, as proposed, the boundary between such councils will be blurred and demarcation disputes will arise.
- The proposal to confer on councils a power of general competence, if adopted and implemented as intended, would change a longstanding constraint on local government in New Zealand and would be a threat to liberty and efficiency. The grounds advanced for the proposal in the Consultation Document reflect the lower order argument of providing greater flexibility without any consideration of the constitutional and legal issues involved. What is more, there is

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<sup>53</sup> Barry, Phil (2001), *How Do We Compare? New Zealand Public Policy Directions in an International Context*, New Zealand Business Roundtable, Wellington.

no proper discussion of the implications of the proposal. For example, if regional councils are given an effective power of general competence as intended, what is to stop them and territorial authorities from owning bakeries, banks and breweries? No provisions are proposed in the Consultation Document that would prevent councils from owning such businesses in the regions or territories of other councils or overseas.

- The Consultation Document contains ill-defined references to sustainability and sustainable development. The key meaning for local government of the proposals contained in the Consultation Document is reported to be the creation of a platform for longer-term changes which recognise that local government plays a key role in pursuing sustainable development in New Zealand. The terms sustainable and sustainable development are not defined and their significance is not examined. The latter term is commonly cited in relation to environmental debates as though it were "well defined and universally agreed" which it is not.<sup>54</sup> The Resource Management Act does not reflect the concept of "sustainable development". It reflects the narrower concept of sustainable management which is defined in the Act. The definition is only applicable to natural and physical resources. There is no reason to believe that an undefined notion of sustainable development is in the national interest or consistent with the government's wider economic and social goals. This is another example of poor quality policy development.
- A substantial expansion of council activities is envisaged without a contemporaneous examination of how such services are to be funded. The Consultation Document proposes that councils be given wider responsibilities for social, economic, cultural and environmental matters. It apparently lifts restraints on council ownership of some business activities and it aims to reduce the pressure on councils to adopt user charges. These factors point to a substantial rise in rates.

Local government interests are calling for revenue sharing with central government. Such a move would break the vital nexus between the responsibilities of councils for spending and related taxing decisions. These funding issues should be examined together with proposals to extend the mandate of councils.

The Forum is unaware of any reason why the statutory provisions relating to rating should not be included in the new act. The financial management provisions of the Act, the power to charge users for services and rating arrangements should reflect common principles and definitions and should provide a consistent and coherent framework for spending, funding, rating and user charges. The Forum submits that rating issues should be addressed in the current review and the Local Government (Rating) Bill should be held over until the review is completed and merged with the new act.

- The relationship between central and local government is mistakenly and unhelpfully described as a partnership. Partnerships are voluntarily arrangements that are entered into, and withdrawn from, on mutually agreed terms. Local authorities are corporate bodies. Under New Zealand's constitutional arrangements, central government, through its control of parliament, is responsible for setting the statutory framework within which local government operates. Central government is not required to obtain the agreement of local government before passing legislation that affects the latter. Indeed it could abolish local government, if it wished to do so, without taking account of the views of local government. Moreover, local government is required to comply with mandatory statutory provisions that affect it regardless of whether the legislation was supported or opposed by the sector. This is critical to the rule of law. For the most part central and local government have distinct responsibilities. While central and local government have discretionary power to act and they may cooperate on a voluntary

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<sup>54</sup> Henderson, David (2001), *Misguided Virtue: False Notions of Corporate Social Responsibility*,

basis, a partnership does not describe the essence of the relationship between central and local government.

- It is also inappropriate to refer to the relationship between local or central government and business as a partnership. In a liberal democracy people transact with strangers on a voluntary basis for mutual advantage but subject to the rule of law. In contrast, the concept of a partnership between the sectors reflects collective decision making and central planning. In a free society and market economy business operates within a set of laws laid down by the government, but it is not in 'partnership' with it. Decentralised decision making and commercial freedom are prerequisites for a dynamic, innovative and prosperous economy.
- Many important aspects of local government, such as regulatory activities that are governed by separate legislation like the Resource Management Act and the Building Act, the Treaty of Waitangi, rating and other funding options, and so-called Auckland issues are not examined (or are examined superficially) in the Consultation Document. The same is true for many parts of the Act such those related to the remuneration of members, accountability and accounting, council property, sale and lease of land, works and contracts, subdivision of land, roads, water supply, sewerage and stormwater drainage, LATEs, transport-related enterprises, public health, recreation and community development, urban renewal, fire prevention, private works, disaster recovery, removal orders and offences. While it may be intended to replace some such parts of the Act, for instance by the power of general competence, it is not clear that that will be the case in all instances. Indeed it is difficult to envisage that the new legislation will be greatly simplified.

7.2 Because the Consultation Document is of such poor quality and so patchy in its coverage, the government faces a massive task in bridging the chasm between the proposals contained in it and the development of an effective

new act. No government committed to genuine consultation, the implementation of sound policy and the presentation of quality legislation to parliament would proceed from the present consultative exercise directly to the introduction of a bill in parliament. *The deficiencies of the Consultation Document should be addressed by appointing an expert group to review submissions and to develop detailed proposals for further consultation before a bill is introduced.*

## **PART II DETAILED COMMENTS**

### **8 The objectives of the review**

8.1 According to the Consultation Document, the proposals contained in it are intended to create an act that:

- is a more flexible style of law, capable of responding to change and the diverse needs of the communities to which it has to apply, without the constant need for amendment and revision;
- consistently expresses a clear and coherent set of ideas about what local government is, why we have it, and what its role is;
- promotes a partnership approach between local government, central government and communities to improve each local community's wellbeing;
- gives councils an appropriate degree of autonomy over local matters, with corresponding accountability to their communities and rights to democratic participation by citizens; and
- clarifies whether local government has responsibilities under the Treaty of Waitangi.

8.2 The following comments arise in relation to the objectives of the review:

- The objectives of the review should focus on appropriate policy rather than on the drafting of a new act. An act is a means to an end,

not an end in itself. It should give legislative effect to the policies of the government. Its policies should advance overall community welfare.

- The Forum accepts that the present act is outdated. It is, however, false to imply that the choice is between the present unwieldy and outdated Act and a power of general competence. Moreover, the legislation applicable to local government will remain extensive as many aspects of local government have not been included in the review or are subject to separate legislation.
- The Forum endorses the view that a consistent, clear and coherent set of ideas about what local government is, why we have it, and what its role is is desirable. However, the Consultation Document contains a grossly inadequate treatment of these matters. The proposed role of local government, for instance, is not evaluated against accepted public policy criteria.
- The objective of promoting a partnership approach between local government, central government and communities to improve each local community's wellbeing is simply mistaken. These relationships were discussed above. The relationship between local government and its community is not one of partnership. Local government is accountable through democratic processes to its electors. It involves coercion. The payment of rates and compliance with many local regulations (like district plans) are not voluntary. From an economic perspective it is better described as one of principals (citizens) and their agents (councillors).

## **9 Purpose, powers and principles**

### **9.1 The purpose of local government**

- 9.1.1 The Consultation Document states that one of the shortcomings of the Act is that it does not clearly express the purpose of local government. This

statement is at least arguable. As Palmer observes, section 37K (which was inserted into the Act in 1989) provides the first comprehensive statutory statement of the purposes of local government.<sup>55</sup> Without acknowledging or examining that section, the Consultation Document proposes that the new act contain the following statement of broad purpose of local government:

... to enable local decision-making by and on behalf of citizens in their local communities to promote their social, economic, cultural and environmental well-being in the present and in the future.

9.1.2 The proposed purpose is undesirable for the following reasons:

- It does not recognise that there should be a clear demarcation between those activities that should properly be the domain of local government and those that should be the responsibility of either central government or civil society (which includes the business sector). The statement is so open-ended that it provides little, if any, guidance to the courts on the proper role of local government. In that event the courts, which have a long history of upholding individual autonomy, will be required to decide the limits of local government activity.
- The purpose of local government should acknowledge that councils are to act in the interests of their citizens and ratepayers ie section 122G(a) should be reflected in the purpose of local authorities.
- The purpose (and powers) of local government would not restrict the activities of regional and territorial councils to their regions and territories respectively. The purpose specified could be met by a council undertaking an activity in any territory or region, or indeed overseas, rather than by supplying public goods and regulatory services for the benefit of *its community*. This is inappropriate. A key argument for local government is that representatives of the local community are better placed than, say, central government to make decisions concerning the provision of public goods and regulation

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<sup>55</sup> Palmer (1993), *op cit*, p 28.



that affect their community. This argument does not apply where territorial and regional councils operate in a territory or region other than that in which their electors are located. The British Local Government Act 2000 restricts local authorities to the promotion of the wellbeing of those who live in, work in, or visit the local area.

- The purpose of local government is stated in terms of process, namely to enable collective decision making, rather than in terms of functions or desired objectives or outcomes. The aim is not, as it should be, the paramount one of promoting the highest possible level of overall community welfare; it is merely the process one of enabling councils to make decisions on behalf of their citizens.
- The aim of promoting social, economic, cultural and environmental wellbeing seems to be all-encompassing. What activities would not be covered by these objectives? If no activities fall outside of these objectives, the purpose is simply to increase wellbeing.
- Section 37K is more specific and provides a much clearer and more precise statement of the purposes of local government than the proposed statement. It should be retained and improved by more clearly demarcating the role of local government from that of central government and civil society.

9.1.3 The Consultation Document proposes that councils have greater responsibility for social issues. Some councils presently provide recreation and pre-school educational facilities. They also pursue some social policies by funding certain expenditures from rates. Some councils provide pensioner or other housing. Such policies were initially funded through subsidised loans provided by central government and delivered through local government. A few councils, notably Christchurch City, have established schemes to provide work for the unemployed. Councils presently have no explicit authority to make income transfers, although the rate relief scheme, while limited, is a close substitute.

9.1.4 The extent and scope of social wellbeing for which councils may be responsible is not examined in the Consultation Document. Will councils, for instance, provide health services (other than public health services) in competition with private providers and district health boards? Will they provide education and training services at school and tertiary levels? Will they assume full or partial responsibility for children who are seriously neglected or abused, for placing the unemployed in jobs and for beneficiaries? Will councils establish income transfer programmes?

9.1.5 The forum submits that an expansion of council involvement in social policy is not warranted for the following reasons:

- The primary responsibility for public spending on health, education and welfare services rests with central government. Some of these services are delivered by agencies that are local bodies, at least for some purposes. We see no compelling argument for devolving those programmes to councils. They have no particular expertise in these areas.
- We strongly oppose any explicit role for councils in income distribution. The responsibility for the alleviation of hardship rests with central government. It is undertaken through the welfare system. The grounds for further redistribution are weak.
- Local government does not have the information on which to make appropriate judgments about the relative welfare of different citizens. Central government struggles with this problem as well. However, it has the advantage of having access to taxation and ACC information, and is able to integrate income transfers with the tax system (eg family support and benefits).
- Local government has no expertise in income transfer schemes. It also generally lacks the expertise to analyse properly the economy-wide effects of job creation programmes.

- The country faces a serious problem of welfare dependency. That problem will be made worse if councils establish income transfer programmes and expand their social services.

9.1.6 Local Government New Zealand included some questions on the responsibilities of central and local government in a 1998 survey of values. Only 36% of respondents reported that local government had a responsibility to help reduce income differences between the rich and poor compared to 60% who responded that central government had such a responsibility. Almost all respondents (96%) reported that central government had a responsibility to help provide a decent standard of living for the elderly compared with 67% who responded that local government had a similar responsibility. Some 71% responded that central government should help provide jobs for everyone who wants one compared with 51% who reported that local government should help provide jobs. These results show that respondents believe that the key social responsibilities should rest with central government.<sup>56</sup> At least since the time of the 1989 reforms governments have tried to make it clear that they do not see an income redistribution role for local government.

## 9.2 The powers and principles of local government

9.2.1 The main powers of local authorities were examined above. It is noted here, however, that there is no ambiguity about whether international treaties that have not been enacted in our domestic law apply to local authorities. New Zealand is a sovereign state. It makes its own laws. The responsibility for doing so rests unambiguously with parliament. International treaties do not generally apply to local government, other incorporated bodies or citizens (while resident in New Zealand) unless the relevant obligations are enacted in New Zealand, are adopted by order in council pursuant to an act or our domestic or applicable international law is consistent with the treaty obligations.<sup>57</sup> Any other approach is inconsistent

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<sup>56</sup> Local Government New Zealand (1999), *op cit*.

<sup>57</sup> Legislative Advisory Committee (2001), *op cit*, pp 81-88.

with constitutional and democratic principles. Moreover, the right to cede sovereign authority by incorporating multilateral treaties into domestic law is a power that resides with central government. We are not aware of any other country where such a power rests with a sub-national level of government.

- 9.2.2 The general principles proposed on page 20 of the Consultation Document are substantially weaker and poorly drafted compared with those contained in section 223C of the Act. The requirements imposed on councils in section 223C are mandatory. It appears that section 223C is to be replaced by the proposal although such an intention is not discussed in the Consultation Document.
- 9.2.3 The first principle in the Act appropriately requires every local authority to conduct its business in a manner that is comprehensible and open to the public. There is no comparable principle in the proposal. The suggested principle 1.1.2 that "Partnership, community consultation and open communication should be a key part of accountable local authority decision-making" is not a mandatory principle. It reflects confused thinking about the nature of a partnership. Community consultation and open communication are not the same as conducting business in a manner that is open to the public – they are more limiting.
- 9.2.4 Furthermore, what does the proposed principle 3 mean? It states "Powers within each local authority (including the community) should be explicit and consistent with the expected role"? The powers of each local authority are established by statute and common law. A local authority is a statutory body. Its powers are not the same as those of citizens who make up the community. The thrust of the Consultation Document is against defining precisely the expected role of councils.
- 9.2.5 Principle 4 states "Policy and service choices should be those that are most effective." This is an example of poor drafting. In addition, the sole criterion of effectiveness is much narrower than that of efficiency. A household refuse service funded from rates may be effective in limiting the

dumping of household garbage in the streets but it may be inefficient because it discourages re-cycling (among other things). Furthermore, it is unclear how this principle relates to the financial management provisions that require other criteria to be taken into account.

9.2.6 The Consultation Document implies that the financial management provisions in part VIIA of the Act should be retained. It is not clear from the Consultation Document whether part VIIB relating to borrowing is also to be retained. In the absence of information to the contrary, we assume it will be. The Consultation Document suggests that the existing provisions should be augmented by principles 6-10. There is no evaluation of the existing financial management provisions and it is apparent that the drafters of the Consultation Document have limited knowledge of them.

9.2.7 The present financial management provisions reflect compromises that followed from an unsatisfactory debate on the initial proposals. While the adopted provisions recognised the principles of economic efficiency and transparency, the practical outcome has been disappointing. Their deficiencies include the following:

- The thrust of the provisions was to encourage councils to focus on their core activities and to exit from other activities. The provisions have not achieved that objective. Councils, particularly in the larger centres, have continued to engage in an extensive range of private good activities. The arguments advanced for such activities often reflect a low quality analysis.
- The provisions were intended to raise the efficiency of council operations. Councils have generally been slow to corporatise their business operations and reluctant to contract out services except where they are required to do so, for instance to qualify for funding from Transfund. Councils are required to assess the costs and benefits of significant proposals. An Audit New Zealand director recently reported that very few councils have prepared cost benefit

studies.<sup>58</sup> This is despite the mandatory obligation on councils to prepare such studies that was introduced in 1996. When cost benefit studies are prepared they may have little impact on decision making or consultative processes. The Waitemata waterfront interchange project, better known as Britomart, illustrates the problem. A cost benefit study was not prepared until May 2001. The findings of the study have not been reported in the draft annual plan, in any consultative document on the project or in Auckland City Council's newsletter, *City Scene*.

- The provisions were intended to encourage councils to apply more efficient methods of funding. Owing to weaknesses in the legislation councils have unduly focused on equity issues (the benefit principle) rather than efficiency. Too many councils have sought to justify their existing funding policies in terms of the legislation instead of conducting a first principles examination of such funding. Some councils have demonstrated a dismaying lack of understanding of the principle of economic efficiency. It was the threat of legal action rather than the force of robust analysis that eventually persuaded the Wellington City Council to reduce discriminatory differential rates on commercial activities.
- Although extensive consultation processes are provided in the Act, many consultative exercises are a waste of time because councils have shown little willingness to respond to valid analysis and argument. Their policies appear to be pre-determined with perhaps one or two items highlighted for discussion. As noted above, the Controller and Auditor-General reported in 1998 that there is a perception that consultations on annual plans and related matters are a sham.<sup>59</sup> The Forum's experience suggests that such perceptions are justified. The Forum decided that there was no point in making submissions on draft annual plans this year. Some other groups that have quite different perspectives on policy issues share our views on this point.

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<sup>58</sup> Brian Smith, personal communication, 11 June 2001.

The Auckland Housing Lobby described consultations on Auckland City's 2001/02 plan as "undemocratic" while the Water Pressure Group described "the submissions process as a meaningless charade" and, like the Forum, decided not to participate in 2001.<sup>60</sup>

9.2.8 The Forum believes that the financial management provisions need to be changed to reduce the discretion of councils and to accord primacy to efficiency as originally intended. Differential rating should only be permitted where a clearly identified community (such as a rural area) is provided with a distinctly different level of public goods from that of other ratepayers and where the differential reflects the difference in the level of such services. Otherwise, after user charges have been applied to the appropriate extent, rates should be levied on the basis of property valuations without discrimination among ratepayers. Steps along these lines, together with the enumeration of permissible council services, would help to overcome the serious shortcomings discussed above, including the weaknesses of local democratic processes.

9.2.9 The Consultation Document proposes four new financial management principles. No arguments are presented for them. Moreover, there is no discussion of how they would affect existing provisions. The first additional principle (principle 6) illustrates the problem. It states "Expenses incurred to deliver policies and services be consistent with the ability of the community to finance them using revenue raising mechanisms suited to those policies". If this principle would require councils to limit their spending, having regard to the benefits of private spending and the deadweight costs of taxation, it might attract our support. But instead it seems to focus on the particular funding mechanism. By what criteria is a revenue raising mechanism judged to be "suitable"? Councils are presently required to choose the appropriate funding mechanisms according to the principles and process contained in the Act. The adoption of the proposed principle would appear to be a backward step.

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<sup>59</sup> Controller and Auditor-General (1988), *op cit*, p 9.

9.2.10 Another principle (number 9) states that debt should not exceed prudent levels. The principle is sensible but it is explicitly provided for in the Act by section 122C(1)(e). Similarly, principles 7 and 10 (taxing and user charges, and the identification of significant risks) are already included in the Act. The question that arises is how do the proposed principles relate to the existing provisions, why are they needed and what, if anything, do they add?

9.2.11 Principle 8 states that "the stewardship of the community's investment in each local authority be focused on the sustainable delivery of policies and services, now and into the future." The language is vastly different from that used in the Act or in the other principles. What does "the stewardship of the community's investment in each local authority" mean? Is this principle trying to say that councils are to focus on policies that are sustainable now and in the future? If so, how does the principle relate to the proposed objective of improving wellbeing? How is sustainability to be assessed? Is the principle a limit on the proposed power of general competence rather than a financial management principle? How do the concepts of prudence, effectiveness and efficiency, which are reflected in the present financial management provisions, relate to that of sustainability? How are conflicts between the principles to be resolved?

9.2.12 In summary, the discussion on the proposed general principles reflects many of the weaknesses of the entire Consultation Document:

- existing provisions are not acknowledged;
- the strengths and weaknesses of existing provisions are not identified;
- options for improvement are not developed and evaluated against standard criteria; and

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<sup>60</sup> O'Connor, James (2001), 'Criticisms of Plan Process', *East and Bays Courier*, 29 June.



- proposals are suggested that are often substantially inferior to the present provisions or are inconsistent with those that are to be retained, and they are poorly drafted.

The principles outlined would not provide a sound basis for local government management. They should be considered afresh by a working party that has the capacity and experience to do the task.

### 9.3 Powers of councils

9.3.1 The Consultation Document recognises that the proposal to confer a power of general competence on regional and territorial councils would lead to both classes of councils undertaking similar services. On the other hand, it does not acknowledge that both classes of councils could also engage in many activities that individuals and private firms undertake. Because regional councils largely perform regulatory activities that are governed by separate legislation, such as the Resource Management Act, they are more likely to compete with territorial local authorities than *vice versa* in the event of change.

9.3.2 This problem should have alerted the government to the deficiencies of the proposal to apply a power of general competence to local authorities and generated a principled discussion on whether a dual structure of local government is the appropriate model in most cases. Instead, without any analysis of such vital issues, the Consultation Document suggests a bureaucratic rule:

It is proposed that when a regional council wishes to take on a new activity of regional scope, it will be required to consult with the affected territorial authorities and central government.

9.3.3 Furthermore, any new activity will require the agreement of territorial authorities in the region but only if the activity is already undertaken by affected territorial authorities. If agreement were not forthcoming the minister would make a final decision after taking advice from the Local Government Commission.

- 9.3.4 The Consultation Document ducks the troublesome issue of a regional council undertaking an activity that does not have regional scope but instead affects one or more territorial authorities in its region and therefore falls outside of the proposed consultation rule. It also leaves unresolved the question of whether each territorial authority has a veto right. There is a brief and vague reference to the protection of the regional focus of regional councils but no details are given. Are regional councils to have a power of general competence but only in relation to regional activities? Such a restriction seems to be inconsistent with the concept of a power of general competence.
- 9.3.5 The discussion also seems to be predicated on the assumption that regional and territorial authorities will restrict their activities to their regions and territories respectively. This is not the case at present in respect of territorial authorities. A LATE formerly owned by Manukau City, for example, operated in Australia. As noted above, the proposed purpose of local government would not restrict the activities of regional and territorial councils to their respective regions and territories. Similarly, the power of general competence (if it applies as intended) would seem to facilitate expansion beyond their areas.
- 9.3.6 These proposals are an example of inferior institutions. Instead of universal rules that protect liberty and lower transaction costs, rules that will lead to an expansion of government well beyond any conceivably justifiable domain, add to uncertainty and lead to endless squabbles and lobbying among politicians are proposed. The predictable upshot would be competition between regional and territorial councils as each tried to build the biggest empire.
- 9.3.7 As argued above, the Forum is opposed to the conferring of a power of general competence. It believes that local government should be confined to those activities that should properly be undertaken by government at the local level. If the government is not prepared to adopt this approach it should, as a minimum, confine regional councils to their present regulatory (and funding) roles and not confer on them the power of general

competence or any other power that enables such councils to supply private goods and services.

## **10 The structure of local government**

10.1 The Consultation Document offers no principled argument for retaining the present split between regional and territorial authorities as the standard model or for retaining community boards. On the contrary, the proposals advocated would blur the boundary between regional and territorial authorities. We think that a more fundamental examination of the structure of local government is warranted.

10.2 If local government were required to focus on the funding and, where appropriate, provision of local public goods and services and valid regulatory activities, the scope and level of its operations would be reduced substantially. In those circumstances, the need for both regional and territorial councils could be re-examined. The argument that regulatory activities should be separated from those related to the delivery of services has less force if councils are not engaged in major commercial and infrastructure activities as providers. In any event the approach has not been applied fully. Territorial authorities engage in both regulatory and service delivery activities and some regional councils, such as Wellington, have retained major commercial and asset management functions, contrary to earlier intentions. Conflicts arise, particularly when councils adopt activist programmes. We think that a unitary approach would be the best model where local government is restricted to its public good and regulatory roles. A report prepared by the Parliamentary Commissioner for the Environment and the Controller and Auditor-General concluded that "the unitary authority model can be an effective alternative model of integrated environmental management and delivering environmental outcomes, provided that it incorporates a number of key features of an

effective environmental management system" that were identified in the report.<sup>61</sup>

- 10.3 The primary concern should be to establish authorities that are properly constrained and, subject to that overriding requirement, responsive to the valid wishes of electors and sufficiently large to operate efficiently. There would be scope to merge councils as all existing district councils are unlikely to be economically viable. On the other hand, the Forum is opposed to excessively large councils that would be remote from electors such as the 'super city' that is sometimes advocated for the Auckland region. It is our experience that smaller authorities that are close to their communities and where many electors know councillors personally are more likely to undertake valid activities efficiently and to refrain from expansion into activities that are inappropriate for local government.
- 10.4 Community boards were transitional bodies that were not intended to continue beyond 1995. They sometimes act as a lobby group for a particular area rather than reflect the interests of the local community as a whole. Their usefulness, notably in the larger urban areas, is doubtful. This would particularly be the case if councils focused on their core public good roles as submitted by the Forum. We suspect that most electors in the main urban areas could not say what their community board does (if they have one) or what it has achieved in the recent past. Board members are generally subject to weak accountability mechanisms. On the other hand, some community boards, like those within the Southland District Council, that have an appropriate mandate have worked well.
- 10.5 Consideration should be given to abolishing community boards except where they represent effectively a community of interest that is unambiguously distinct from the remainder of the authority. Such communities might include the Hauraki Gulf islands within the Auckland City Council and some rural areas within city councils and district councils

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<sup>61</sup> Williams, J Morgan and Macdonald, David (undated), *Local Government Environment Management: A Study of Models and Outcomes*, Parliamentary Commissioner for the Environment and Controller and Auditor-General, Wellington.

with large towns. The criteria for the retention or establishment of such community boards should be included in the legislation. The abolition of ineffective and unnecessary community boards would produce savings in meeting fees, the cost of elections and, most importantly, costs incurred in responding to low quality proposals.

- 10.6 Special purpose entities such as Infrastructure Auckland should be abolished. There are no valid arguments for Infrastructure Auckland. It confuses lines of responsibility, diminishes the accountability of councillors to electors for their spending decisions, and generally contributes to economic inefficiency. Some previous members of Infrastructure Auckland agree privately that it should be wound up. No similar body exists or has been found necessary in other centres. Infrastructure Auckland has acknowledged that stormwater projects in the region comprise many small projects within each territory rather than large projects that strain council funding. They are quite capable of being funded by councils in the usual way. Transport projects should, where feasible, be funded by users (including congestion pricing) and through existing funding arrangements. As an investment fund Infrastructure Auckland is poorly diversified and it has suffered major losses. Its investment in business operations should be sold and the proceeds returned to citizens. Alternatively, its shares should be distributed directly to citizens.

## **11 Membership**

- 11.1 The Consultation Document states that the present minimum and maximum number of members of territorial authorities, community boards and regional councils be retained. No reason is given for this view. Territorial authorities must have between 6 and 30 members, community boards must have between 4 and 30 members and regional councils must have been 6 and 14 members.
- 11.2 A judgment is required on the level and structure of representation that would enable electors to have adequate access to their representatives and permit elected representatives to exercise their governance responsibilities

effectively and at an appropriate cost to ratepayers. The greater the number of elected representatives, the higher the probability that a broad spectrum of views will be reflected in a local authority's deliberations. However, as the number of elected representatives increases and as organisational structures become more complex, the difficulty of decision making increases and the accountability of individual representatives declines. Unnecessary costs are also incurred. This provides a strong counter-argument against large authorities, and against the current structure comprising regional and territorial councils and community boards. Once the size of councils and boards increases beyond a certain number, the benefits of greater diversity of elected representatives are outweighed by the diseconomies of size.

11.3 The Forum believes that the maximum level of representation should be reduced for the following reasons:

- The responsibilities of councillors in the larger territorial authorities have been reduced over recent years by changes in their functions and organisation. The establishment of LATEs, for example for water and stormwater, and the contracting out of some services have relieved councillors of responsibility for important activities.
- If local authorities focus on their core activities, as advocated in this submission, the responsibilities of elected representatives can be substantially reduced. Furthermore, the badly needed reorganisation of roading activities would allow council involvement in roading to diminish in the next few years.
- Councils should concentrate on their representation and governance roles. (These roles are discussed further below.) There is considerable scope for councils to delegate operational activities to their staff. The payment of meeting fees encourages councils to maintain too many committees and to hold an excessive number of meetings. Busyness is not necessarily an indication of high productivity.

- Research findings from organisation theory suggest that the maximum size of councils should be reduced. In many ways the role of councils is comparable to that of company boards of directors. The academic literature suggests that keeping boards of companies small can improve their performance. For example, one leading scholar, Professor Michael Jensen of the Harvard Business School, finds that once boards get beyond seven or eight members, they are less likely to function effectively and can be more easily controlled by the chief executive officer.<sup>62</sup>
- The present maximum size of territorial councils enables them to be much larger than the Cabinet (there are 20 ministers within Cabinet) despite having considerably lesser responsibilities. The total number of elected representatives in a local authority may also be high relative to the level of representation in parliament. Auckland City, which accounts for 9% of the population of New Zealand, has 72 elected representatives or three for every five members of parliament. Members of parliament have broader legislative and representation roles than councillors or community board members.

Wellington City Council comprises 19 members consisting of a mayor and 18 councillors. Wellington City has two community boards with 12 members. Thus Wellington City, which has half the population of Auckland City, has 31 elected representatives or one for every four members of parliament. Christchurch City serves a broadly comparable population to Auckland City. Christchurch has a council of 25, comprising a mayor and 24 councillors, and six community boards with 36 members. This makes a total of 61 elected representatives or one for every two members of parliament.

11.4 A substantial reduction in the maximum number of elected representatives can be achieved without compromising the principles of representative government. We think that no council or community board should have

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<sup>62</sup> Jensen, M C (1993), 'Presidential Address: The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems', *Journal of Finance*, vol 48, no 3 (July), pp 831-880.

more than, say, 10-12 members. The long-term aim should be to reduce the membership of authorities to, say, 7 or 8 for the reasons noted above. The current minimum sizes of local authorities can be retained. The criteria for establishing the size of councils within the range prescribed should be included in the legislation.

- 11.5 The Consultation Document proposes that a review of council membership and the basis of election should take place every six years rather than every three years as presently provided. It also suggests a modified process which would start with an 'independent' team being appointed by council



members on the nomination of the chief executive and electoral officer to prepare a report and options. Councils would make the decision but interested parties would have the right to appeal to the Local Government Commission as presently provided.

11.6 The proposal recognises the present problem of self-interest and is a step in the right direction. It does not, however, go far enough. Unless genuine independence applies, not only at the start but also throughout the process, self-interested incumbents will bias outcomes to their advantage. If that were not the case we would not observe the present pattern of membership.

11.7 The review team should be appointed independently of the council, perhaps by the Local Government Commission. The team should represent the interests of ratepayers rather than councils and boards. A new process would be necessary. We also think the review team's recommendation, together with any recommendation by the affected council, should be the subject of community consultation. The review team could then report to the council for decision. Its decision would be subject to appeal as at present.

11.8 There is a further problem with the present process. The criteria for the review of membership are far too narrow. They focus on population ratios (despite the comment in the Consultation Document). The overall number of elected representatives, costs and other issues discussed above cannot be taken into account. This problem needs to be addressed by adding broader criteria.

## **12 Treaty of Waitangi**

12.1 The Consultation Document indicates that the government has yet to decide whether and, if so, how the Treaty of Waitangi may affect the new act. There are several points in the Consultation Document that are valid. First, the Consultation Document correctly observes that local authorities are not directly involved in the settlement process. The parties are the

Crown (represented by central government) and Maori. Indeed any obligations that arise under the Treaty rest with central government, at least in the first instance. Central government can request the involvement of local government or it can pass legislation requiring it to take certain actions. Secondly, the Consultation Document is on sound ground when it notes that the general aim of local government "is to provide for a degree of self-government for the benefit of all communities including Maori." Thirdly, it is appropriate to ask whether there are any impediments to participation in local government by Maori or other groups. The focus here should be on the removal of unjustified policy-induced impediments (if any) and not on the provision of special treatment for any particular group.

12.2 The Consultation Document does not address radical options that have been promoted elsewhere. A position statement prepared by the New Zealand Society of Local Government Managers and Local Government New Zealand contained several suggestions.<sup>63</sup> It states that the special status of Maori as tangata whenua and treaty partner generates an obligation on parliament to ensure that Maori are effectively represented in local government. The statement goes on to suggest that:

A range of approaches, such as different ward/constituency boundaries or the adoption of the single transferable vote system may successfully fulfil this obligation in some districts.

12.3 The position statement also notes that certain "non-electoral arrangements" such as the appointment of iwi/hapu representatives to council committees and effective consultation may be successful. It then states:

Nevertheless, the option of separate Maori representation (elected by Maori electors within the district), as proposed by Environment Bay of Plenty Regional Council, is endorsed as one that should be made available to councils and communities as a further tool which can be used alongside, or instead of, those described above.

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<sup>63</sup> Local Government New Zealand and New Zealand Society of Local Government Managers (2000), *A New Legislative Framework for Local Government Elections: A Policy Position Statement by Local Government New Zealand and New Zealand Society of Local Government Managers*, Local Government New Zealand and New Zealand Society of Local Government Managers, Wellington.

12.4 The position statement, which was only two paragraphs long, contained an inadequate analysis of the issues involved. Some of the proposals on Maori representation, such as the proposal to provide separate representation for Maori, are undemocratic.

12.5 The position statement refers to the partnership between the Crown and Maori as the motivation for its proposals. This is ambiguous and debateable. On the one hand, Chen and Palmer report that:

At this point in time, it has been firmly established ... that the Treaty is a partnership and that the Crown is responsible for that partnership.<sup>64</sup>

However, Sir Douglas Graham has explained why this is an inappropriate description of the relationship between the Crown and Maori:

In many cases today both in the courts and at the Tribunal there is reference to the "Treaty partnership" and to "Treaty partners". It is commonly known that parties in any partnership owe a duty to act with utmost good faith to the other, and to consult fully on any future action which may affect the partnership. To describe the relationship between Maori and the Crown therefore as being *like* a partnership seems quite sensible and unobjectionable. But to say that it *is* a partnership raises a number of problems. The Crown is not in partnership with Maori in running the country and it would be totally unacceptable in my view if this concept were to be pursued. It implies some sort of joint management with veto rights vested in each party. That cannot be the case.

The problem of definition and description of the relationship has come about because Maori as the other party to the Treaty do not live separate from the Crown as if in another country. The Crown represents all New Zealanders living in this country including Maori. New Zealand is a democracy where the majority carries the day. Certainly the Crown has duties to Maori which are unique and not shared by other New Zealanders. But joint management there is not ... Maori ceded sovereignty in exchange for a concomitant guarantee of rights. The correct approach is to ensure that that guarantee is respected and that redress is available if it is not.<sup>65</sup>

12.6 There are no domestic or international precedents for the courts to describe the Crown's relationship with Maori as a partnership. The courts may at

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<sup>64</sup> Chen & Palmer (1999), 'Local Government and the Treaty of Waitangi', in Local Government New Zealand, *He Waka Taurua – Local Government and the Treaty of Waitangi*, Research Monograph Series, paper 8, Local Government New Zealand, Wellington, p 8.

some stage again take the opportunity to clarify their description of the Treaty of Waitangi.

- 12.7 Even if the view that the Crown is in partnership with Maori endures, it does not require or justify separate representation of Maori on councils. As Sir Douglas noted, "the majority carries the day" in a democracy. This fundamental democratic principle is incompatible with the proposition that

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<sup>65</sup> Graham, Douglas (1996), *Trick or Treaty?* Institute of Policy Studies, Wellington, pp 20-21.

Maori, or any other group, should be given preferential representation on councils. There should be one rule for all citizens. The dangers of the alternatives, namely tyranny of the majority or the minority, are apparent from the deplorable experiences of countries such as Fiji, Bosnia and South Africa.

12.8 There is a strong argument for moving away from, rather than toward, separate Maori representation in parliament. The Royal Commission on the Electoral System recommended the abolition of the Maori seats and that may ultimately come about, for instance if Maori accept that they are adequately represented and their needs are being met in other ways.<sup>66</sup> It is also instructive that Chen & Palmer did not identify separate representation for Maori among the six options that it examined.<sup>67</sup> The proposals breach principle (a) of the position statement which states (correctly) "Representative arrangements must be *fair to all persons*" (emphasis added).

12.9 The implications of the Treaty of Waitangi for local government are a significant policy issue that should be examined carefully. The brief discussion in the Consultation Document does not provide a sound basis for advancing any legislative proposals that go beyond arrangements that apply to other government agencies or in other areas, and does nothing to advance community understanding. Most importantly, as a significant constitutional issue, any proposal should be the subject of a referendum, otherwise it has the potential to be very divisive.

## 13 Non-resident ratepayer franchise

13.1 The Consultation Document proposes that the non-resident ratepayer franchise be abolished on the grounds that enrolled ratepayers account for a small and declining proportion of all ratepayers. The Consultation

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<sup>66</sup> Royal Commission on the Electoral System (1986), *Towards a Better Democracy: Report of the Royal Commission on the Electoral System*, Government Printer, Wellington, p 295.

<sup>67</sup> Chen & Palmer (1999), *op cit*.

Document suggests that the ratepayer franchise is difficult to justify on cost effectiveness grounds.

13.2 The Forum submits that the non-resident ratepayer franchise should be retained for the following reasons:

- There is a long established democratic principle that there should be no taxation without representation. This principle is aimed at providing some protection for the minority from the tyranny of the majority. The property owned by non-residents is subject to rates and thus such ratepayers should be entitled to vote, if they so wish. (The situation might be different if councils were not funded primarily by rates.) What is more, present funding arrangements include discriminatory taxes such as universal charges and differential rates that may bear no relation to the level of public goods provided to the ratepayer or a particular class of ratepayers. This is a further ground for allowing all ratepayers to vote since it may be possible for councils to impose, directly or indirectly, discriminatory taxes on non-resident property if such ratepayers are disenfranchised.

As no person can exercise two votes, the proposal would disenfranchise incorporated businesses. Such businesses pay a substantial proportion of local authority rates.

- The fact that most non-resident electors have not exercised their right to enrol and vote is not a sufficient reason to withdraw the franchise. It would be regarded as highly undemocratic if residents were denied the right to vote in future on the grounds that they had not voted in the past couple of elections. Given the low turnout in local body elections many residents would be disenfranchised by such a rule (other things being equal). The right to vote should an issue of sufficient importance to the ratepayer arise is a democratic constraint on the behaviour of councillors (albeit a limited one) whether it is exercised or not. There are few constitutional checks on the powers of local government and to weaken them further would be a step in the wrong direction.

- While non-resident property owners may account for a relatively small proportion of property owners and residents in many local authorities, that is not necessarily true for all authorities (for example the Thames-Coromandel District Council).

13.3 Rather than abolishing the ratepayer franchise, it should be retained and councils should be required to make a reasonable effort to inform all ratepayers of their right to vote.

## 14 Governance

14.1 The governance model presented on page 24 of the Consultation Document puts councils at the centre. The model should start with citizens. An early concept of local democracy involved meetings of the whole community at which decisions were made. While this approach still has merit in very small communities, it is not feasible for most communities other than by way of referenda on major issues. The residents therefore elect representatives to act on their behalf. From an economic perspective councillors and board members can be viewed as the agents of the electors. Regular elections are an important means by which the wishes of the community are reflected in the policies of local authorities and elected representatives are held accountable.

14.2 Councillors and thus councils have two main roles – representation and governance. The latter involves appointing, monitoring and rewarding or sanctioning the chief executive, setting the strategic direction of the organisation, and providing high level advice and support. While the Consultation Document notes the representation and governance roles of councils, its discussion implies an involvement of councils in operational activities (for example the choice of interventions and the selection of goods and services to be purchased).

14.3 The Consultation Document may well reflect the role presently performed by many councils but it does not reflect their proper role. The failure to adequately differentiate between the roles that councils should perform



and those that should be undertaken by the chief executive (and his or her staff) is one of the key weaknesses in council operations.

- 14.4 Compared to most company boards, many councils adopt an excessively hands-on approach to management. The mayor of one large city personally approves leave without pay applications from relatively junior staff despite a clear statutory provision (section 119B) that makes the chief executive the employer of all other staff. (Councils employ the chief executive.)
- 14.5 The Consultation Document notes that the Act does not explicitly define the role of councils. It then suggests that the same approach should be taken in the new Act "because it is generally not possible to legislate for 'good governance practice' ". The present role of councils is defined to some extent implicitly in that certain roles are explicitly conferred on the chief executive (see sections 119B to 119D). A more explicit description of the roles of councils may help.
- 14.6 As noted in *Refocusing the Role of Local Government*, another approach would be to focus on the incentives that operate on councillors. For many elected councillors, meeting allowances are a significant element of their remuneration. Such allowances encourage councils to maintain too many committees, to hold an excessive number of meetings, to engage in operational matters rather than strategic issues and to expand council activities. It would be more efficient to pay members a flat fee, related to the level of work involved, as is generally the case with company directors.
- 14.7 Provided that councillors are paid on a flat fee basis, councils should generally be permitted to establish structures for decision making as proposed in the Consultation Document at page 27. Councils should not, however, be able to establish entities with members directly elected to them by residents. This would confuse lines of accountability. Moreover, the need for committees, workshops and advisory groups appointed by the council would be much reduced if councils are restricted to public good

activities and if operational matters, including the provision of advice, are undertaken by the council's executive.

- 14.8 We do not see why it is necessary to legislate for a performance management system in a new act that is intended to avoid undue prescription. Surely such a system is incidental to the chief executive's existing roles of ensuring the proper performance of functions, duties and powers of councils and employing staff.
- 14.9 Section 119C allows the appointment of a group of chief executives, one of whom is nominated as the principal officer. The Consultation Document proposes that this provision be dropped. We support that proposal.
- 14.10 We also agree that chief executives should continue to be appointed on fixed term contracts. The present requirement to advertise the position at the end of the term (up to five years) is too restrictive. If a council is satisfied with the performance of its chief executive and is unlikely to appoint another candidate, unnecessary cost is incurred in seeking applications and applicants are unfairly enticed to enter a contest that has effectively been pre-determined. It would be more efficient to allow councils the option of not advertising the chief executive's position at the end of the first five year term if the council is satisfied on reasonable grounds that its chief executive has performed well and it is unlikely to find a better candidate. This approach would mirror that which applies in respect of departmental chief executives in the public service.
- 14.11 As noted in *Refocusing the Role of Local Government*, the review of council activities by central government is limited and relatively poorly resourced. Consideration should be given to strengthening the external monitoring of councils, perhaps by establishing an independent agency similar to the Education Review Office. The agency would review the efficiency of council operations and report to ratepayers, parliament and the council on its findings. This would increase the incentive for councillors to undertake effectively their governance role, inform voters on the performance of their council and generally raise the efficiency of the local government sector.

## 15 Planning, consultation and reporting

15.1 The Consultation Document proposes that councils be required to prepare long-term plans. To a large extent this continues the policy that applies now. The proposed plan will, however, include reporting on the regulatory activities of councils, which are often omitted or treated superficially in present long-term and annual plans. This is a desirable suggestion. There are, however, some points that we do not support. They are noted below:

- Although it is not entirely clear, it appears that long-term council plans are not to be confined to the activities of the council (and its agencies) but are also to include activities for which the council has no direct responsibility. The "new plan would include the identification of desired community outcomes, the role of the council in achieving those outcomes through its services, activities and policies, *and through partnerships with other bodies and organisations*" (emphasis added). Further, "The importance of such partnerships has already been recognised in the government's approach to regional development and it is anticipated that council long term plans will link to regional strategies."

There is a vast difference between a council plan which reports to electors on the council's long-term objectives, policies and finances and one that attempts to provide a plan for economic, social, cultural and environmental matters for the territory or region. This broader scope is implied by the loose use of the word partnership in the document and the ambiguity of the drafting. Local government is said to work in partnership with all major groups.

A plan that reports to citizens on its intended activities is entirely appropriate for a council. However, a plan that includes the long-term objectives and activities that are to be undertaken by private firms, voluntary groups and individuals is inconsistent with a liberal democracy where the government's role is to establish the

institutional framework, fund and/or provide public goods and then give its citizens as much opportunity and freedom of choice as possible. It reflects central planning of the type adopted in socialist countries. No government, no organisation and no individual can possibly have the information necessary to prepare a central plan that has any credibility. The failed attempts to set targets for economic growth at the national level illustrate the problem. The information that is required is widely dispersed. Moreover, accountability principles require a clear focus on those actions for which councillors can and should be held accountable – not the private activities of other people and firms.

We therefore submit that the long-term plan should focus solely on those activities that are the responsibility of councils and their agencies (eg LATEs). Unlike the present plans this should require the presentation of financial projections on a consolidated basis rather than for the council without its LATEs. We would oppose strongly any suggestion that the present long-term plans by councils be replaced by broader plans that stray beyond the responsibilities of councils.

- The purpose of long-term plans should have nothing to do with the development of partnership relationships. This idea reflects fuzzy thinking. Long-term plans should encourage councils to adopt a medium-term approach to their activities, to ensure that their plans are consistent over time and that they are realistic. From the perspective of citizens, long-term plans are an important accountability tool. The plan can be tested against public input, and councillors can be held accountable at the polls for the quality of their plans and their ability to achieve them.

15.2 The Consultation Document proposes that "a more focused approach" be taken to the annual plan as this will reduce compliance costs incurred by "councils who can end up reviewing all policies and services each year" (*sic*). Very few councils have undertaken anything approaching a searching

examination of their activities, let alone on an annual basis. The overwhelming record since the financial management provisions were introduced in 1996 has been a continuation of business as usual with very few changes in the classes of services provided, privatisation of commercial activities, the establishment of LATEs, contracting out, or the method of funding, except where councils have been compelled to make changes. Rates payable by households have also increased at almost twice the rate of other consumer prices. They increased by over 36% between the June quarters of 1991 and 2001 whereas the all groups CPI increased by 19% in the same period.<sup>68</sup> Furthermore, the quality of information produced in annual plans has, in some cases, deteriorated over the last few years.

15.3 The proposed extension of long-term council plans is not a sufficient reason to weaken annual plans as proposed. Major businesses routinely prepare detailed annual plans even though they have long-term plans as well. Annual plans are the only documents presented to ratepayers that contain detailed financial information on the programmes of councils. They are the key documents for establishing benchmarks against which council performance is monitored. Three yearly long-term plans are no substitute. Moreover, ratepayers can expect greater certainty about council plans over one year than over three years.

15.4 The present planning process can be improved in several ways:

- Councils should be restricted to their proper role of funding and, where justified, providing public goods and services and valid regulatory activities. This would improve efficiency generally, simplify council operations, free councillors to focus on issues that are of vital importance to their local communities, improve the transparency of council operations and enhance the monitoring of councils by ratepayers and citizens.
- The planning process would also be improved if councils were required to engage in principled analysis and discussion on their

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<sup>68</sup> Information supplied by Statistics New Zealand.

objectives and policies in line with the principles for consultation outlined above. Some groups have concluded that councils essentially adopt a pre-determined position in their draft plans and have been discouraged from participation. Constructive comment is often met by silence or the reiteration of low quality arguments from the plan. Wellington City Council (and many other councils) asserted for several years that the ability of firms to claim an input tax deduction for GST paid on rates and an income tax deduction for rates provided a benefit to firms that justified higher rates on businesses than on residential ratepayers. This argument was advanced despite a detailed examination that showed that the Council's position was based on a faulty analysis. It was not until the Inland Revenue Department, Audit New Zealand and private tax advisers all informed the Council that its position was mistaken and the Council was threatened with legal action that it began to change its policy. However, the process took several years instead of a month or two.

- Financial projections contained in annual plans should relate to the council alone and to the council and its LATEs and other entities in which it holds a significant interest. A consolidated approach is required to evaluate financial performance when council-owned entities undertake operations on behalf of councils (eg Metro Water Limited in Auckland City). Annual accounts are prepared on a consolidated basis whereas annual plans are not. This mismatch should be addressed by requiring consolidated accounts in both cases.
- Plans (and comparable documents) can be made available in an electronic form, in addition to a printed version, to reduce the cost of printing and distribution.

15.5 We believe that detailed information on consultative documents should be available for those groups that wish to investigate council operations and performance in some depth. Other citizens can free ride on their analysis

and commentary. It is also appropriate to provide citizens with information that is summarised and user-friendlier. These should be complementary approaches and not alternatives. Councils such as the Auckland City Council and the Auckland Regional Council do this now.

- 15.6 One example of user-friendly information that should be provided to every ratepayer with their rate demands is information on the allocation of the average dollar of rates among each main activity undertaken by councils. This would tell ratepayers what they are paying for through their rates. Some councils do this now.
- 15.7 The question also arises whether there ought to be a formal process that enables citizens to seek corrections to key consultative documents that are grossly inaccurate or omit certain facts that could be expected to have a significant bearing on the views of citizens. The Office of the Controller and Auditor-General and the Department of Internal Affairs will usually investigate a complaint that a council has not complied with a statutory provision. Auckland City Council omitted significant information from its draft annual plan in 1996/97. The Office of the Controller and Auditor-General and the Department of Internal Affairs upheld a complaint by the New Zealand Business Roundtable that the draft plan did not comply with section 223D of the Act. Steps were taken to rectify the omission in the final plan that was adopted.
- 15.8 In its recent consultations Auckland City Council sought expressions of opinion on whether money should be set aside for the development of an arena. The draft plan and the user-friendly information provided to citizens stated that the Hillary Commission supported the proposed site. It did not tell citizens that that advice did not take account of the cost of alternative sites. Nor did the Council tell citizens that a cost benefit study that it had commissioned showed that the project would be grossly uneconomic. One option would be for the Office of the Controller and Auditor-General to intervene where a valid complaint is made that information provided in a consultative process is found to be grossly inaccurate or misleading because of the omission of information or

misstatement of it. The appropriate action in such cases would be to require publication of a correction.

- 15.9 The Consultation Document proposes that the special consultative procedure should be changed to remove the right of submitters to be heard by councils in open meeting. Instead councils would acknowledge submissions and, following consideration of submissions, provide a response setting out the reasons for council decisions. The present process involves a substantial commitment of council time and often leads to repetition of information contained in submissions. On the other hand, citizens should have the right to make submissions to their elected representatives and be given an opportunity to respond to any questions that councillors may wish to ask. On balance, we think that the automatic right to be heard should be replaced with a discretionary right that would enable councillors to hear selected submitters, if they wished.
- 15.10 The proposals relating to service choice are unlikely to advance efficiency. The issue of what constitutes "significant changes to service delivery" is not defined. If it is narrowly defined, as seems to be the intent, it has the potential to impede most changes in council operations that are not approved in long-term or annual plans. This would be inefficient and probably impractical. Suppose, for example, that the government announces a policy to fund the provision of pensioner housing through councils with all costs borne by the government. For those councils (most) that do not provide pensioner housing, this would be a significant new policy. Under the proposal they would need to go through the special consultative process or defer participation until an annual or long-term plan is adopted.
- 15.11 The proposed approach seems more like direct democracy rather than the delegation of decision making to councils within a broad accountability framework. It is a good example of the inherent conflict in the Consultation Document between the idea of conferring a power of general competence on councils and providing flexibility on the one hand, and instituting new rules that limit the freedom of councils to take appropriate



decisions on the other. We think the proposal is unnecessary. Councils should be free to undertake enumerated activities and incidental activities. They should generally be required to prepare annual plans and long-term plans and otherwise be free to take decisions that are lawful.

15.12 Councils should be required to privatise their private good businesses and be prohibited from owning such businesses in the future. There are no valid grounds for councils owning such businesses. Elected public bodies are likely to be relatively inefficient owners for the reasons given below:

- Public enterprises often enjoy competitive advantages. They may, for example, use public funds to subsidise their activities and competition may be impeded or prohibited in other ways. The absence of competition leads to higher costs, slow innovation and an inadequate focus on the needs of the customer.
- Public enterprises benefit from an implicit guarantee which reduces the sanctions associated with the threat of commercial failure and discourages monitoring by financial market participants.
- Public sector managers may be protected from the transfer of ownership (for example, takeover) which impairs performance.
- Directors who do not have an ownership interest in the business manage public enterprises whereas directors with such an interest generally manage private firms.
- Politicians may interfere with commercial decisions of public enterprises resulting in inappropriate prices, over-staffing, excessive non-staff input costs, under-capitalisation and inappropriate plant location and size.

There is substantial research that shows that governments are on average and over time inefficient owners of commercial businesses.<sup>69</sup>

- 15.13 The remaining issue concerns council-owned or controlled entities that undertake public good activities and operate on a not-for-profit basis. In our view such entities should be fully consolidated with the council's own operations and included in annual and long-term plans, and be subject to the Local Government Official Information and Meetings Act and similar legislation.

## 16 Financial management

- 16.1 Although the financial management provisions adopted in 1996 have led to improvements, the Forum does not agree with the view reported in the Consultation Document that they are generally working well. The financial management provisions reflect compromises that followed from an unsatisfactory debate on the initial proposals. While the adopted provisions gave some recognition of the principles of economic efficiency and transparency, the practical outcome to date has been disappointing. It was hoped that the provisions would induce local authorities to focus on their core business, to raise the efficiency of their operations and to adopt more appropriate funding arrangements.
- 16.2 Too many councils have, however, sought to justify their existing activities and funding policies in terms of the legislation instead of conducting a first principles examination of activities and funding arrangements. Councils in the main centres and some district councils appear to have little appreciation of the boundaries between their proper role and those of individuals, firms and voluntary groups. Some have demonstrated a dismaying lack of understanding of the principle of economic efficiency.
- 16.3 Very few councils have prepared cost benefit studies where required to do so by section 122C(1)(c). In some cases where cost benefit studies have

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<sup>69</sup> Megginson, William L and Netter, Jeffrey M (2001), 'From State to Market: A Survey of Empirical Studies on Privatisation', *Journal of Economic Literature*, vol XXXIX, no 2, pp 321-

been prepared, they do not appear to have informed the relevant council's decision making process or public consultations. Two examples are the Britomart and arena projects in Auckland City. Another example is the Western Bay of Plenty's 1996 roading cost benefit study.

- 16.4 The imposition of clear statutory limits on the activities that councils may engage in, the adoption of economic efficiency as the main criterion and closer monitoring of compliance with statutory provisions by the Office of the Controller and Auditor-General would help to overcome these weaknesses.
- 16.5 Local authorities are required to provide for depreciation in preparing their forecast and actual operating and financial position statements in their annual plans and annual accounts. They are required to do so because such statements must be prepared in terms of GAAP (sections 223D(4) and 223E(3)). There are also specific requirements relating to depreciation in the financial management provisions of Act (part VIIA). Local authorities should continue to make full provision for depreciation in preparing their financial statements. This is necessary to better measure the cost of services provided and to record assets on an appropriate basis.
- 16.6 The question of whether depreciation or any other operating expenses are funded from operating revenues should be dealt with simply in terms of whether councils are permitted to plan for an operating deficit. There are no compelling grounds to treat depreciation differently from other categories of expenses. Arguments for doing so are a hangover from cash accounting and are inconsistent with accrual accounting.
- 16.7 The intent of the provisions relating to depreciation contained in section 122J is appropriate but there is confusion in the legislation between the proper measurement of expenditure and the valuation of assets on the one hand and funding provisions on the other that should be clarified.

## **17 Funding decisions**

### **17.1 The proposed process**

17.1.1 The Consultation Document states that concerns have been raised that the process for making funding decisions "is too reliant on technical economic analysis and it pushes councils to consider user pays and asset sales as the default option for funding services."<sup>70</sup> The Consultation Document implicitly accepts this criticism and then adds "The current process for making decisions does not appear to support the proposed purpose of local government to promote social, economic, cultural and environmental well-being." A new process is then suggested.

17.1.2 There is no evidence to support the assertion that the present process is too reliant on technical economic analysis. While it requires councils to follow a process of analysis and decision making, it provides considerable scope for councils to make their final funding decisions on grounds other than economic ones (see sections 122D, 122G and, in particular, 122I). There is no evidence of a large shift to user pays or asset sales. In our experience councils have resisted such suggestions despite the force of economic argument in their favour. Moreover, council decisions will be safe from legal challenge unless they fail to follow the process required by the Act, make decisions that no local authority could reasonably so decide or act other than in good faith. The Forum believes that the courts apply an excessively high threshold in examining whether council decisions are unreasonable.

17.1.3 The Consultation Document suggests a new process. Step 1 focuses on the reason for the service. There is no change of substance at this step. Step 2 focuses on who benefits. The present Act requires the costs of services to be allocated according to one or more of the funding principles listed in section 122F of which the benefit principle is one. The benefit principle is an equity rather than an efficiency principle. It has limited relevance to

genuine public goods. If the beneficiaries of particular policies can be identified, user charges may well be feasible.

- 17.1.4 The third step in the proposed procedure asks how the service should be funded. The options suggested are general rates, targeted rates, fees and charges, or a mix of these funding tools. The next question to be asked is how the selected funding tool affects demand for the service and the efficiency of collection. These are narrow efficiency considerations. They do not, for example, focus on the deadweight costs of rates or why the cost

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<sup>70</sup> The Consultation Document notes elsewhere that the financial management provisions of the Act, "while still relatively new, have been recognised as having significantly enhanced the quality of local government financial management and decision-making."

of services should not be charged to those who demand services. The next issue posed in step 3 simply says "allow for costs imposed by others". It is unclear what this means. The final question in step 3 asks whether any other finance such as borrowing or asset sales is required or desirable.

17.1.5 Step 4 involves the taking of an interim decision on the funding of goods and services and ensuring consistency with the law and the long-term plan. Consultation takes place in step 6 and then final decisions are taken. This requires prices and rates to be set. The last step in the process involves the inclusion of reports in the annual plan and annual report on significant variations between the annual report and long-term plan.

17.1.6 The process outlined is very similar to the present one.<sup>71</sup> However, it is less transparent and it places more emphasis on the benefit principle. It is unclear whether the present principles are to be kept, consistent with the statement that existing financial management provisions are to be retained, or are to be dropped.

17.1.7 The fundamental problem is that many council decisions under the present Act and the current proposals do not give sufficient attention to the proper principles that should apply in funding council spending. The funding principles and process need to be brought into conformity with a contemporary public policy approach to user charges and taxes, and the legislation needs to be simplified. The former point is elaborated below.

## 17.2 The principles

17.2.1 The problem is that discriminatory taxes may be applied in circumstances where a user charge for services supplied or a uniform rate of tax on all ratepayers may be more efficient. A key concern is that a majority of ratepayers may succeed in imposing the costs of goods and services that they demand on a group that is poorly represented in the political process. Unless the correct principles are reflected in the new legislation,

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<sup>71</sup> See McKinlay (1998), *op cit*, p 34.

understood by councils and carefully applied, considerable inefficiency and inequity could arise.<sup>72</sup>

- 17.2.2 Greater clarity is required in distinguishing among a user charge that constitutes an appropriate price for services supplied, a justified tax on a subset of a local authority's ratepayers to fund local public goods that clearly benefit them, a discriminatory tax on ratepayers, an appropriate tax to fund public goods that benefit all residents and justified charges designed to internalise external costs imposed on people or firms other than developers.
- 17.2.3 The Forum addressed these matters in its 1998 submission on the *A Future Direction for Local Government Funding Powers* but it is apparent from the superficial discussion contained in the present Consultation Document that little notice has been taken of the submission.<sup>73</sup> A principled approach to this issue is vital to the efficiency of local government. We therefore spell out the principles that should apply not just to financial contributions but more generally. We submit that the taxing and charging provisions of the new act should reflect the principles noted below and the financial management provisions should be brought into conformity with them.
- 17.2.4 The efficiency of a user charge depends on whether it is the best way of encouraging the production of a socially optimal amount of the underlying good (or service).<sup>74</sup> As defined, a user fee is a price that might either aim to recover the user-induced marginal cost of supply or correct a market failure. The former aspect is of prime importance to the funding of council outputs while the latter may arise in relation to certain resource management issues.<sup>75</sup>

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<sup>72</sup> The constitutional importance of properly distinguishing between valid fees for service and taxes is discussed in Legislative Advisory Committee (2001), *op cit*, pp 55-59.

<sup>73</sup> Ryall, Tony (1998), *A Future Direction for Local Government Funding Powers: A Consultation Document*, Department of Internal Affairs, Wellington.

<sup>74</sup> Gillette, Clayton and Hopkins, Thomas (1987), 'Federal User Fees: A Legal and Economic Analysis', *Boston University Law Review*, vol 67, pp 795-874.

<sup>75</sup> There are few examples of situations where councils impose taxes or charge fees on market failure grounds, such as where external costs arise.

17.2.5 The *MIT Dictionary of Modern Economics* explains that the price of a good signals what has to be given up in order to obtain the good.<sup>76</sup> From the point of view of society it is the good's opportunity cost. Charges that track the marginal cost of supply force fee-paying users to consider at the margin whether the benefit they hope to derive from the good is commensurate

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<sup>76</sup> Pearce, David W (ed) (1992), *MIT Dictionary of Modern Economics*, MIT Press, Cambridge, p 340.



with its cost of supply. *As long as potential purchasers can avoid the charge by going without*, the user charge deters a welfare-reducing supply if the prospective purchaser deems the benefit from the good to be less than its cost of supply. In this environment, user fees are a price and can be interpreted as reflecting a balance between marginal benefit and marginal cost.

17.2.6 Fundamental to this case that user charges improve efficiency are the assumptions that:

- the commodity being sold is a private good;
- the good is purchased voluntarily;
- competition creates pressures to supply the good at minimum cost;
- the price reflects the marginal benefit of the good to the purchaser and to society; and
- the price reflects the opportunity cost of supplying the good – eg social marginal cost.

17.2.7 User charges have a useful potential role to play where a government agency provides private goods. As a matter of best practice, private goods should be supplied privately and competitively. Thus where user charges are appropriate, the related activity should be privatised. If a government agency supplies private goods, it should be exposed to competition from private providers and, to the greatest feasible extent, to full commercial disciplines in respect of pricing, cost control and cost recovery. There is no case for making the purchase of private goods mandatory.

17.2.8 A public good is the polar opposite of a private good. As noted above, with the strictest form of a public good, it is not feasible to charge people who benefit from its provision because it is too costly to exclude those who benefit but do not pay. Moreover, once a public good is made available, a new consumer can benefit without imposing additional costs on existing

consumers. Virtually by definition, the funding of a publicly provided public good is a tax rather than a pricing issue.

- 17.2.9 Local public goods benefit a subset of a population. Hence it may be efficient to fund these goods from local taxation, with affected residents using a collective process to determine the amount of spending and therefore of the tax. As long as people who expect to benefit from local public goods pay the tax, this process may provide a better match between benefits and costs than other feasible arrangements. However, this proposition must be assessed on a case-by-case basis because local public goods can often be efficiently provided privately, as the fact that supermarkets provide car parks illustrates.
- 17.2.10 Most benefits from certain local public goods may clearly accrue to a particular subset of a local authority's ratepayers. Flood control or farm-related pest control may be examples. It is desirable to confront people who want a local authority to supply such goods with the costs of supply by requiring them to pay according to the benefit received.
- 17.2.11 However, a council may also use targeted taxation to force a minority group to pay for benefits enjoyed by other people. Certain local authorities have revealed their preference to tax businesses (including farmers) out of all proportion to the benefits that they derive. There is little ground for believing that they would use any power to tax on a discriminatory basis in a disciplined manner. Many would instead apply such powers to benefit politically influential groups while using the lack of transparency concerning the distribution of benefits to deny that this is the case.
- 17.2.12 Writing in the context of the United States, Gillette and Hopkins usefully distinguish between a user charge and a tax in the following terms:

A user fee is a price charged by a governmental agency for a service or product whose distribution it controls. A user fee is, at least in theory, a benefit-based source of revenue whose logic is simple. Payment of a user fee reflects receipt of a valued service. By contrast, federal income taxation is generally not benefit-based: rather, it

imposes burdens that reflect complex Congressional judgments about, among other things, a taxpayer's ability to pay.<sup>77</sup>

- 17.2.13 In similar vein, a NZIER report for the Ministry of Agriculture and Fisheries on cost recovery issues defined a tax as:

... compulsory unrequited payments to government – unrequited meaning that the payments are not normally in proportion to benefits.<sup>78</sup>

Based on such definitions, taxes are associated with compulsion and the inability to relate the size of the impost to the magnitude of the benefit received by the taxpayer.<sup>79</sup> Conversely, user fees are related to the value derived by the payer, or the cost of supply, where the payer is the beneficiary and can choose whether to 'buy' and so incur the charge. (Part charges apply where only part of the benefit accrues to the payers.)

- 17.2.14 Club goods are an intermediate case. Unlike the case of a public good, with a club good people who do not pay for access to the club's facilities can be excluded. The use of public roads by motorists is a case in point. However, as long as there is excess capacity, a club good may share the public good characteristic that the use of its facilities by any one member does not detract from the ability of any other member simultaneously to enjoy those facilities. Uncongested golf courses and cinemas are further examples of club goods.

- 17.2.15 The public provision of a club good permits, again by definition, the possibility of charging people who wish to benefit from the service. Clubs do not use coercion to fund their activities. Membership is voluntary. Credit Suisse First Boston argued that it is desirable to charge those using such services directly:

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<sup>77</sup> Gillette, and Hopkins (1987), *op cit*.

<sup>78</sup> Clarke, Mary with assistance from Gale, Stephen (1998), *Cost Recovery of Passenger & Craft Border Clearance Services: An Economic Analysis of Funding Options*, Report to the Ministry of Agriculture and Forestry, NZIER, Wellington.

<sup>79</sup> Middlemass, E M (1991), *Government Charges: A Study of Charging for Goods and Services in the New Zealand Public Service*, pp 1-68, cites, at paragraph 5.2, a 1985 judgment by the High Court of Australia to similar effect.

... since the annual access or membership charge is part of the test that members are prepared to fund the total cost of the activity.<sup>80</sup>

The case for charging members of any group or club the opportunity cost of the facilities provided is stronger the greater their ability to determine the level of service and the amount of the charge.

- 17.2.16 Road-user charges, petrol taxes and motor vehicle licence fees currently more than fully fund the cash expenditures of the suppliers of road infrastructure services. It is not compulsory to buy a vehicle that is subject to petrol tax or road-user charges. There is therefore a valid efficiency argument for confronting such road users with charges that reflect use-related costs of supply. (These include the costs of increasing future capacity and justifiable maintenance of existing roads.) However, as the experience with petrol tax in particular indicates, the actual charges imposed when there is a statutory monopoly may have a general revenue element. Optimal tax issues can arise even when purchase is not mandatory.
- 17.2.17 The discussion to this point has distinguished starkly between private, public and club goods. It has pointed to the firm conclusion that a case for coercive funding only arises in the case of public goods where private provision is inefficient. However, some commodities have a mixture of these characteristics. For example, schooling is a private good, but it is sometimes argued that education, particularly at the primary level, produces spill-over effects that benefit a wider community. Conversely, pollution may generate negative spill-overs. In a local authority context, debates about who benefits from improvements to the main street may invoke spill-over issues.
- 17.2.18 Spill-over effects in a private good context arise from what economists call externalities. Economists recognise different types of externalities and have

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<sup>80</sup> Credit Suisse First Boston (1998), *Regulation of the Food and Beverage Industry*, New Zealand Business Roundtable and New Zealand Food and Beverage Exporters' Council, Wellington.

determined that many do not justify government action. For example, it is not desirable for governments to protect unsuccessful businesses from the spill-over effect reflected in the loss of market share to a competitor. Many externalities that take the form of private nuisances can be addressed adequately by common law.

- 17.2.19 Where government action is warranted on account of an externality, it might take the form of regulation, corrective taxes or subsidies. The Resource Management Act reflects a regulatory approach. Co-funding is one conventional form of subsidy. Examples may include the co-funding of private schooling and stadiums. A virtue of co-funding compared with full funding from general revenue is that it encourages the people who benefit to reveal their true preferences. However, all subsidies and taxes are open to abuse through political processes. Safeguards are important.
- 17.2.20 On the supply side, the relationship between user fees and marginal cost may be especially problematic when the supplier is a statutory monopoly. Charges could be too low where users exercise undue political influence over the fee-setting process. Conversely, charges could be too high in any one of three distinct cases. First, a profit-maximising statutory monopoly might set price to equal marginal revenue, not marginal cost. Second, a statutory monopoly or regulated industry (whether or not government-owned) may operate in a cost-plus manner, so that user-fees are too high because costs are excessive. Third, the government may set user charges above the costs of supply for general revenue purposes – as appears to be the case in respect of the petrol tax.
- 17.2.21 The foregoing comments relate to the funding of local government-provided goods and services by the users of those services through a combination of user charges and taxation. Local authorities may also need to fund expenditure that arises from nuisances such as an overflow of the stormwater system caused by the discharge of industrial waste into it. The clean-up will often benefit ratepayers that are harmed rather than the firm that caused the nuisance. The policing of local authority rules and other options to enforce property rights is a crucial obligation of good

government. All residents benefit from well-enforced property rights and none can be excluded from these benefits. The incentive to comply with local authority rules arises from appropriate fines and the risk of detection of offences. The costs of policing nuisances should therefore be funded from fines with any balance funded from general revenue.

17.2.22 The application of the benefit principle has led to inappropriate funding arrangements and may lead to the introduction of inefficient funding tools. The idea that those who benefit from council services should bear the related cost has much to commend it in terms of efficiency. However, it should not be pushed too far since there is often no objective basis for determining who is, in fact, the ultimate beneficiary of services provided by a council. Just as the seller of a book or magazine does not know how many people will read and benefit from it, a council does not know who ultimately benefits from its activities. It may be one or more of the landlord, the tenant, the employee, the proprietor, the customer, the motorist or a visitor, or even the person who sold a property to the current owner at a price which reflected the net benefit of council-provided services.

17.2.23 There is a further problem in that the benefit and efficiency principles may conflict in some situations. Where marginal costs are below average costs, efficiency requires use-related charges to be limited to marginal costs, as long as total costs can also be funded efficiently. The benefit principle might imply higher user charges. If the perceived beneficiaries cannot influence the level of output produced or the cost of supply, efficiency considerations may not support levying that group. The activity should be funded by efficient taxes.

17.2.24 The discussion can be summarised as follows:

- There are grave risks that local authorities will impose inefficient taxes and misprice services. Monopoly prices are one source of such inefficiency.

- Where user charges are appropriate in terms of the principles outlined in paragraph 17.2.6, the relevant activity is a private good that should be privatised. In this case privatisation should be required and user chargers should not be permitted.
- Local public goods should be funded by efficient taxes. Sound principles, including the principle of no taxation without representation, should apply and there should be safeguards against predatory taxation.
- The consent of members should drive charging structures and levels for club goods. In the case of roads, for example, there could be some element of general tax funding to cover the public good element (footpaths in the central business district and, more generally, facilities for pedestrians and perhaps cyclists). The balance should be funded by some combination of an access fee and a use-related charge.

### **17.3 Application of principles**

17.3.1 The proposed targeted funding tools risk becoming discriminatory taxes in the following circumstances:

- where the affected services are mandatory;
- where the link between the value of the service as perceived by identified beneficiaries and the amount of the charge is tenuous; and
- where the beneficiaries have little influence over the spending programme and the level of spending.

17.3.2 The critical question in such cases is whether the targeted funding tools would enable revenue to be raised at a lower economic cost than general rates. This is most unlikely to be the case for the following reasons:

- Broad-based taxes payable by the population that benefit from local public goods are generally considered to be more efficient than

selective taxes. The optimal tax literature suggests that tax should be levied on goods and services where the demand is relatively insensitive to small changes in price. This would permit a given amount of revenue to be raised with relatively little distortion to consumption and production patterns. However, the information required to identify such goods and services is not available to central or local government. For this and other reasons, there is support in the tax policy literature for uniform rates of tax. This is the key reason for the adoption of a uniform rate of GST.

- In contrast selective taxes payable by the population that benefits weaken the accountability of elected representatives. They enable excessive taxes to be imposed on minority groups that are less than proportionately represented in the political process. Differential rating is an example. Selective taxes can lead to higher spending than otherwise. Projects that would not proceed if they had to be financed from general rates may be implemented if they are funded from selective taxes.

17.3.3 Legislative authority to apply user charges where they are likely to be economically efficient should be conferred on local authorities. The legislation should, however, allow such charges to be imposed only when the following conditions apply:

- the affected goods or services are club goods or services; and
- users are protected against abuse arising from the dominant position of the supplier.

17.3.4 Councils should be permitted to charge the costs of public goods to identifiable sub-groups of ratepayers where there are compelling efficiency grounds to do so and where adequate safeguards for political minorities exist. The responsibility for demonstrating that such taxes are efficient should rest on the council.



- 17.3.5 The new legislation on pricing should be restrictive rather than permissive so that the risk of inappropriate and excessive charges is limited. This is consistent with the Forum's view that discriminatory taxes are generally undesirable. If necessary the present financial management provisions should be amended to remove any ambiguity between the efficiency approach advocated in this submission and the benefit principle.
- 17.3.6 The balance of a local authority's current spending should be funded from general rates (and miscellaneous revenue).

#### **17.4 Funding infrastructure**

- 17.4.1 The Consultation Document proposes two approaches relating to the funding of new infrastructure. Under the modified *status quo* option the existing provision for financial contributions (which may include the provision of land) under the Resource Management Act, supplemented by user fees and charges under the new act, would apply. An alternative option would provide a new specific funding power to enable councils to charge developers for the costs (presumably the capital costs) associated with infrastructure. There is no suggestion that affected property owners would thereafter pay lower user charges.
- 17.4.2 The issue needs to be resolved in accordance with the principles outlined above. The particular classes of infrastructure and other grounds for taxes or fees need to be examined separately. Compulsory contributions of land without just compensation are an unwarranted taking that should not be permitted. Environmental externalities (if any) should be examined properly as most do not warrant government action. If action is justified then the issue of the choice of instrument arises. Public goods should be funded according to the principles outlined while the provision of private goods would justify user charges.

### **PART III CONCLUSION**

## 18 Conclusion

18.1 The Forum's main conclusions are noted below:

- The local government sector is large and its effects are pervasive. It is vital that the sector makes the largest possible contribution to the overall wellbeing of society.
- The local government sector is massively under-performing. The achievement of the ambitious goals for improving economic growth rates and social indicators set by the government will be impeded unless the performance of the sector is substantially improved.
- The institutional and policy framework within which local government operates is the primary influence on its performance. The overriding objective of the review should be to strengthen that framework.
- The concept of limited government is fundamental to the constitutional and legal principles that New Zealand was fortunate to inherit from Britain. An all-inclusive mandate for councils and a power of general competence are inconsistent with those principles.
- The activities that councils may engage in should be tightly circumscribed and enumerated. The deliberate specification of limited powers is a vital constraint on local government. It would prevent local government from expanding into activities that are not enumerated and thus help protect liberty and promote economic efficiency and growth.
- The best possible contribution that local government can make to the advancement of the overall wellbeing of the community and thus to the achievement of the government's broad goals is to undertake its protective and public good roles as efficiently as possible.
- Any role beyond those will impair overall welfare by reducing individual autonomy and choice and discouraging wealth creation

and other activities that are undertaken by individuals, private firms and voluntary organisations.

- The deficiencies of the Consultation Document should be addressed by appointing an expert group to review submissions and to develop detailed proposals for further consultation before a bill is introduced.
- The Forum expects full and genuine consultation at all further stages of the review, consistent with the prime minister's undertaking that the government would do more to listen to business concerns.

## **The Local Government Forum**

The Local Government Forum was established in 1994 to promote greater efficiency in the local government sector and to contribute to debate on policy issues affecting the sector.

The Forum comprises mainly business organisations that have a vital interest in the activities of local government. The following organisations are members of the Forum:

- Business New Zealand
- Federated Farmers of NZ (Inc.)
- New Zealand Business Roundtable
- New Zealand Forest Owners' Association Inc.
- Property Council of New Zealand Inc.
- Wellington Regional Chamber of Commerce

The Hon David Caygill is also a member of the Forum.