



[Reading Room: Local Government](#)

Liberalising the Regulation of Local Government Infrastructure

An Issues Paper

McKinlay Douglas Limited, New Zealand Institute of Economic Research, Brent Wheeler and Co, December 1996.

This document provides a summary of a study for the New Zealand Treasury on the regulation of local authority infrastructure produced jointly with the New Zealand Institute of Economic Research and Brent Wheeler and Co.

Summary

Local authorities are responsible for important parts of the country's infrastructure including water supply, wastewater and land drainage. They are also responsible for many roads and have key roles in public transport and parking. These industries are large, local authority water supply and sewerage systems involving capital costs of \$6 billion and annual expenditure of \$600 million. Their scale is roughly comparable with the telecom or electricity distribution networks.

Providing the right amount of infrastructure of the right quality and in the right place is important. It is a base for economic growth and jobs, and it is frequently crucial to health and social well-being.

The Clyde dam is an example of too much expenditure on infrastructure and in the wrong location. On the other hand, Auckland currently faces road congestion, water, and stormwater problems. These suggest that it has inadequate infrastructure. The wrong kind of investment could however lead to further congestion, or capacity being installed in the wrong place.

This report looks at ways of expanding the options available for dealing with these issues so that the right kind of infrastructure is built where and when it is needed.

The current legislation contains a raft of constraints that limit the ways local authorities can ensure the provision of the appropriate infrastructure for their communities.

There are also constraints on provision by entities other than local

authorities. These exist because much of the legislation governing the activities assumes local authorities will own, provide and regulate the industries.

The report indicates that (on a conservative estimate) removal of these constraints could produce efficiency gains in the areas of roads, parking, water, sewage and stormwater of the order of \$100 million per year. This would enable substantial improvements in economic growth, environmental conditions and employment.

Constraints

Local authorities' charging is limited by the legislation and the way it is interpreted, councils often lack the powers to price these functions efficiently.

Local authorities enjoy powers to operate utilities not available to private entities, and unlike private companies they can organise customer relationships through regulation and the use of rates and compulsory charges. They are, however, subject to legal rules not applied to private entities.

Local authorities have a number of important public good roles such as protecting public health. These powers see them regulating their own activities as well as those of potential competitors. Such conflicts of interest are never easy to manage and may lead to inefficient or ineffective outcomes.

The law does not encourage individuals to create the long term rights that would allow landowners to arrange for infrastructure between themselves. The legislation governing individual utilities can further restrict the creation of non standard bundles of rights and allow local authority policies to override private arrangements. The kinds of service which local authorities can offer are often closely defined in the legislation preventing them from offering innovative types of service.

Another set of constraints concerns local authorities investment in infrastructure. Local authorities do not have to earn a return on the community capital they have invested in infrastructure. This results in understating the true costs of infrastructure services. This in turn can lead to over investment. It also favours local authority provision over investment by private entities which have to earn returns for their owners and factors spending on capital rather than labour.

There are also impediments to local authorities choosing the most efficient form of organisation for these activities. It can also be difficult to delegate, transfer or jointly exercise many statutory functions. Local authorities also have to comply with a range of procedures originally designed to protect the public from excessive use of taxing and compulsion powers. These procedures can be hard to integrate with effective commercial negotiations. They are inferior to the modern accountability regimes created for local government since 1989 and many of them are redundant.

Removing Constraints

It is possible to imagine removing many of these constraints. This

analysis does not require any mandated shift from current methods of ownership, provision, or funding. Rather it turns on the idea that removing the identified constraints will allow changes to occur as more efficient alternatives become apparent.

A low constraint regime can be constructed by:

- examining the rationale for current constraints,
- maintaining constraints only if the rationale remains relevant,
- selecting the most effective kind of constraint to meet the rationale,
- giving preference to a generic constraint rather than an activity or location specific constraint.

Generally this exercise results in a regime which allows access to legal powers by new entrants, and the separation of operation from regulation. It also provides for flexibility for local authorities in pricing, choosing corporate forms, finding appropriate scales for operations, and transferring ownership.

Priorities For Action

Some potentially large gains could be achieved from simple changes such as requiring local authorities to earn a return on capital or freeing up their pricing powers. These changes would pass the true cost of the service on to users and enable them to adjust their use of the service accordingly.

Removal of some of the other constraints (like the operational and regulatory powers that favour local authority provision) would be more complex. In many cases alternative statutory procedures would need to be constructed. Some cost would initially be incurred as local authorities move from regulation to contract based relationships.

To remove all the constraints identified, a new regulatory regime would have to be constructed that could appropriately deal with market power issues raised by private ownership of infrastructure. This study has assumed such a regime would roughly follow the models adopted for the electricity and gas industries. This involves low entry barriers, a level playing field for all providers, light handed regulation based around information disclosure, and last resort use of central government price control.

In some cases, the nature of individual infrastructure services may raise particular health and safety issues that require modification of a generic regime. For instance provisions to ensure the quality of water supplies might be necessary, analogous with the extensive provisions in the electricity industry to deal with safety issues.

The creation of such a new regulatory regime, involving consultation and the detailed design of an information disclosure regime, is likely to be a complex exercise.

Constraints in Infrastructure Legislation

This section describes many of the constraints found in the legislation and suggests ways of removing them.

Pricing

To provide infrastructure most efficiently local authorities must charge prices to individuals or groups of users that match the real costs that they impose on the systems.

The set of charging and pricing tools available to local authorities to achieve this match is incomplete. As a result local authorities cannot achieve as close a match between costs and charges as they should.

Local authorities clearly lack the power to charge most efficiently for some of their most important functions, for instance:

- they have no general powers to charge directly or indirectly for road use.
- some kinds of proxy charges for water and sewerage for use are available while others are not.

Proxy charging involves making a charge on something which approximates the demand users make on infrastructure.

An example of a permitted proxy is the 'pan tax' which allows local authorities to charge for sewerage according to the number of toilets in a property. Local authorities, however cannot charge for sewerage by the amount of water supplied to a property, even though it may be a good proxy for demand for sewerage since (in many cases) much of the water supplied finds its way into the sewerage system.

Another example in relation to sewerage concerns constraints on the pricing for treating trade-wastes in Auckland. These mean that businesses spend too much on pre-treating waste that would actually be beneficial to Watercare's Mangere treatment plant.

In other cases it is not clear exactly how the law allows local authorities to charge. For instance doubts have been expressed about the legality of a two step tariff for water which imposes a flat fee for consumption up to a fixed amount and creates a volume based charge for higher levels of consumption.

This occurs because much of the legislation defining charging powers (especially the Rating Powers Act 1988) has grown, ad hoc from a base in nineteenth century legislation.

The legal decisions reviewing local authority charges often struggle to extract meaning from the provisions they interpret. It is frequently difficult to decide what economic approach to pricing can validly fit within the statutory provisions.

A more efficient alternative would be to construct purposive provisions which allow a wide range of charging mechanisms (including proxy charges) to be used so long as they can be linked back to the efficient carrying out of the function the local authority is performing.

Low Constraint Approach

Give local authorities a broad discretion to set prices and charges.

Link that discretion to the purpose of activity and the efficient allocation of costs.

Some of that linkage could be provided by reference to the existing economic principles and accountability procedures under part VII a Local Government Act.

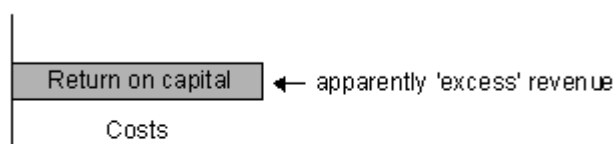
Cost of Capital

Local authorities are not required to earn a return on their communities' capital which is invested in infrastructure. Earning a return is not an unfair cost to the customer. It is the real cost of foregoing the income that could have been earned in using the capital in another way, such as putting it in the bank or paying off debt. In addition, most of the return on capital will be required for reinvestment in maintaining and upgrading the infrastructure. If this does not come from the users of the service, then it has to be added to general rates.

Failure to obtain a return on capital leads to a number of inefficiencies. It distorts choices between debt funding and 'equity' (in the sense of funding from ratepayers). To borrow local authorities must pay the lender an appropriate price for the use of their capital. Local authorities can however, get capital from ratepayer/owners without recognising the real cost (in their lost opportunities for other spending) by taking money for capital expenditure from them. Requiring a return on capital would make the costs of equity funding more explicit.

This approach would clearly recognise the investment that ratepayers/owners have in infrastructure. A provision requiring local authorities to show the return on capital was introduced in 1989. The provision was later amended to refer to 'cost of capital'. The provision was not well accepted and some local authorities have adopted a nil cost of capital. This may have occurred because it was not clear how a charge for capital could be treated in local authority accounts:

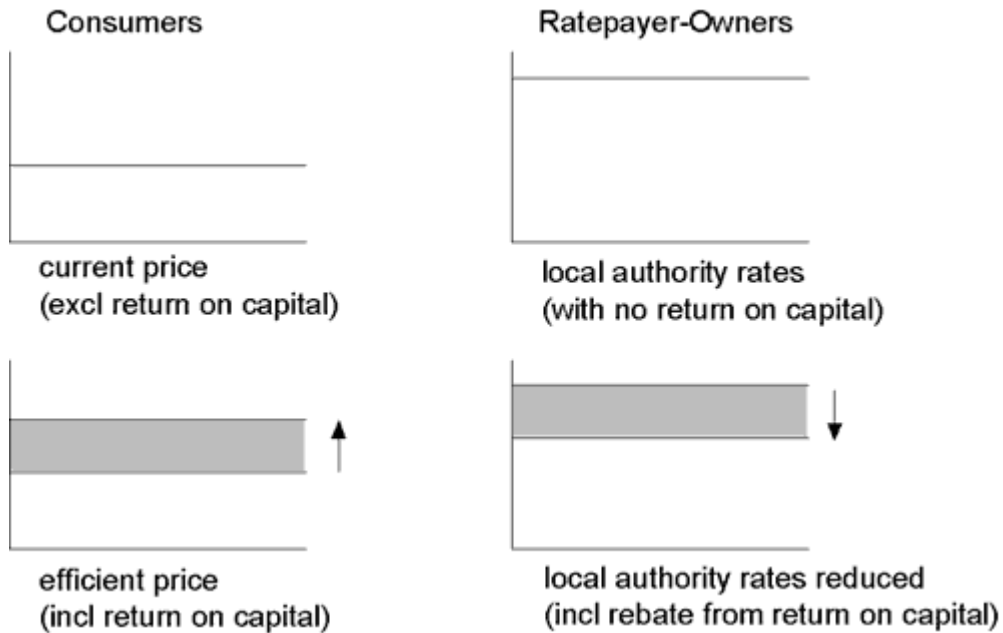
Cost of Capital - Excess Revenue



For functions where a distinction is made between users of

infrastructure and its ratepayer owners the return on capital can be returned to ratepayer/owners is a rebate on rates. Water reticulation (assuming that metering is economic) this separation is straightforward:

Return on Capital: Paid by Users to Owners



The approach would, though create fewer efficiencies functions where it is more difficult to separate users and owners.

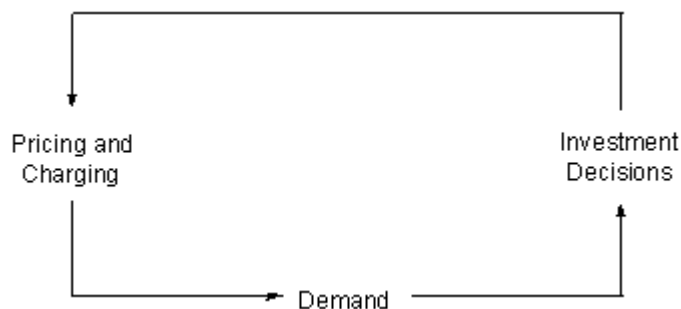
This approach is in fact only one aspect of the distinction between the interests local authorities have as owners of assets and purchasers of services for their communities. Many of the efficiencies of central government reform from recognition of this distinction.

This approach does not involve any greater total cost to the community as a whole but creates a more efficient allocation of costs between users and owners. It would also mean that any inefficient management or investment would immediately be apparent to ratepayers as a hike in rates.

A further benefit is that it automatically deals with intergenerational equity issues in respect of costs and benefits. This is so because each generation of users is paying for capital as it makes use of it.

A return on capital would also produce more efficient investment decisions and see systems grow to more accurately match the preferences of users. This is so because getting an efficient use of resources requires that the full costs of meeting consumer demand are built into prices. When this is done prices reflect the true costs of new investment and establishes that consumers are willing to pay this cost rather than reduce demand or switch to an alternative service.

Link Between Prices and Investment Decisions



Leaving return on capital out of this loop means that all the costs are not included and proper signals are not sent. It can result in over investment and inefficient expansion of systems.

The absence of a return on capital also distorts choices between public and private provision. Private entities must earn a return on their owners investment in them. If local authorities do not have a similar requirement, there will be a distortion in favour of provision by local authorities at falsely low prices.

The absence of a return on capital also distorts in favour of investment in capital rather than labour.

A return on capital would also provide useful disciplines on local authorities governance of infrastructure activity. A level playing field with private equity would focus both public and private owners on the most efficient kinds of ownership and governance structures.

The explicit recognition of their investment would also encourage ratepayers to concentrate more closely on their local authority's performance.

Low Constraint Approach

Require local authorities to earn a risk weighted return on capital in activities such as infrastructure where separate ownership and purchase interests can be established.

Operational Powers

Operating utilities over large areas involves dealing with the acquisition of land and other rights, access rights to maintain the infrastructure, and issues about interference with (and from) other utilities and land uses such as trees and roads.

These issues are regulated through a complex set of statutory provisions which do not provide a level playing field between local authorities and other entities.

Although a level playing field for the acquisition of land and other rights exists under the Resource Management Act 1991 it is lengthy and does not suit the day to day operation of utilities. Local authorities have powers unavailable to other entities, examples (from the legislation applicable to water supply) include:

Operational Powers

Powers to enter land, construct and maintain works, interfere with other utilities Sch 14, 16 LGA s379 (1) LGA.

Regulation that Facilitates Operation by Territorial Authorities

General power of control (for water supply purposes and subject to RMA) of watercourses, streams, lakes (s384 LGA).

Offence to take water from systems without authorisation (s391 LGA, s395(1) LGA), or to interfere with Council water meters (s396 LGA).

Local authorities can rely on regulatory provisions in the legislation in ordering their relationships with customers, examples (again using water supply) include:

Statutory requirements not to allow water to run to waste (s382 LGA).

Controls on removal and connection of pipes connected to systems (s383 LGA).

Some charges for water recoverable as rates, which are a charge on land binding future owners.

Statutory powers in relation to ownership, testing of water meters (s396 LGA).

Private operators have to rely on agreements with customers and enforcement of their rights through the general law.

Parking provides a current example of how such powers can favour local authority provision. Local authorities can run a parking building and enforce rules about its use through bylaws and collect any unpaid charges as fines for the breach of bylaws.

Private operators have to rely on rules established through contracting and must organise their own methods of collection using the general law. They, for instance may need to pay for attendants or systems to ensure payment which local authorities don't require.

Experience with reform in Telecoms, electricity and gas suggests that customer/supplier relationships can be effectively ordered through contracting and reliance on generic legal protections such as the Fair Trading Act. These methods could be used by local authorities and other operators alike.

Another set of provisions distort in favour of connection to local authority infrastructure, examples are:

- The power to compel connection to public sewerage systems (s459 LGA)

- Pricing powers which allocate the costs of reticulated systems to those who are not connected.
- Subdivisional consent powers which (although effects based in origin) can be used to distort in favour of connection to local authority systems.

Local authorities provide a reticulated system normally make some kind of judgement that it will be more efficient (or create fewer externality issues, such as health problems) than other forms of provision and use these powers to give effect to this judgement.

Such centrally made decisions may not always be the most efficient and they will tend to discourage small scale innovation to meet local needs.

Efficiency will be greatest if the legislation is neutral as between provision by local authorities, by other operators, and provision by individuals or groups of landowners.

This would allow most efficient balance between different kinds of provision to be found. Thinking on this issue is often dominated by the history of large scale provision by local authorities. Some feel for the scope for other forms of provision can be gained by considering the other ways water and sewerage treatment can be provided. Substitutes for reticulated water include such as rooftop collection, bores, tankers and bottled water. Substitutes for reticulated sewerage including septic tanks and other forms of on site provision. These substitutes would also need to be priced properly. For instance the costs of consents, monitoring and enforcing of standards for on-site sewerage provision would need to be sheeted home to those taking up this option.

Alternatives to local authority provision of reticulated water are surprisingly common. The Ministry of Health Register of Drinking Water Supplies lists 427 community supplies provided by entities other than local authorities and 478 communities supplied by local authorities. Many of these are run by very small community groups. Larger schemes are run by institutions such as schools, hospitals, universities and army bases. Large commercial operations (such as dairy companies) provide water to surrounding communities. There are also a few examples of private individuals supplying surrounding communities.

Local authorities however also have operational disadvantages compared with private operators. They comes from the legal frameworks which are applied when local authority actions are legally challenged.

The public law frameworks used involve closer scrutiny of actions than the private law frameworks usually applied to private operators. Some clarification of the nature of the rules applicable to local authority operation of infrastructure (separate from those applicable to their regulatory and other roles). Ideally those rules should be as closely aligned with the generic rules for customer protection such as the Fair Trading Act.

Low Constraint Approach

Removing powers to compel connection**Removing or discouraging the allocation of costs to those not connected to reticulated systems****Replacing the powers that regulate customer relationships with powers for TAs to deal with the issue through contracting****Clarifying the nature of legal rules applicable to local authority operation of infrastructure.**

Generic Constraints

Local authorities also have a set of constraints on the way they govern their activities and transact their business. These constraints exist across the range of local authority functions including the infrastructure industries studied.

Scale and Organisational Form

The legislation (especially s247C LGA) contemplates that local authorities can use a wide range of corporate forms (including trusts, partnerships, companies and joint ventures). In practice however the specific legislation governing infrastructure can closely specify the methods to be adopted. This can often make the more general powers legally unavailable.

Local authorities cannot always exploit the economies of scale and scope that may exist in the operation of infrastructure. Their powers are constructed around the limits of their own districts (although the provisions on water and sewerage contains limited powers to supply outside boundaries). Local authorities do have powers to enter into joint arrangements but these can be complex often involving blurred accountability and difficulties with ownership issues. Joint provision is not common except where mandated by specific legislation.

A more efficient model is potentially provided by s33 Resource Management Act and s15 Biosecurity Act. These provisions allow functions to be transferred to other local authorities. Key elements of these provisions are listed below:

- Both parties must agree
- The local authorities must consider communities of interest efficiency capability and expertise.
- The transferring local authority remains responsible for the function.

The use of corporate forms which fall within the definition of Local Authority Trading Enterprise (LATE) are governed by part XXXIVa LGA. The definition of LATE is widely drawn (it catches any company controlled directly or indirectly by a local authority). The definition is so wide because it operates for tax purposes to make income to a LATE and income from a LATE to a local authority taxable. The same

definition also operates to invoke the quite complex accountability and reporting procedures of part XXXIVa LGA.

In practice two impediments to the use of LATEs can be noted:

- Income streams from enterprises carried on through LATEs are taxable (while those inside local authorities are not).
- The perception that LATE status involves a significant loss of control.

Ideally choices of corporate form would be tax neutral. This might be achieved by making all 'contestable' activities of local authorities taxable. This would involve complex definition enforcement issues. Alternatively all local authority income could be made taxable on the basis that public good activities would not generate surpluses and only trading activities would end up being taxed.

Another approach would be set a cost of capital requirement which is equivalent to a pre tax rate of return.

The control issue might be partly addressed by:

- Clarifying that statement of corporate intent procedure can allow effective control (perhaps by explicitly signalling that a period of negotiation prior to delivery).
- Clarifying the degree to which local authorities can provide support for LATEs.

The issue of support is less clear. The legislation has evidenced a distrust of financial support by local authorities for LATEs. This has been based on the underlying idea that rates backed support for local authority owned commercial enterprises is anti-competitive.

The actual provisions do not, however clearly or comprehensively deal with the issue. Provisions inserted in the Local Government Act in 1989 and 1996 prohibited particular kinds of support such as guarantees. The 1989 version was avoided in practice and the same may be true of the 1996 controls.

The question of support could be more effectively addressed through transparency and accountability provisions. These could clearly identify the nature of any support and require it to be justified (perhaps according to the criteria in part VIIa Local Government Act). Generic Commerce Act controls could also apply to any anti-competitive behaviour revealed.

There are also doubts about the ability to transfer operational powers to a LATE. Section 594 ZK LGA attempts a general transfer, but this may not be fully effective. Significantly the legislation transferring operational powers to Watercare Services Limited contained extra and more explicit transfer provisions.

Low Constraint Approach

Create generic provision for local authorities to transfer infrastructure functions among themselves.

Make corporatisation decisions tax neutral.

Allow operational powers to be effectively and unequivocally transferred to LATEs.

Allow rates based support for LATEs to be limited by accountability and the economic principles in part XVIIIa LGA.

Procedural Issues

The legislation sets out procedures which local authorities must follow before they can carry out certain transactions. They include:

- Section 230 LGA (which requires notice of meetings where decisions to sell land are made; this effectively operates as a prerequisite for sales).
- The Public Bodies Leases Act (which prescribes forms of lease and leasing procedures).
- Section 40 Public Works Act (which requires land not required for public works to be offered back to those from whom it was acquired).
- The Public Bodies Contracts Act (which provides formal requirements for contracts).

It can be very difficult to comply with these publicity and procedural provisions and also carry out effective commercial negotiations.

These provisions were drafted before the introduction of the modern accountability provisions based around the Local Government Official Information and Meetings Act and the annual plan procedures under the LGA. These modern mechanisms could be used to deal very effectively with most of the concerns which lie behind these provisions.

The 'offer back' provision in s40 Public Works Act should be amended to recognise that land (although no longer in public ownership) can still be devoted to a public purpose or the purpose for which it was taken. This can occur through an arrangement with a private entity or a joint arrangement between private owners. The offer back obligation should not be triggered in such situations.

Property Rights

The legislation appears to favour collective provision of infrastructure by local authorities because of a presumption that this is more efficient than leaving individuals to make their own arrangements.

This may frequently be true (especially in the past when product and capital markets were less sophisticated). The most efficient kinds of arrangement will however, emerge only when the framework leaves individuals free to make their own arrangements between themselves.

There are impediments to this kind of provision. In some cases local authorities have jurisdictions which can override private

arrangements, for instance the creation of rights of way between owners is subject to local authority regulation.

It can also be difficult to create non standard bundles of rights. For instance a group of farmers might want to agree among themselves about access to their properties. They could deal with ownership of a road to meet their needs, its maintenance, access, and the kinds of use to be made of it. A range of public rights could be part of such mixes. The law governing roads however fixes in place certain sets of rights that go with a few specific kinds of road status.

It is also generally difficult for individuals to create legal rights that will attach to land and apply to future owners. These kinds of rights are necessary so that infrastructure can be operated according to a fixed set of rules over time and so that the costs and benefits can be factored into the prices for services and for the properties served.

The land transfer system requires rights to be specified and defined very accurately. The costs of surveying and legal work inhibit the creation of private arrangements.

This is recognised in a number of provisions such as the proposed amendments to the Local Government Act (contained in the Local Government Law Reform Bill introduced in December 1994). These provisions would apply to land drainage and irrigation schemes and allow a shorthand method of transferring schemes to land owners and creating the necessary sets of rights as between them. Any loss of accuracy (as compared with accurate surveying) would be factored into prices.

The Tasman District Council has proposed using tradable permits to abstract water. This would be achieved under the Resource Management Act. The rights would be traded by individuals through intermediaries such as land agents. Such approaches also have potential to be applied to other infrastructure where capacity constraints are reached, such as roading. The current legal regime however does not allow tradable rights to be used in such contexts.

Assessments of Efficiency Gains

A range of techniques (involving the use of overseas studies and analysis of local authority data in New Zealand) allow some assessments of efficiency gains to be made. These techniques when applied to the water industry give these results.

Assessment of Potential Efficiency Gains: Water Industry

Assessments of the gains from removing the constraints.

Efficiencies in production through ownership effects
contracting 27 - 68 m

Effects of more efficient pricing 18 m

More efficient investment 15 m

60 - 101 m

The techniques on which these estimates are based do not capture all the gains available from liberalising the rules governing local authority action or the creation of private rights.

Neither does the assessment deal with efficiencies that might be gained through pricing abstraction or making water rights tradable. These gains could be considerable since 75% of delivered water is used for livestock or irrigation. Prices established through such a regime would be reflected in the cost of water delivered to all end users and efficiencies would result from better allocations between uses.

On the other hand some of the efficiencies estimated may already be achieved by local authorities notwithstanding the constraints in the current regime, for example:

Franchising of Papakura District Council's water system to an overseas water company.

The use of a build - own - operate - transfer contract by Wellington City for new sewerage treatment and outfall.

Contracting the operation of water supply (eg Wellington and Masterton).

Contracting for water sources (Oamaru).

Tradable water right regimes (Tasman District).

A more anecdotal approach can be used to illustrate the potential efficiency gains. The example involves a Crown scheme and a local authority power board. Although it does not involve a local authority of the sort currently constituted it clearly illustrates the practical effects of the kinds of constraints identified and the gains to be made from their removal.

The Maniototo Irrigation Scheme

The Maniototo irrigation scheme was promoted in the early 1970s by the Ministry of Works (MWD). The scheme to irrigate 9300 hectares was originally in 1974 approved at an estimated cost of \$4.2 million, the Government would meet the total costs of construction and one half of the costs of the off-farm distribution works would be recovered from the users through water charges over 40 years.

In 1980, as a result of new subsidies for local hydro-electric power schemes, the Government approved an expansion of the scheme in a joint construction venture with the Otago Electric Power Board. This provided for the additional costs arising from the power scheme to be met by the Board. Costs of the irrigation scheme had by this

time reached \$14.7 m. The joint venture reduced the irrigation schemes share to \$14.5 million.

By September 1983, the actual expenditure on the irrigation scheme had reached \$17 m although work was only 45% complete. The estimated cost of completing the scheme was then estimated at \$39.5 million. Costs were trimmed by deleting some areas from the irrigation scheme saving an estimated \$12.5 million. The affected farmers were paid \$1.5 million in compensation. The legislation did not permit a scheme to be stopped, and an amendment to the Public Works Act had to be passed.

The farmers in the deleted area still wanted water. They commissioned their own scheme with a turn-key contract avoiding the over-designed and overly-complex structures proposed for the MWD scheme. The project was completed on time for \$1.7 million and delivered more water than the MWD scheme would have.

The magnitude and implications of this outcome is compared with the MWD scheme:

	Government	Farmers
Total cost	\$12,250,000	\$1,700,000
Subsidy	\$ 8,170,000	\$ 0
Farmer share	\$ 4,080,000	\$1,700,000

This can be seen as an example of the example of the efficiencies to be gained by the removal of constraints which had previously prevented, or inhibited, innovation and efficiency.

Constraint Aspect Efficiency Impact

Ownership Only the Crown could own the schemes. Better managers productive were not able to gain ownership. The Crown agent (MWD) did not have incentives to make economical investment dynamic decisions as its role as manager could not be threatened.

Entry The perception that very large government subsidies were dynamic available for government schemes probably dissuaded people from contemplating private schemes as well as influencing farmers away from supporting them.

Inputs Only MWD were allowed to design and build a government productive funded scheme. They did not have incentives to minimise costs and alternatives were not offered.

Pricing Prices were set by statute and regulation and ministerial decision. allocative
They were not set by real costs and consistently ignored the opportunity cost of capital.

Outputs There were legal, political and administrative constraints on using productive water for any purpose other than irrigation. allocative dynamic

Governance Crown ownership precluded the development of alternative productive governance structures. allocative dynamic

Options for Reform

It is possible to look at the options for reform canvassed in this paper and make some assessment of the difficulty gains they could produce.

The table below summarises some very preliminary and qualitative assessments of the options.

Further efficiencies might be achieved if rights to capacity could be traded between individuals.

Option	Design Complexity	Efficiency Gains
Require return on capital	Low	High
Flexible pricing powers for LAs including tradable capacity rights	Low-Med	Med-High
Operational powers on a level playing field	Med	-
Construct elements regulatory regime to deal with abuse of dominant position by private owners of infrastructure	High (note information disclosure regulations)	-
Provide for customer relationships to be ordered on contract	Med	-

Remove barriers to use of substitutes	Med (note effects based controls and performance standards are required)	-
Remove barriers to choices of corporate form	Med (note complexity of tax issues)	-
Remove procedural barriers for LAs	Low	Low
Allow easier creation by individuals of binding rights including tradable capacity rights to support infrastructure	Med	-

This ordering indicates that the most effective rates to efficiency could lie in requiring local authority owners to earn a return on capital. The creation of more flexible pricing powers for local authorities could also achieve significant gains without great cost.

The other options deal more fundamentally with the elements of the statutory regime which assume local authority ownership provision and control. Dismantling elements of this architecture could be complex, and would the task of designing level playing field, how barrier, replacements.

Some of these elements could be addressed in isolation from each other. It is however hard to estimate the gains that might be available from any one of these areas, as opposed to the others.

The task would be most difficult if all the barriers were to be removed and a regime (such as one based on information disclosure and threat of price regulation) was developed.

Conclusions

The study indicates that significant efficiency gains could be made through relatively simple legislative changes such as requiring a return on capital and providing more flexible pricing powers for local authorities. Such changes could be grafted on to the economic principles and reporting and accountability frameworks which already exist in the legislation. There are, though accounting and valuation

issues underlying the idea of a return on capital. The purpose and the advantages of such a requirement would also need to be accepted by local authorities.

As long as these issues were addressed in an ordered and coherent way there appears to be no fundamental reason why such changes could not be made relatively quickly.

The removal of other constraints would produce further efficiency gains but raises some quite complex legislative design issues but they appear to be solvable. In addition solutions to some of them (for instance barriers to corporatisation and removal of unnecessary procedure) would have benefits beyond infrastructure across the whole of local authority operation. Further development of thinking on these issues could provide a template for future legislative reform.

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