

**THE 1990S
LOCAL GOVERNMENT REFORMS
IN NEW ZEALAND:**

**WHAT WAS ORDERED AND WHAT HAS BEEN
DELIVERED**

**A paper prepared for
Local Government New Zealand**

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READERS GUIDE TO THIS PAPER

This guide is intended to give the reader a brief overview of what to expect. It does so by providing brief details of the content of each of the substantive parts of the paper.

Part 1: Introduction

This paper is a re-write of a paper first delivered in 1994 and written to assess the major reforms to local government introduced by New Zealand's Labour Government in 1989/90. This re-write assesses the impact of the reforms a further three years on. It does so in a context of continuing change, highlighting the major changes to financial management legislation introduced in 1996 and the forthcoming changes to the ownership and management of New Zealand's roading system.

Part 2: What was ordered

This part puts the local authority reform process in context with the Labour Government's approach to public sector reform. It outlines the problems identified by the Labour Government and the approach which it decided to take to reorganisation.

It then goes on to outline how the main objectives for the reform process were set and what they were.

Part 3: What was delivered

In this part, the actual reforms, as they emerged, are outlined and compared with the objectives set. Particular emphasis is placed on the decisions taken in respect to regulatory powers and where they should be placed, the new powers given local government in respect of commercial activities, and the changes in respect of accountability and consultation.

Part 4: Post 1989/90 changes

New financial management legislation has been put in place with the intention of requiring local authorities to apply a public good framework to decisions about the activities they undertake, who benefits from those activities and how they should be funded. This section also discusses forthcoming changes in the ownership and management of New Zealand's roading system and the implications that will have for local government as the sector loses one of its major functions.

Part 5: What is still to come

It is obvious that we are only part way through the reform process. In this part, the paper identifies a number of major items which still need to be addressed. An immediate priority for central government is rewriting the legislative framework for water and waste water

infrastructure so that it is neutral as between public and private sector management or ownership. Other priorities include rewriting the Rating Powers Act and the Local Government Act both of which are increasingly out of tune with the needs of local authorities and the communities they serve.

Ongoing reform is likely to be evolutionary rather than imposed. Further structural change is likely as local authorities consider the benefits of scale, especially if they lose their roading functions; there is also an increased interest in revisiting the separation between regulatory and service delivery functions, with a growing interest in the creation of unitary authorities (local authorities combining the functions of territorial local authorities and regional councils).

Finally, it also seems likely that local authorities will play an increasingly important role in the delivery of core central government social services both as a co-ordinator/facilitator and possibly as a provider under contract.

Part 6: The role of consultation

The new requirements for consultation, and the associated accountability requirements, were clearly intended to act as constraints on local government activity. Initially, there were signs that the special consultative procedure, with its requirement that local authorities consult with their communities before taking defined types of major decisions, might significantly increase the legitimacy of local government action. The process appeared to offer the potential to obtain a public mandate for specific courses of action thus strengthening local government's hand.

More recently, it seems that the process may also have the potential to risk undermining the legitimacy of local government, largely because of differing expectations between local authorities and the publics whom they consult. The latter have expected consultation to be about deciding whether or not to go ahead with a proposal whereas, for local authorities, it has been seen (correctly from the legal perspective) as simply one further step in gathering information on which to make a decision.

Partly in response to this local authorities are increasingly drawing a distinction between the formal legal requirement to consult, and what makes for good communication and are experimenting with a variety of ways of building understanding between themselves and their communities.

Part 7: Local Authorities as local government

This part argues that local authorities, increasingly, are becoming the local governments of their districts. It speculates that a number of different factors are, possibly irrevocably, shifting the balance of governance from central to local government.

PART 1: INTRODUCTION

In the past eight years, New Zealand's local government sector has undergone a series of major reforms. In 1989, the Government, through the Local Government Commission, undertook the most comprehensive reform of local government New Zealand has ever seen. The number of local authorities was reduced from more than 800 to 87. Most special purpose local authorities were abolished and the number of territorial authorities reduced by two thirds.

This was accompanied by quite major changes in the legislative framework for local government. Chief Executives were formally designated as the employers of local authority staff (previously, staff had been employees of the elected Council) in a move intended to mirror the policy/operations split which central government had adopted as a principle for public sector reform. The Government also legislated new and demanding requirements for consultation and for disclosure of information. At the same time, New Zealand's environmental and planning regulation underwent a comprehensive rewrite.

Change continued. In 1992, the Government refined the role of Regional Councils and legislated for the compulsory corporatisation of electricity distributors, a number of which were owned by local authorities.

In 1996, it legislated a comprehensive rewrite of the financial reporting and accountability requirements for local government and, at the end of 1997, is part way through a process which will fundamentally change the role of local government in the provision of roading (which for many of New Zealand's rural authorities has been their principal undertaking). Further change is foreshadowed with indications that central government would like to make the provision of water and waste water services and infrastructure contestable.

At the same time, within social services, there are signs that the Government sees an increasing role for local government in the co-ordination and, possibly, delivery of key social services.

The purpose of this paper is to provide an overview of the changes of the past eight years or so and something of a crystal ball for the changes yet to come. Looking forward, the emphasis is on the potential for local authorities to become truly the **local government** of their districts.

In keeping with that approach, this paper is divided into six parts:

- What was ordered; an overview of the 1989/1990 changes;
- What was delivered;
- Post 1989/90 changes;

- What is still to come;
- Consultation/accountability;
- Local authorities as local government.

This last point is perhaps both the most exciting and the one which offers greatest potential benefit for the people who live in the communities administered by New Zealand's local authorities. Trends such as globalisation and changing technology are both limiting the scope of central government on the one hand and, on the other, highlighting the need for local communities to take responsibility for determining their own futures.

Local authorities, as the holders of the senior democratic mandate within their communities, are ideally based to become the genuine government of their localities if by government is meant accepting the responsibility for working with the community to determine their desired outcomes and then taking the lead in helping realise those.

PART 2: WHAT WAS ORDERED: AN OVERVIEW OF THE 1989/90 CHANGES

The then Government's intention to conduct a comprehensive reform of local and regional government was announced in the so-called December Economic Statement released on 17 December 1987. The timing itself was significant. This was at the high point of the public sector restructuring associated with the policies of Roger Douglas, Minister of Finance from 1984 to 1989, and of the policy framework developed for him by the Treasury.

At the time the reform programme was announced, the internal divisions which later brought down the Labour Government had still not emerged into the public arena. The Labour Party was flushed with its success in earning a second term in office despite the major reforms it had undertaken during its first term.

It had learned a great deal about the process of reforming the public sector. In particular, it had learned that if you wanted to change things, it was better to get on with the job, and clean up the detail later, than wait until every last point had been agreed before moving ahead. The best known example of this was the restructuring of a number of major government trading enterprises as government owned companies under the State Owned Enterprises Act. The Government's experience with that restructuring had taught it that, if it tried to seek agreement with key public sector bureaucrats, before reforming activities for which they were responsible, it would be extremely difficult to do so. The cost of getting a few things wrong through acting swiftly was seen as less than the cost of getting nothing right through accepting interminable delay.

In the local government sector this was reinforced by the experience and circumstances of the responsible minister. Dr Michael Bassett had held the portfolios of health and local government in the period 1984 - 1987. In the second term of the Labour Government, his only portfolio was local government. New Zealand thus had the relatively unusual situation of an experienced senior minister, with no other responsibilities, holding the local government portfolio.

As well as the time to concentrate on the portfolio and, possibly, the incentive to demonstrate his effectiveness as a minister, Dr Bassett brought other assets to the position. He had been a long term Auckland city councillor so knew local government well from the inside. Of perhaps greatest importance, he was also an historian and brought to the portfolio an historian's awareness of the history of local government reform. Typically, both in New Zealand and elsewhere in the English speaking world, the reform process has been a reformer's graveyard. The history is commonly one of seemingly rational proposals for reorganisation being developed, at great expense, only to be abandoned for political reasons. In New Zealand, the relative powerlessness of the Local Government Commission, against political pressure, had become virtually notorious. Even major statutory change had been proved vulnerable if it could not be acted on within the term of the government which achieved it. Thus, Henry May's attempt, as Minister of Local Government, to streamline the restructuring process during the

term of the 1972 - 1975 Labour Government, was frustrated when the legislation he succeeded in placing on the statute books was emasculated by the incoming National Government.

This history reflects the fact that, traditionally, local government has been something of a political football. Successive central governments have felt free to intervene on an ad hoc basis, often to pander to pressures from local elites within their own party organisations. Their ability to do so was strengthened by the general perception that local government was of relative insignificance; that its traditional functions were relatively mundane and offered little opportunity for significant gain in the quality of governing or service delivery. It was the preparedness of senior ministers in the then Labour Government to see the potential role of local government which was the trigger for change.

The December 1987 Economic Statement thus brought together two major themes; the Government's ongoing commitment to fundamental reform in the public sector and a ministerial determination to see the reform process through within the Government's current term. What, then, was ordered (promised) by the Government? The Economic Statement set out the Government's position in these terms "As a fundamental principle it is agreed that local or regional government should be selected only where the net benefits of such an option exceed all other institutional arrangements". Five subsidiary principles were also identified. These were:

- Individual functions should be allocated to local or regional agencies which represent the appropriate community of interest;
- Operational efficiencies are desirable;
- Any authority should have clear non-conflicting objectives;
- Any trade-offs between objectives should be made in an explicit and transparent manner;
- Clear and strong accountability mechanisms should be encouraged.

Behind these statements of principle lay a perception that New Zealand's local government sector was in dire need of radical surgery. In part, this was very much a matter of central government applying, to the local government sector, much the same principles of analysis as it had been applying to its own operations. This was based on a quite powerful analysis of public sector organisation which had persuaded key government advisors, and ministers, of the need for fundamental change. It had been argued, and accepted by ministers, that much of New Zealand's poor economic performance had to do with the way in which roles and responsibilities within the public sector were jumbled together. That analysis argued that the typical public sector entity (department, agency or whatever) included within it a mix of functions such that performance was significantly undermined by major conflicts of interest, conflicting objectives, and the lack of any basis for effective accountability. As well as the

emphasis on separating commercial and non-commercial objectives, and the activities which supported them, this analysis also stressed the need to "unbundle" a series of functions including:

- Policy advice;
- Regulation;
- Service delivery;
- Purchasing (financing) services;
- Monitoring performance;
- Evaluating the effectiveness of services.

Additionally, it was argued that effective measurement of public sector performance was very difficult to achieve in the absence of reliable and up to date accounting information. This implied replacing traditional public sector cash based accounting with accrual accounting. It also implied developing techniques to recognise the inherent differences between public sector and private sector accounting requirements.

When this analytical framework was applied to local government, the situation seemed an extremely sorry one. Amongst the immediate problems which that type of analysis highlighted were:

- Confusion between the role of councils and of their senior management in terms of who was responsible for policy and who for implementation. Councillors were seen as all too often concerned with day to day minutiae rather than with the business of deciding policy and monitoring the organisation's performance. Furthermore, with councillors straying between policy and day to day management, it was extraordinarily difficult to assess performance. Managers would always have the fall back position that it was really the councillors who were responsible for any particular outcome.
- The built in bias towards inefficiency resulting from the absence of any genuine contestability in the provision of council services (the fact that councils almost always used in-house provision).
- The lack of proper commercial structures for council trading activities, or activities which were potentially trading, and the consequent confusion between commercial and non-commercial objectives.
- The lack of suitable incentives and accountability arrangements for management of both trading and non-trading activities effectively denied councils the ability to hold

managers accountable for the efficient use of resources in a trading environment.

- As well, the plethora of authorities, and the small scale of many, was seen as wasteful of resources and as a barrier to recruiting managers with the skill and training needed for the operation of complex organisations.

The Government was also concerned at the poor accountability of local authorities to their constituencies. The low level of turn out at local authority elections was seen as a symptom of an apathy which was, if not caused by, at least contributed to by the lack of quality information on local authority activity and the difficulty which citizens had in engaging with their local authorities. Improving information flows through measures such as changed accounting and accountability requirements, and providing more opportunity for citizen involvement, were seen as possible ways of addressing this problem; reform could be justified both in efficiency terms and as a means of improving local democracy.

The Government therefore set to with a will to put in place a series of major changes. In terms of the reorganisation of local authorities themselves, it gave the Local Government Commission a statutory direction that it should:

"Before the close of the first day of July 1989, prepare such final reorganisation schemes as in its opinion, are necessary to improve local government in New Zealand or any part of New Zealand".¹

The structural reform which the Local Government Commission then put in place was without parallel in New Zealand's history, and probably internationally, both for its fundamental nature and the speed with which it was achieved. The fact that more than 800 disparate bodies could be reduced to rather less than 100, with the number of territorial authorities reducing from over 200 to just 74 was quite extraordinary. It owed much to the willingness of the then government to put in place a process which was, quite deliberately, insulated against political interference; decisions were to be taken by the Commission in accordance with a legislative mandate, and not by the Government. The Commission was required to consult, and did so extensively, with a concern that its process be seen as legitimate, but it had the final power to decide.

This is perhaps the major lesson of the New Zealand experience, for other countries contemplating local government reform. To be truly effective, move quickly, so that there is insufficient time to build up opposition to change, and use a process which is, as far as possible, free from political interference.

It is pleasing to see that there has been international recognition of New Zealand's achievement. The award of the Bertelsmann Prize to Christchurch City 1993 was a specific recognition of the impact of local government reform and the manner in which that authority had adapted. It recognised not just the structural reform itself but the other reforms which are

¹ *Quotes are from Section 6 Local Government Amendment (No.3) Act 1988.*

the principal subject of this paper.

The power of individual local authorities to influence the process was restricted to a right given them in these terms:

"The Commission shall grant every local authority affected by the scheme the opportunity to meet with and be heard by the Commission on the application of the scheme to or within the district of the local authority".¹

The Commission was ready and willing to undertake this responsibility. In July 1988 it sent a memorandum to all regional authorities, territorial authorities and special purpose authorities setting out the principles which it would adopt (these principles are set out in Appendix I of this paper).

The proposed restructuring was intended to be a comprehensive "first principles" review of the structure and functions of local government. Legislation specifically stated that the Commission, in carrying out its functions, "shall not be constrained by the existing form of local government in New Zealand".¹

The Government, in considering how to reform other aspects of local government, began the process by taking a similarly "first principles" approach to seeking the ideal rather than starting from the actual and making changes to that. This was implicit in the stated fundamental principle "that local or regional government should be selected only where the net benefits of such an option exceed all other institutional arrangements".

This statement had been expanded on with the comment in a discussion document released in February 1988,² that "This suggests that the key role for local government lies in the provision of local public goods where such goods are not more efficiently provided by markets, voluntary arrangements or by central government ...". This statement had sent alarm bells ringing throughout local government. It was correctly interpreted as implying a central government view that local authorities should only be providers of goods or services (as opposed to being purchasers on behalf of their communities, or regulators of provision) when this was demonstrably the best option.

Typical of the reaction of local authorities was the following statement taken from the submissions of the Manukau City Council in response to the February 1988 discussion document. It commented:

"The Council is concerned that the discussion paper assumes that individual functions can be assessed purely on the basis of economic criteria in isolation from overall objectives. The City Council is a multi purpose local authority, and individual operations

² *Reform of Local and Regional Government: Discussion Document prepared by the Officials Co-ordinating Committee on Local Government.*

are assessed in terms of their usefulness to the City in fulfilling its mission. The City works to objectives and is by experience best able to determine which functions are most necessary to continue that development".

Leaving aside the issue of whether the principle the Government had advanced did mean assessing activities purely on an economic basis, it is clear that local authorities saw this principle as striking at the very heart of their ability to act in ways which they saw as responsive to the needs of their communities. As a consequence, this particular principle ran into very substantial opposition and was dropped before the legislation enacting the major organisational and other changes to local government, which was passed as the Local Government Amendment (No.2) Act 1989, was introduced into Parliament.³ However, it resurfaced in the 1992 Local Government Amendment Act but restricted to regional authorities. The relevant provision is contained in what is now Section 247D(2A) of the Local Government Act which provides "... a regional council shall not carry out its works or perform its functions by using its own staff unless it is satisfied that the advantages of this option for the ratepayers of the region clearly outweigh those of any other option". In passing it is worthy of note that this principle, first espoused by a Labour Government, and then abandoned, quite likely because of local government opposition, resurfaced in legislation promoted by a National Government. There have been occasional suggestions that the National Government is of a mind to extend this principle to territorial local authorities if it judges that the reform process, in its absence, has not been effective to achieve the desired efficiencies.

What of the rest of what was promised? The Government, itself, was not specific on detail. Instead, the issue of working out how to translate the Government's principles into practice was referred to the Officials Co-ordinating Committee on Local Government ("OCCLG") with a brief for it to report to the Government on the measures which should be taken to implement its principles and how this should be done.

The question of what was promised is therefore best established by reviewing the work of OCCLG and the reports which it referred to the Government. I now do this under the five headings of local government organisation, legal powers, regulatory v non-regulatory activities, commercial activities and accountability.

Local Government Organisation

The paramount concern in respect of organisation was the relationship between the council on the one hand and management on the other. In order to clarify their respective roles it was

³ *The decision to drop it seems to have been taken, informally, by ministers without the involvement of officials. The then Deputy Prime Minister, the Rt Hon Geoffrey Palmer, was questioned on this issue in June 1988 at a conference of the New Zealand Institute of Public Administration. He responded by saying "The point that your quote from the Statement of 17 December was a piece of economic analysis that was offered to the Government by the Treasury and which found its way into the Statement. It has subsequently been publicly disowned by the Minister of Local Government. Indeed, I don't accept it, and I know David Caygill does not accept it".*

seen as necessary to separate out responsibility for policy from responsibility for implementation. Associated with this change was how to improve the accountability framework for senior management.

Officials saw the answer to both of these questions as lying in repeating, within local government, the change which had taken place in central government with the enactment of the State Sector Act 1988. That Act made the chief executive of a government department the person responsible for its activities and the employer of staff. In formal terms, under the Act, the chief executive was left with full responsibility for implementation with decisions on policy emanating from the responsible minister except to the extent that authority was delegated to the chief executive.⁴

Officials argued for a parallel situation in local government with a shift to what is usually referred to as the "general manager" role of a chief executive who acts as the employing authority and is, him or herself, employed under contract by council with specified performance requirements. Here, the objective was to remove mayors and councillors from day to day intervention in the running of the affairs of the local authority and have them focus, instead, on policy issues and on reviewing the chief executive's performance in implementing council's policy decisions. This approach could be seen either as an endeavour to protect the management of local authorities from the effect of the inevitable lobbying, of politicians, by individual citizens or local interest groups or, on the other hand, as an exercise in political naiveté in its expectation that politicians would be prepared to put aside dealing with the minutiae of issues of immediate concern to their electors.

Legal Powers

Here the concern was with rationalising the powers which local authorities have to undertake activity in terms of the Local Government Act and other empowering legislation. Anyone who has looked at that Act will be well aware that it is a somewhat haphazard construction. Although there may lie, buried within it, a single organising rationale, that has long since disappeared as a series of ad hoc amendments have been made to enable local authorities to undertake various types of specific activity. At the heart of this problem is the fact that local authorities are statutory corporations and, as such, have only that power which the law confers upon them. The courts have traditionally taken the view that, when considering the legal powers of statutory corporations, they should construe legislation against the existence of a power unless it is clearly intended, on the face of the legislation, that the power should exist.

This has been a source of frustration both to local authorities and, from time to time, to central government. Its major beneficiaries, it could be argued, have been those lawyers who specialise in local government law, much of whose deliberations have focused on finding obscure provisions, within the Local Government Act or some other legislation, which would

⁴ *The provisions of the Public Finance Act 1989, and the way they have been interpreted, somewhat modify this situation.*

actually allow a local authority to undertake some activity or other outside the normal ambit of local authority endeavour. Often, where this search has been unsuccessful, the result has been a further ad hoc amendment to the Act to facilitate the plans of a particular local authority, something which has been a significant contributor to the present ramshackle structure.

The view which officials arrived at was that this problem should be addressed in two ways. First, the legislation should clearly state the purposes of local government. Secondly, local authorities should be given a power of general competence. The exact form this power should take was the subject of considerable debate. In particular, officials spent some time arguing over whether local authorities should have a power of general competence in carrying out their functions as local authorities - which would require any particular action to be construed against what the functions might imply - or whether they should have a power of general competence without constraint. In December 1989, officials recommended, and the Cabinet Committee on the Reform of Local Government and Resource Management Statutes agreed, "that local authorities should have all the powers of a natural person except where they are restricted by other enactments" and noted "that this would mean that the regulatory functions and powers of local authorities would still need to be specifically authorised by statute".

Regulatory v Non-Regulatory

How to deal with the regulatory and non-regulatory powers of local authorities was, and for that matter, remains one of the more difficult debates in local government reform. Some of the Government's advisors, applying the pure public sector restructuring model discussed above, argued strenuously that one objective of the reform process should be to separate regulatory activities from non-regulatory activities. This view had found its way into the December 1987 Economic Statement as "Any authority should have clear non-conflicting objectives. Responsibility for making trade-offs between objectives should be seen as a separate objective. This suggests amongst other things that institutional arrangements should separate service delivery functions and regulatory functions. Otherwise a regulatory authority could potentially guarantee its service delivery arm an unfair commercial advantage. Minimising conflicts of interest will ensure that authorities are less liable to capture by pressure groups". It was strongly suggested that such authorities would use (and by inference had in the past used) their regulatory powers to favour their operational activities. This was seen as, at least potentially, preferring a local authority's operational activities against potential competitors and, separately, as relieving the local authority's operational activities from the scrutiny of an independent regulator.

In structural terms, this was argued to require that the reform process should create two separate sets of local authorities, one whose only functions were regulatory and one which had no regulatory responsibilities. In practice, the suggestion made was that regional councils should be set up with purely regulatory functions, and stripped of all their operational activities, and that territorial local authorities should be purely operational, with their regulatory activities turned over to regional councils.

The contrary view was essentially a pragmatic one. It was argued that there would be significant difficulty in achieving a clear separation of regulatory and service-delivery functions. Furthermore, this would require a duplication of administrative structure if there was to be ready access to regulatory authorities on the part of the public. Officials advancing this view argued, instead, for internal separation between regulatory and service delivery functions at both the management and committee levels of councils.

A significant amount of time was spent debating not only the theory of the separation but how it might operate in practice. Officials never did reach agreement. The issue was determined in the context of the statutory brief which should be given to the Local Government Commission, as it was that body which was to have the responsibility for creating the new local government structure and assigning functions to its different components. Officials finally agreed that two options should be presented to Cabinet for decision:

- Separation of regulatory and service delivery functions by type of authority;
- Separation of regulatory and service delivery functions within local authorities.

As a separate, but major, undertaking running in parallel with reform of the local government structure itself, the Government was also committed to a review of New Zealand's Resource Management Legislation. The objective of the review was to consolidate New Zealand's numerous Resource Management Statutes. This was to include a redefinition of the purpose of environmental planning and the development of an integrated approach to planning which would, on the one hand, facilitate sustainable resource management, on the other hand, minimise compliance costs. It is not the purpose of this paper to go, deeply, into those changes but it is essential to recognise that they were integral to the whole process of local government reform, especially as resource management is a major function of local government.

Commercial Activities

The issue of what would happen to the trading, or potentially trading, activities of local authorities was debated during 1988. The timing of this debate was significant; it was taking place as the initial success of the corporatisation of major government trading enterprises was becoming very apparent. Officials, and the Government, believed that similar gains would be possible within local authorities. They were also persuaded that they could expect, within local authorities, the same resistance to corporatisation as they had met within the Government's own trading activities.

This saw a strong bias, in the debate, towards compulsory corporatisation of local authority trading activities. A reading of the related papers suggests that this was seen as a relatively foregone conclusion; the real issue which appeared to need decision was whether local authorities would be permitted to retain ownership of their trading activities once they had been corporatised. Local government, itself, seems to have, at least initially, taken the attitude that this was the issue which needed to be fought rather than the question of corporatisation itself.

In its April 1988 statement of principles on the reform of local government, the New Zealand Local Government Association urged that "dividends from local government trading activities should be available to general revenue for general spending purposes (as the equivalent dividends are available to central government)".

Accountability

The Government's statement of principles included that "clear and strong accountability mechanisms should be encouraged". It saw measures such as "electoral processes, mandatory information flows, and contestability in the provision of services" as contributing to this.

Expert advice was sought, by OCCLG, as to the form which accountability provisions might take. The recommendations which came back included:

"That a legislative framework for local government accountability be developed incorporating:

- The roles and principles of local government as set out in this paper" [this recited the roles and principles which had already been agreed by officials and government];
- A mechanism which shows transparently how the objectives of a particular local authority accords with these roles and principles;
- A means by which a local authority's operations are transparently assessed against stated objectives;
- Mechanisms by which these assessments are linked to financial, professional, political and community accountability structures.

"That their framework should ensure the transparent:

- Establishment of clear objectives on an activity by activity basis;
- Separation of commercial from non-commercial objectives;
- Separation of regulatory from non-regulatory objectives;
- Resolution of conflicts of objectives."

These recommendations gained general support from officials.

The detailed work on accountability provisions was the last of the major pieces of policy work

carried out in the reform package. As a consequence, it was done with the benefit of knowledge of the nature of the major changes which were taking place in other aspects of the reform.

Again, it seems likely that this aspect of the reforms drew, quite closely, on parallel reforms taking place within central government. By the time accountability provisions within local government were being closely examined, central government had become very used to imposing, on its various entities, requirements which, in many ways, reflect the same annual plan/annual report cycle which is now at the centre of local government accountability.

PART 3: WHAT HAS BEEN DELIVERED

As is not uncommon in the political process, delivery has fallen short of, or been different from, what was actually promised. I now examine what we got under the same five headings of local government organisation, legal powers, regulatory v non-regulatory activities, commercial activities and accountability.

Local Government Organisation

What we did get is the formal separation of policy and implementation. Under Section 119C of the Local Government Act, a local authority may appoint either a single chief executive officer or a group of senior executive officers. That CEO or those senior executive officers are responsible to the local authority for employing, on its behalf, within their area of responsibility, staff of the local authority and negotiating their terms for employment. Under Section 119D, the CEO or the senior executive officers are responsible to the local authority for:

- Implementing the decisions of the local authority;
- Providing advice to members of the local authority and any community boards;
- Ensuring that all functions, duties, and powers delegated to him or her or to any person employed by the local authority, or imposed or conferred by any act, regulation, or by-law are properly performed or exercised;
- Ensuring the effective, efficient, and economic management of the activities and planning of the local authority.

There remains a tension between the wording of the Act and the practice which many councils wish to follow. The rigorous application of these provisions of the Act would clearly exclude councils, or individual councillors, from interfering in matters of implementation. Their remedy, if dissatisfied with any particular act or omission on the part of council staff, should be through the chief executive's contract which, if well drawn, should detail the performance expected of the chief executive, the way in which that performance will be measured, and the remedies/rewards which should follow from the performance which the chief executive delivers.

Life, as might be expected, is not as easy as this. Councillors within local authorities, much more than ministers in central government, are in close touch with individual ratepayers or groups of ratepayers who look to them to deal with the detail of specific council activity. It is very common for ratepayers to expect their individual councillors, particularly under a ward system, to act as advocates on their behalf and to deliver particular outcomes. It is hardly surprising that, politics being the business it is, some councillors find it difficult to accept their exclusion from implementation.

Nonetheless, what we do have is a statutory separation and one which underpins a chief executive's right to tell his or her mayor or councillors to keep away from implementation. To a degree, chief executives are doing this and mayors and councillors are understanding and accepting why but there is still a widespread propensity for elected members to act as though they are managers.

The other side of this is that mayors and councillors have a greater opportunity to focus on issues of policy, something which is of increasing importance given the issues now confronting the local government sector.

At the time of the 1989 changes, it was generally thought that it would take three electoral cycles for elected members to become accustomed to seeing their role as primarily one of policy rather than implementation. Eight years on, there is some concern that this has not happened and that part of the reason is the failure of the legislation to define, clearly, the role of elected members in a way which is complementary to the statutory definition of the role of the Chief Executive in Section 119D.

This is a matter of increasing concern both at a government level, within local government management and amongst major ratepayer groups. It is seen as compounded by the fact that remuneration for elected members still focuses more on the number of meetings which they attend than on the scope and responsibilities of the position which they hold.

This is widely seen as unfinished business and there is an expectation that the Government will consider including a statutory definition of the role and function of elected members at the same time as it reassesses the way in which they are remunerated (a matter of some concern to elected members themselves and the subject of major work by their representative body, Local Government New Zealand).

Legal Powers

The outcome, so far, has been something of a mixed bag. We did get the specification of functions. Section 37K of the Local Government Act now spells out the purposes of local government⁵. We did not get a power of general competence. Legislation was drafted for

⁵ *The purposes of local government in New Zealand are to provide, at the appropriate levels of local government:*

- *Recognition of the existence of different communities in New Zealand.*
- *Recognition of the identities and values of those communities.*
- *Definition and enforcement of appropriate rights within those communities.*
- *Spoke for communities to make choices between different kinds of local public facilities and services.*
- *For the operation of trading undertakings of local authorities on a competitively neutral basis.*
- *For the delivery of appropriate facilities and services on behalf of central government.*
- *Recognition of communities of interest.*
- *For the efficient and effective exercise of the functions, duties, and powers of the components of local government.*
- *For the effective participation of local persons in local government.*

introduction into the House in 1990 but failed to get the necessary priority. It remains, so far as I am able to judge, the view of officials that such a power should be introduced.

This seems only logical as many of the powers which local authorities now have, as a consequence of the reform process, particularly those which will be discussed in a moment under the heading of commercial activities, come very close to giving them a power of general competence, but in a very convoluted way. There is a clear need to rationalise and simplify the legislation.

The major difficulty seems to be the lack of resources, within the responsible department (the Department of Internal Affairs). Informally, officials of that department estimate that rewriting the Local Government Act, within their current resource base, would take some 10 years. This is unacceptable for a sector which has such a significant impact on the New Zealand economy; I expect to see increasing pressure on the Government not just from local government itself but from major ratepayer groups, urging that a higher priority be given to streamlining the legislative framework within which local government functions.

Regulatory v Non-Regulatory Activities

As noted earlier, officials failed to reach agreement on whether or not there should be separate types of authorities for regulatory and service delivery functions.

This issue was actually determined at the ministerial level. In this respect, it is worth remembering that two of the key ministers who oversaw the local government reform process had both had a very long experience in local government as councillors. One, as already noted, was Dr Michael Bassett, the Minister of Local Government. The other was David Caygill who had served three terms on Christchurch City Council.

Both of these ministers believed, based on their own personal experience, that territorial local authorities were capable of managing regulatory and service delivery functions without getting themselves into situations of conflict. They also listened favourably to the argument that vesting regulatory functions in regional councils, solely, could give rise to other difficulties including problems of access and complications with processes under the proposed Resource Management Act and other legislation which contemplated what amounted to two tiers of regulation.

What we actually got, therefore, was a decision to leave substantial regulatory functions with territorial local authorities, coupled with a set of rules in Section 223C of the Local Government Act on conduct of affairs which included, for every local authority and every community board, requirements such as that, so far as is practicable:

- Its regulatory functions are separated from its other functions;
- Where a committee of a local authority or community board is charged with, or has

responsibility for, regulatory functions, that committee shall not be charged with or have responsibility for functions that are not regulatory functions;

- Its management structure:
 - Reflects and reinforces the clear separation of regulatory functions from other functions;
 - Is capable of delivering adequate advice to the local authority or community board or any committee of the local authority or community board so as to facilitate the explicit resolution of conflicting objectives.

There is no doubt, also, but that this outcome reflects the strong pressure brought to bear on central government by territorial local authorities which were determined to retain their regulatory functions in areas such as town planning.

In the Resource Management area, substantial consolidation was achieved. The Act, which had been a major preoccupation of the Labour Government, especially of (now) Sir Geoffrey Palmer, was finally passed into law by the National Government as the Resource Management Act 1991. It is a shift from the control oriented philosophy of the previous legislation to an impacts emphasis. As the Ministry for the Environment states in its publication, Resource Management: Regional Policy Statements and Plans, "the focus of the Act is on controlling the adverse effects of resource use in a region to achieve sustainable management. It is not intended to promote any particular resource use or to advocate one sectoral interest over another".

It places a major emphasis on consultation in several different respects. These include:

- Requirements that the principles of the Treaty of Waitangi must be taken into account and that the relationship of Maori and their culture and traditions with their ancestral lands, water, sites, waahi tapu and other taonga is a matter of national importance.
- The emphasis on consultation, at an early stage, in the preparation of plans.
- The provision for pre-hearing meetings as an informal means for seeking to resolve issues which may be outstanding between consent applicants and other parties.

Commercial Activities

We did not get compulsory corporatisation. Instead we got a series of legislative changes which, taken together, have given significant additional power to local authorities to utilise corporate structures and other arrangements as vehicles. These changes have also created more than just a little concern over just exactly how they are intended to operate and what the management, accountability and taxation implications of the new powers are.

The one vestige which remained of the suggestion that all trading activities should be corporatised was the transport sector.⁶ Authorities operating public passenger transport services were required to corporatise those. Authorities which wished to obtain Transit New Zealand subsidy for public passenger transport or roading purposes were required to comply with the requirements of the competitive pricing procedure if they wished to obtain subsidy. In a number of cases, this requirement prompted local authorities to corporatise activities such as their professional services or aspects of their works and services activities. Subsequently, the Government has amended the Transit New Zealand legislation to require accounting ring fencing of most road related activities for which local authorities receive financial assistance.

For the remainder, instead of requiring corporatisation, the Government, in the 1989 Amendment Act, made provision for two alternative options for placing local authority functions in corporate form.

The better known of the two options was part XXXIVA of the Local Government Act which provides for the formation of local authority trading enterprises ("LATEs"). The definition of LATE is very extensive. It includes a company in which a local authority holds equity securities that carry 50% or more of the voting rights at any general meeting of the company but goes on to include any organisation through which a local authority or local authorities operate a trading undertaking with the intention or purpose of making a profit, and in respect of which they exercise 30% or more of the votes at any meeting of the members or have the right to appoint trustees, directors or managers of the organisation. As a final catch all, it includes any other company or organisation, being an organisation through which a trading undertaking is operated, which a local authority or local authorities, directly or indirectly, have control of by any means whatsoever. There are certain exclusions including energy companies, airport companies and port companies.⁷

Part XXXIVA provides a quite comprehensive code for the establishment of LATEs, and the transfer of undertakings to them, including provisions relating to the transfer of contractual undertakings and other rights and liabilities. It also sets out detailed provisions regarding the control and accountability of LATEs including provision for what is known as a statement of corporate intent as well as the principal objective of every LATE as being "to operate as a successful business".

Section 247C in part XVIA of the same Act provides "A local authority may, for the purpose of performing any function or duty or of exercising any power conferred on it by or under this Act

⁶ *Certain other trading activities, at a local authority level, were corporatised as a legislative requirement, but this was done not so much as part of the reform of core local government but as the outcome of specific policy measures in other sectors. The commercial activities of harbour boards were corporatised, as Port companies, in the context of transport reform and local authority owned municipal electricity departments were corporatised under the Energy Companies Act 1992 as part of the reform of the electricity distribution sector.*

⁷ *Appendix II sets out the relevant sections of the Local Government Act.*

or any other Act ... form or participate in the formation and operation of a company, trust, partnership, or other body" and goes on to provide a wide range of powers for subscribing for and disposing of interests in any such body, entering into partnerships, unions of interest, concessions and a range of other relationships. The section concludes by providing "Nothing in this section shall restrict the power of a local authority to form or hold any interest in any local authority trading enterprise under Part XXXIVA of this Act".

There is considerable debate as to why these two separate and individually comprehensive sets of statutory powers for entering into a variety of corporate and other commercial arrangements should have been included in the Act at the same time. The most logical explanation, and one which is accepted by a number of legal advisers, specialising in local government law, is that the LATE provisions apply when a local authority wishes to corporatise a trading activity which is intended to operate at a profit and that Section 247C is intended to apply when the authority is transferring a function which is not intended to operate on a profit making basis.

In itself, the distinction seems logical. There are quite valid circumstances in which a local authority might wish to place a function in a corporate structure, whether a company, a trust or some other entity, but without a requirement that it operate at a profit. Its reasons for doing so could include:

- A desire to distance the operation from the council's own decision making processes;
- A concern to limit the council's risk in relation to the activity;
- The objective of placing the activity under commercial disciplines to ensure that it operates on a least-cost basis.

In contrast, the detailed provisions in respect of LATEs seem more clearly to have been designed for the management of complex commercial undertakings much the equivalent of the Government's state owned enterprises. In support of this view, the detailed provisions in the legislation, in respect of LATEs, reflect discussion in the early official papers on the importance of establishing competitive neutrality between local government trading activities and their private sector competitors.

The task of distinguishing between entities established under Part XVIA and those established under Part XXXIVA is complicated by the fact that the definition of LATE has been re-written from time to time to suit taxation policy rather than to clarify the powers of local authorities. The background to this is that local authorities are generally exempt from tax on income except income from certain defined sources. One of these sources is any income from a local authority trading enterprise (note, this extends far beyond any dividends on share capital or interest on debt to include payments for any purpose whatsoever including management services, rent, consumables and so on).

Some local authorities had designed structures which, under the original definition of a LATE, enabled them to avoid taxation which the Government had intended they should pay. A common strategy was to establish a LATE and then set up one or more subsidiaries as the actual entities from which the local authority received payments. Under the original definition, subsidiaries of a LATE were not themselves LATEs, so that any money received from them was exempt from tax.

The comprehensive definition now given is such that lawyers refer to the concept of the "accidental LATE" by which they mean an entity or arrangement which could later be construed as being a LATE although the local authority concerned had no such intention. Note that the term "organisation" is defined to include "any partnership, trust, arrangement for the sharing of profits, union of interest, cooperation, joint venture, reciprocal concession or other similar arrangement". This raises the possibility that, for example, a lease by a local authority to another party which provided for part or all of the rental to be assessed in relation to turnover might well come within this definition and make the rental income taxable.

How does this somewhat confused state of affairs compare with what was promised? The original emphasis, when local authority trading activities were being reviewed during 1988, was on requiring the corporatisation of all activities of a trading nature. There was a clear emphasis on separating them, as far as possible, from their parent local authorities so that they received no support, or suffered no disadvantage, by virtue of their local authority ownership. This has been significantly watered down, both by the removal of compulsion, and by the way in which separation between the two has been managed. Boards of directors may include a majority from the parent local authority (the statutory requirement is that at least two members must be neither councillors nor employees). Although there is a requirement that no local authority "shall give any guarantee, indemnity, or security in respect of the performance of any obligation by a local authority trading enterprise", that is easily circumvented. There are numerous examples of LATEs which have been formed with very significant uncalled capital held by the parent local authority thus, effectively, providing the equivalent of a guarantee.

There is no doubt but that the provisions of Part XXVIA and XXXIVA have added, extensively, to the range of mechanisms available to local authorities for achieving their desired objectives. They appear also to have allowed a significant extension of local authority powers beyond anything which was within their capacity prior to those changes. In legal circles, there has been a significant debate over whether local authority owned companies can undertake activities which would be outside the powers of their parent local authorities. There is an argument that, if the parent lacks the power, then it cannot, in practice, give itself those powers simply by forming a separate corporate entity. A conscious attempt to extend powers may not, however, be the main motive for establishing separate corporate entities. It seems at least equally likely that the main reason why local authorities are using separate corporate entities as a means for undertaking activities which they would not carry out, directly, themselves is to manage risk, by taking advantage of limited liability, and to place those activities under commercial disciplines and commercial management.

Related to this is the issue of whether the new corporate is, itself, inherently limited in what it may do simply because its parent happens to be a local authority. It is clear that a number of the commercial initiatives which the new corporates have undertaken have been substantially on their own initiative and without necessarily having the active encouragement of their parent local authority.

Two examples will illustrate the wide range and extent of the type of activity which, through their corporate offshoots, local authorities are now starting to undertake. Although they both concern companies which are not, in a formal legal sense, LATEs, the legal principles are such that what happened could equally have taken place through a LATE. The examples are:

- The Southland Regional Council is the majority shareholder in Southport New Zealand Limited, its local port company. That company, whilst under regional council ownership, acquired 75% of the capital of Southland Farmers Co-operative, a major regional farm servicing company. Subsequently it added to its farm servicing interests by acquiring 34% of the capital of Taranaki Farmers (otherwise the Farmers Co-operative Organisation Society of New Zealand Ltd). As a consequence, the Southland Regional Council became, effectively, a major player in stock and agency activity in Taranaki, something not expressly contemplated by the Local Government Act.
- Enerco New Zealand Limited is a listed public company active in gas distribution in Auckland, Hawkes Bay, Manawatu and Wellington. In 1994, through a series of on-market purchases and off-market acquisitions from major shareholders, South Power Ltd, the electricity distributor for Christchurch and environs, acquired majority control and now holds 68.8% of the capital of Enerco. South Power itself is owned 87.6% by Christchurch City Council which can therefore be seen as playing a major role in energy distribution throughout New Zealand.

Undoubtedly the new corporate powers of local authorities will see a number of other illustrations of local authorities extending into major commercial undertakings, either within their own boundaries but outside their normal areas of activity, or outside their own boundaries or both.

Currently, the next major area where individual local authorities may use LATE structures to enter into activity outside the boundaries of their own districts is water and waste water. There is a growing recognition within the sector that economies of scope and scale both argue that it is no longer in the best interests of ratepayers for each individual local authority to try and operate its own water and waste water systems (in Auckland and Wellington there is already consolidation at the bulk water level through regional bodies). There are signs that a number of local authorities are looking at ways in which they can reduce costs, or increase the options available for their own communities, through combining activities with other local authorities (perhaps through jointly owned LATEs) or by exiting in favour of other local authority (or perhaps private) providers.

Subject to being able to finance the relevant activity, the same potential exists for expanding non-trading activity. In effect, local government may well have been given an indirect power of general competence but in a way which is subject to more than a little confusion both as to the exact nature of their powers and as to the taxation implications of their activities.

Accountability

Delivery through the 1989/90 reforms in respect of accountability appeared substantial. Before the reforms were enacted, local government accountability requirements were minimal. Accounts were prepared on a cash basis, for the entity as a whole, and were virtually meaningless as a source of information on its activities. The opportunity for public involvement in the affairs of the local authority was very restricted; apart from the right to elect members of the local authority, the only other real provisions for input were the right, under special order procedure, to be advised, by way of public notice, of certain council decisions before they were taken and the opportunity to petition for a poll in respect of local authority borrowing.

Post-reform, accountability requirements now include:

- A comprehensive annual planning/annual reporting cycle;
- A move to accrual accounting with a statutory requirement that "every local authority shall adopt financial systems and reporting and record keeping procedures that are consistent with generally accepted accounting practices recognised by the New Zealand accounting profession as appropriate and relevant for the reporting of financial information in the public sector";
- A revised Local Government Official Information and Meetings Act which permits substantial access to local authority information and rights of attendance at meetings (so much so that many observers see this as almost dysfunctional in the extent to which it denies local authorities the opportunity of developing options, in an informed way, before they get into the public arena);
- A requirement that LATEs produce a detailed statement of corporate intent;
- The provision, in Section 716A of the Local Government Act, for what is known as the special consultative procedure which requires the local authority to give public notice of proposals subject to the procedure and gives the public an opportunity not only to make written submissions but also, if they wish, to be heard in person. This procedure applies to the consideration of the authority's annual plan and also to a number of other actions. For example, under Section 594O of the Act, "If a local authority proposes to divest itself of any undertaking that it regards as significant, it may deal with the proposal only in accordance with the special consultative procedure";
- The heavy emphasis, in the new Resource Management Act, on consultation and on

the right of any person to make submissions on plans or applications for resource consents and to be heard and call evidence.

The core of the new accountability requirements is the annual plan/annual report cycle. The annual plan is required to outline, for the current financial year in particular terms and for the next two in general terms:

- The intended significant policies and objectives of the local authority, local authority trading enterprise, company, or other organisation;
- The nature and scope of the significant activities to be undertaken;
- The performance targets and other measures by which performance may be judged in relation to the objectives.

It is required to include indicative costs including both an allowance for depreciation and the cost of capital employed⁸, the sources of funds, and the rating policy of the local authority. It must explain any significant changes as between financial years and it is to be adopted before the end of the third month of the financial year to which it relates which means, in practice, that it needs to be published, in draft, before the year begins.

The annual report is, in essence, an assessment of the local authority's performance against the matters covered in the plan as well as including comprehensive financial data.⁹

The introduction of this set of changes was not without its difficulties. Quite apart from the need to shift from cash based to accrual accounting, which itself was a very major undertaking, the changes suffered from some significant confusion over just what was required. No central government agency took any responsibility for providing guidelines, to local authorities, on just how they should respond to the new statutory requirements. Some Councils took the view that the term "significant activity" required quite a detailed break down of their various functions. Others treated it as synonymous with their committee structures and reported, as one whole, the mix of apples and oranges which each of their committees managed.

There was major confusion over the issue of cost of capital. In the original legislation the requirement was to report "a return on capital employed". The accounting advisers to many local authorities told them that this term was meaningless as, since most of their activities were not being undertaken to make a profit, they were not seeking a return on capital and should report accordingly. In 1992 the provision was changed to require local authorities to report "the cost of capital employed".

⁸ *This specific requirement was repealed by the No. 3 Act; instead, local authorities are now required to have regard to the cost of capital as part of the process of considering the costs and benefits of different options, something the Act states they must do whenever making any decision with significant financial implications (including a decision to do nothing).*

⁹ *Appendix III sets out the relevant sections of the Act in full.*

This was an attempt to get back to what the legislation was probably intended to mean in the first place; making provision for the opportunity cost of capital which is an economic and not an accounting concept. From this perspective what was needed was to get local authorities, both when reporting on their use of existing resources, and when considering new investment, to recognise that capital has a real cost and that understanding this has very practical benefits in terms of managing resources. Particularly in capital intensive activities, unless you have a clear understanding of the opportunity cost of capital, then you are at risk of making highly sub-optimal choices as between different investments or in terms of retaining versus selling any particular asset.

The change did not get the desired result of more extensive reporting of the cost of capital. The underlying problem seems to be a technical one, that the way in which the legislation was written required this to be reported in accordance with generally accepted accounting principles. Those principles deal with financial transactions, and not with opportunity cost. Accordingly, strict compliance with the legislation seemed to mean reporting a zero cost of capital rather than the intended opportunity cost. This provision has subsequently been repealed.

The initial reaction to the new regime was that it had produced major benefits in efficiency terms (especially as a consequence of the new information available to elected members and managers as the result of accrual accounting) as well as informing citizens on just what it is that their local authorities are doing for them.

There was also initial enthusiasm for the new rights which the public had, especially under the special consultative procedure, to put forward their views before Councils made important decisions. In the first few years of the new requirements, the public took an active interest in the annual planning process and, generally, numbers of submissions increased year by year.

More recently, there have been increasing concerns that this process may not have been as effective as originally hoped and that it may, contrary to expectations, be contributing to public disillusionment with local government.

Much of the problem lies with the differing expectations which local authorities, and their publics, have had of the consultative process. Generally, members of the public when going through the process of making submissions and then appearing in person before their councils, have assumed that they are taking part in a genuine debate over the issue and that their views will influence the outcome. This has been particularly the case if a Council proposal has attracted a large number of submissions. Members of the public have tended to see the special consultative procedure as akin to a referendum or survey which the Council would treat as directive.

The reality is otherwise. In a number of Court cases on the legal obligations of Councils undergoing the special consultative procedure, the Courts have emphasised that the process is

in no way akin to a referendum. Instead, the obligation on the local authority is to provide sufficient details of its proposal so that the public can make meaningful comment, to assess that comment with an open mind and then to make a decision. The Courts have emphasised repeatedly that it is the responsibility of local authorities to make decisions, following consultation, on the basis of all the information available to them and that the numbers of submissions, for or against a proposal, is an irrelevant consideration.

Not surprisingly, the result has been public discontent with the process and some degree of scepticism about the intentions of local authorities when they go to consultation. This has been unfortunate for local authorities themselves who have generally gone to a great deal of trouble to make the consultation process work. Hindsight has shown that all too often the formal process has worked in such a way that proposals have been taken to public consultation at a stage in the decision making process when there may be very little prospect of making any significant change.

Many local authorities are now recognising that there is a major difference between consultation in the sense of formal legal compliance and consultation in the sense of communication with ratepayers and building and responding to an understanding of their needs and preferences. As a result, there is an increasing use of techniques such as focus groups and satisfaction surveys as a means of improving understanding coupled with an emphasis on seeking public input at a much earlier stage than contemplated by the formal legal process. A number of local authorities are also using this kind of approach as a means of refining performance measurement (one of the requirements for the annual plan/annual report cycle is that local authorities specify the performance measures against which to assess their activity). It is now not uncommon for changes in satisfaction ratings, year on year, to be treated as an important performance measure.

There are also concerns that the heavy emphasis on consultation, and the unrestricted right for any person to be heard on notified consent applications, may be giving rise to difficulties and costs which were not fully anticipated. The provisions reflect a concern that too much local government decision making had taken place with insufficient or no consultation. As has already been observed, the right of citizens, pre-reform, to have access to local authority decision making was strictly limited. Under the former Town and Country Planning Act, in order to become involved, particularly in respect of consent applications on individual projects, people needed to establish that they had standing; in essence, a greater interest in the project than the public at large. This had been widely criticised, especially by environmental groups, as excluding consideration of public interest issues.

This interest in wider consultation can be seen in other legislation, such as the Health and Disability Services Act, which imposes significant consultative responsibilities on regional health authorities when determining how they will go about purchasing services for the public for whom they are responsible.

There is some evidence that the emphasis on consultation, and open access to the resource

management process, may be carrying very substantial costs with it. Although the special consultative procedure does mean that councils cannot take major decisions without first consulting their citizens, it also provides an opportunity for determined opponents, or well organised special interest groups, to play a dominant role at least in terms of timing as opponents prove able to drag out the decision making process. In effect, it can be seen as a manifestation of the problem of the vocal minority versus the silent majority.

For councils this is a real concern in respect of infrastructure where the fear is that, when all of the possible options for necessary work have an element of controversy, the Act opens the way for interminable delay.

Even although it is now nearly eight years since the special consultative procedure was introduced, we still seem to be in something of a transition process. The initial enthusiasm which greeted the public's new rights to be involved has been replaced by a growing understanding that consultation, by itself, is not sufficient to restore public influence over local authority decision making. It is of the nature of the special consultative procedure, particularly when applied to the annual plans of local authorities, that the proposals which are put forward to consultation will often have a certain inevitability about them. How realistic, for example, is it to expect that a local authority going to consultation on the range of activities it will undertake in the coming year is genuinely open to major change?

Despite that, the special consultative procedure will remain a feature of local government accountability. It is at its weakest when people expect that, of itself, it will be sufficient to ensure that local authorities bend to the public will. It is at its most useful when it is seen as simply one of a number of different tools, and local authorities and their publics recognise that it needs to be supplemented by other measures such as:

- Even handed and objective means of sampling the opinion of the local population (amongst other things to avoid the "squeaky wheel" effect);
- Commitment by the public to ensuring that people of quality stand for and are elected to their councils;
- A willingness on the part of key stakeholders to invest time and effort in understanding the issues facing their local authorities and the options open to them.

PART 4: POST 1989/1990 CHANGES

Major though they were, the 1989/90 reforms to local government were only the beginning of a process which is still working its way through. In this section of this paper I discuss the major changes which have been implemented since the 1989/90 reforms. In the next section, I look at changes yet to come.

In 1992, the Government passed the Energy Companies Act, the outcome of several years of intense analysis and debate over the future of New Zealand's electricity industry. At the time, virtually the whole of the industry was in public ownership. The Government through the Electricity Corporation of New Zealand Limited (a state owned enterprise) owned all of New Zealand's major generation capacity as well as the National Grid. Local distribution was undertaken by a combination of 35 special purpose local authorities known as Electric Power Boards (which had been excluded from the 1989/90 restructuring in the expectation that electricity reform would be the subject of a separate process) and 13 local authority owned distributors, commonly operated as business units within the parent local authority.

The effect of compulsory corporatisation was to turn what had typically been relatively low key service activities into extremely valuable commercial businesses. For those local authorities, such as Wellington, New Plymouth, Palmerston North, Christchurch or Dunedin which had the good fortune to own the local electricity distributor, the effect was a major enhancement to their balance sheets. The future ownership of Electric Power Boards was left, by the Government, to be determined through a rather complex process involving the people who had been selected as future directors of the corporatised companies, the people who had been the former elected members, and the public through the special consultative procedure. In only one case did ownership come back to local government (South Taranaki District Council became the owner of Egmont Electricity). In virtually every other case, ownership was allocated to trusts representing consumers, to consumers through share giveaways or through a combination of these two methods. From a local government perspective, the practical impact has been that those local authorities which own their electricity undertakings have been significantly enriched by restructuring and those which did not are now, in relative terms, significantly less well off.

The second major change came in 1996 with the passage of what is variously referred to as the Number 3 Act or the New Financial Management Legislation¹⁰.

This Act was the last of a series of enactments which the Government passed between 1993 and 1996 with the objective of raising, significantly, the reporting and accountability standards imposed on people responsible for managing other people's money. Earlier legislation on this theme included:

¹⁰ *The formal title of the legislation is the Local Government Amendment (No. 3) Act 1996.*

- The Companies Act 1993;
- The Financial Reporting Act 1993 (setting new standards of reporting for companies);
- The Fiscal Responsibility Act 1994.

This last Act was particularly influential in the introduction of the No. 3 Act. The purpose of the Fiscal Responsibility Act was “to improve the conduct of fiscal policy by specifying principles of responsible fiscal management and by strengthening the reporting requirements of the Crown”.

The Act imposed a series of reporting requirements on the Crown including the publication of economic and fiscal updates at key times through the budgetary cycle and, in particular, before each general election (here the motivation was the experience which the National Government had, when taking office in 1990, of finding that the fiscal information which was publicly available in the lead up to the election was misleading to such an extent that it was forced to make major changes to the policies on which it had campaigned).

The Act also spelt out principles of responsible fiscal management which the Government was required to follow with the proviso that it could depart from them on a temporary basis so long as it spelt out why, and when and how it intended to return to compliance.

The principles included:

- Reducing total Crown debt to prudent levels;
- Once prudent levels had been achieved maintaining those by ensuring that, over time, operating expenses did not exceed operating revenues;
- Achieving and maintaining levels of Crown net worth to provide a buffer against future adverse events;
- Managing fiscal risks prudently;
- Pursuing policies consistent with a reasonable degree of predictability about the level and stability of future tax rates.

Business interests, in particular, concerned about what they saw as the impact of excessive expenditure and an unfair allocation of the rates burden, argued that similar legislation should be applied to local government. The argument for doing so was assisted by the fact that the annual plan/annual report process imposed by the 1989 legislation was seen as being generally inadequate to:

- Give interested ratepayers the information they needed independently to assess and evaluate the quality of local government spending and revenue decisions and the true costs associated with individual activities;

- Ensure that local authorities were required to apply an economic framework to their decision making.

The purposes of the new legislation were spelt out in the Act as *“to promote prudent, effective, and efficient financial management by local authorities:*

- (a) *By specifying principles of financial management to be observed in local authority decisions; and*
- (b) *By providing a structured framework for local authority decision making on financial management; and*
- (c) *By providing an effective and appropriate avenue for public participation in local authority financial policies and funding decisions; and*
- (d) *By clarifying the appropriate exercise of local authority autonomy in financial policy and funding decisions; and*
- (e) *By requiring local authorities to explain their selection of funding mechanisms; and*
- (f) *By recognising that, while rating mechanisms are an appropriate means of funding:*
 - (i) *expenditure in respect of which it is not practicable or appropriate to identify the direct beneficiaries of that expenditure; or*
 - (ii) *expenditure which benefits the community generally,;*

The appropriate use of rating mechanisms is not limited to the funding of such expenditure.”

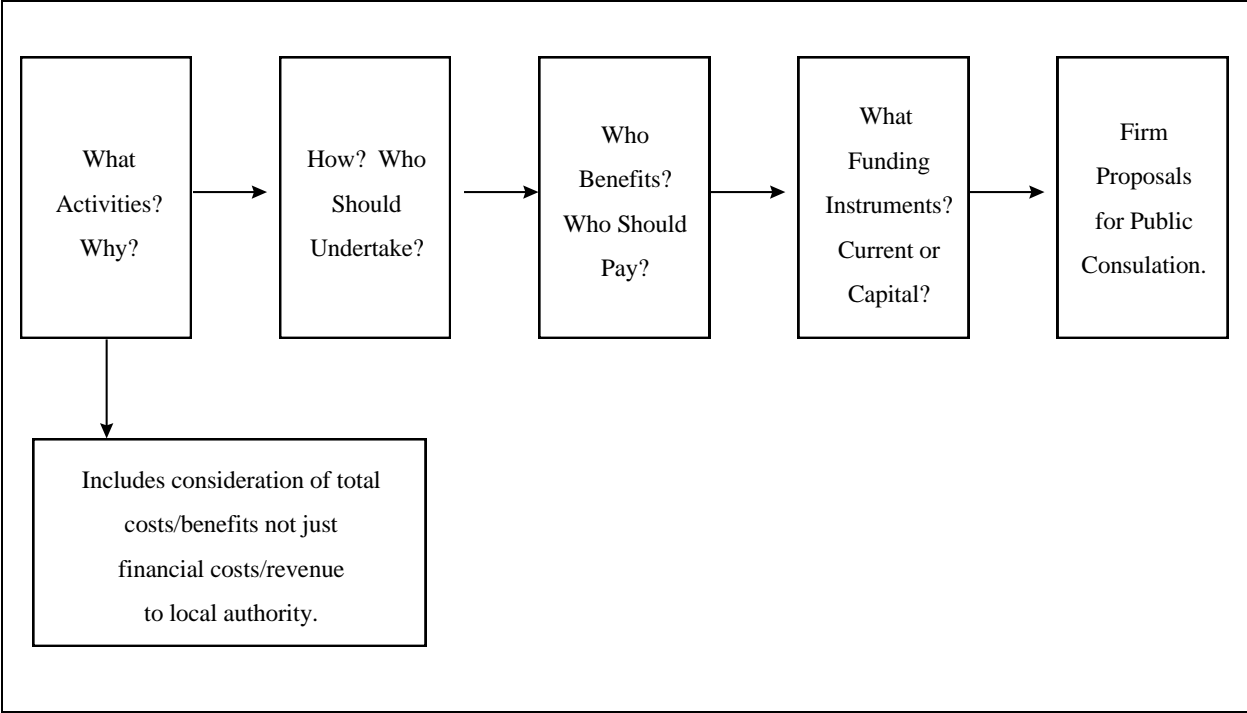
This was to be done by requiring local authorities to adopt:

- A funding policy;
- A long term financial strategy;
- A borrowing management policy;
- An investment policy.

In a very real sense, this legislation was a throw back to the discarded principle of the 1989/90 reforms that “as a fundamental principle it is agreed that local or regional government should be selected only where the net benefits of such an option exceed all other institutional arrangements”.

At the heart of the legislation was an attempt to impose a public good framework on local authority decision making.

Although the legislation itself is complex, its basic principles are comparatively straightforward. They are set out in the following diagram.



The funding policy is intended to provide for the medium term (the forthcoming financial year plus the next two) detailed specification, by function (a term not actually defined in the Act) of what the local authority will be doing, why, who it believes benefits and how it intends allocating the costs of activities and obtaining the finance to meet those costs.

The long term financial strategy is intended, as the name implies, to take a longer term view. Its purpose is to look out over a minimum of 10 years at commitments, cash flows, funding sources, expected activities (and the reasons for undertaking them), issues of balance sheet management and contingencies which the local authority thinks are likely to impact on it. A principal reason for requiring this long term look is concern that the most important impacts on a local authority's financial viability arise from major infrastructure investments where long life issues are critical.

The other two requirements of the new legislation are the development of a borrowing management policy and an investment policy; these are, for local authorities, the equivalent of the treasury management policy which would be expected within a well run private sector corporate.

Initial expectations of the legislation, especially from the business community, were high. There was (and is) a widespread belief that local authorities used their rating powers as a means of achieving cost shifts from residential ratepayers to business ratepayers. Under the Rating Powers Act, New Zealand local authorities have a power to establish what are known as rating differentials. Rates are normally struck as so many cents in the dollar of the land or capital value. The power to differentiate allows local authorities to decide that different classes of property, instead of paying the standard rate, will pay a rate based on a differential which could be a multiple (or a fraction) of the standard rate.

This power has been widely criticised by the business community many of whose members believed that local authorities were using their differential rating powers to provide services for residential ratepayers at the expense of the business community.

The requirement for local authorities to go through a process which required them to apply economic principles to the determination of who benefited from particular services and to allocate costs in accordance with benefit was seen as a means of restraining cost shifting amongst different categories of ratepayers.

One difficulty with this approach is that although economists generally agree on the technical description of public goods, externalities, merit goods and so on, there is no ready way of determining in respect of any particular good or service the extent to which it is private, public or both. These judgements are far more subjective in nature.

This can be seen with the way in which local authorities have approached justifying the common decision that library services should be funded through rates rather than on a user pays basis. Critics of the way in which local authorities fund libraries argue that books are substantially private goods and that the people who benefit from their use are those who read them or use them as reference tools. Local authorities typically argue (in what is clearly a merit good and/or externality argument, although seldom expressed as such) in terms such as "Dunedin takes pride in its standing as one of the countries oldest cities and being the seat of the original University of New Zealand. Founded by Council in 1908 the library reflected the importance then of cultural values to the city, and today the Resident's Opinion Survey continues to rate this amenity very highly. Council has always supported equitable access to library facilities for the whole community, regardless of ability to pay."

The Government also included in the legislation a number of provisions which, taken together, mean that it is substantially for the individual local authority to decide the extent to which it will apply the economic principles underlying the legislation in any particular case. Thus local authorities have a discretion:

- To decide the extent and detail of information to be considered, the degree to which benefits and costs are quantified, the extent to which different options are considered and the extent and nature of any written record;
- To make judgements about fairness and equity and judgements concerning the extent

to which the principles governing the funding of expenditure needs are relevant to any particular case. This part of the legislation goes on to state “which judgements may reflect the complexity and inherent subjectivity of any benefit allocation for specified outputs and the complexity of the economic, social, and political assessments required in the exercise of political judgement concerning rating”.

So far, only nine of New Zealand’s local authorities have gone through the process of complying with the new legislation (compliance was voluntary for the financial year beginning 1 July 1997 but compulsory from 1 July 1998). It is accordingly still much too early to make conclusions about how the legislation will work in practice. However, preliminary impressions include:

- Compliance costs are likely to be high. The process of going through a local authority’s activities, function by function, in the level of detail required by the new legislation has proved extremely demanding. However, as the legislation requires the preparation of a full funding policy and long term financial strategy only once every three years (with summaries of this material published in the Annual Plan in other years), and the likelihood that preparing for the first time is probably more burdensome than revising them will prove to be, the compliance costs may reduce;
- The amount of material being made available for the public may, perversely, defeat the objective of informing ratepayers simply because it is so voluminous. There is a risk that, rather than increasing public understanding, these documents will fall into the category of “public secrets”, material which is available but which shuts out most potential users because of the time and skill required to make use of it;
- Both because of the difficulty, in any particular case, of deciding the public good characteristics of a given activity, and because of the discretions under the legislation, it may be very easy for local authorities to comply in form but largely ignore the intent of the legislation in substance;
- On the other hand, the greater level of detail required, and the emphasis on linking current plans to a long term financial strategy, and both of these to a “first principles” justification for being involved in the activity at all, has the potential to enable the more responsive local authorities to obtain a genuine ratepayer mandate for their proposals.

It would be relatively easy to be dismissive of the No 3 Act as a misguided and ineffective measure the main consequence of which is likely to be a substantial increase in compliance costs. It is certainly the case that at least some local authorities are likely to emphasise compliance in form over compliance in substance. However, I prefer to take a more optimistic view.

Dissatisfaction with local authority rating and funding practices, and propensity to spend “other people’s money” on projects of appeal to elected members, had been high. Litigation over rating decisions was increasingly frequent with a growing concern that the Courts, rather than

elected members, were becoming the final arbiters of rating decisions.

A government, faced with this situation, could have legislated for tighter central control over local government and its spending patterns (England under recent conservative governments provides a parallel). Instead, the New Zealand Government opted for attempting a solution which could be called “autonomy with responsibility”. There is good reason to believe that most local authorities understand that this is the approach which underlies the current legislation.

Most local authorities, also, are becoming increasingly aware that their actions, including their decisions as to the activities they undertake and how the costs of funding them are allocated, have real implications on the level and nature of economic activity within their communities. As New Zealand’s economy becomes increasingly open, and the pressures of global trading, capital and labour markets become more real, most elected members, and an overwhelming majority of executives, are becoming more and more aware of the fact that they cannot escape the consequences of their decisions.

There is, accordingly, good reason to believe that both elected members and local authority executives have quite strong incentives to try and comply with the spirit of the legislation. For many of them, admittedly, this means trying to come to grips with a relatively new way of looking at their activity. The language of public good economics has not been the normal language of the Council chamber but this may now be changing.

In summary, my conditional judgement on the new legislation is that it does have potential to lead local authorities to think about their decisions in economic terms and be satisfied that their judgements about activities and the chosen means of funding them are sustainable within a public good framework except to the extent that, for good and sufficient reasons which they are prepared to justify in public, they have chosen to depart from them.

At the same time, it is also important to note, especially for any countries seeking to follow the New Zealand example, that the legislation does impose very high compliance costs and is, in many respects, so poorly drafted that there is genuine confusion as to its intent (it is, for example, surprising that the whole of the focus of the funding policy should be around “functions” when that term is nowhere defined).

A Changing Role?

That major change in reporting and accountability requirements is about to be followed by an equally major change in the scope and nature of local authority activity.

Historically, the major activity of New Zealand’s Territorial Local Authorities, both by value of assets involved and by percentage of expenditure, has been the provision of infrastructure, primarily:

- Water and waste water;
- Roothing,

but also Ports, electricity, airports and waste disposal.

Electricity has been corporatised and a number of local authorities have sold their shareholdings. Ports were corporatised in the late 1980s and although no major port has been wholly privatised, a number of port companies have become listed public companies through the sale of a minority shareholding. Airports, of any significance, tend to be jointly owned by central government and local government. Increasingly, waste disposal is shifting to the private sector (both actual collection and the operation of transfer stations and land fills).

Water, waste water and roading are still almost totally within the public sector (one territorial local authority, Papakura District Council, has recently franchised the management of its water and waste water system to a private sector company, but still retains ownership of the assets).

Together, these two activities make up more than half of the balance sheet and operating expenditure of the typical territorial local authority, whether urban or rural, with rural authorities more heavily biased towards roading and urban towards water and waste water.

The Government is part way through a major review of roading. A possible outcome is that all local authority owned roading will be vested in a series of local authority trading enterprises, quite likely as regional joint ventures in order to achieve the economies of scale which Government believes would result from rationalising administration (at the national level Transit New Zealand which owns and operates the state highway system would be corporatised). Over time funding would be expected to shift from the present part tax, part road user charges, part rating mix to one based entirely on tax and user charges.

The involvement of local authorities would shift, in substance, from that of direct ownership and management of the roading system (apart from state highways) to the relatively lesser ones of:

- Continuing to have a planning involvement, especially under the Resource Management Act;
- Purchasing, on behalf of the local community, amenity aspects of roading over and above the minimum which the roading companies decide to provide;
- Governance of the LATE in which it was a shareholder in conjunction with its fellow shareholders.

The immediate impact on local government would be substantial. Even for major urban authorities, roading expenditure is approximately 20% of their operating costs and the management of roading is a significant part of their total activity. For rural local authorities, roading bulks much larger; in some cases roading expenditure may be as much as 60% or

more of the operating budget when grants from Transfund, the Crown entity responsible for allocating roading funds, are taken into account.

This change has been driven by concerns that the existing system had a number of problems including: property owners subsidise road users; average pricing distorts transport decisions; there is no direct relationship between road service providers and road users; dual management structures blur responsibilities for road management, planning, road users do not pay the actual cost of their road use;

There was also an increasing realisation that problems of road congestion, common in Auckland and of increasing concern in Wellington, were best dealt with by the introduction of targeted pricing.

All of these considerations pointed towards commercial management of the roading system as a whole with, as far as possible, road users paying for road use through mechanisms which accurately signalled the true resource costs which their use incurred.

Broadly similar arguments are also surfacing in discussion of the future ownership and management of water and waste water assets. In many parts of the country, these services are placing an increasing burden on the environment. There is an increasing awareness that, if you wish, for example, to constrain water consumption or minimise the extent to which effluent is discharged into the environment, then the user or the discharger should face the true economic cost of that activity.

In recognition of these concerns, the Government has been looking closely at the regulatory framework for water and waste water and recognising that it needs revision (local authorities are not required to provide water and waste water services; instead, they have statutory authority to do so if they wish. However, this legislation is written in such a way that many of the powers necessary for the effective running of a water or waste water network are available only to local authorities).

It seems likely that, within the next few years, the Government will legislate so that water and waste water activities can be corporatised and there will be strong encouragement (likely to be welcomed by a number of local authorities facing environmental pressure) to introduce efficient pricing.

The implications of these shifts are profound as they will, substantially, move local government away from the core activities which it was established to undertake; more of the implications of this in the last section of this paper.

PART 5: WHAT IS STILL TO COME

In an earlier version of this paper, written in 1994, I foreshadowed a number of changes which are now well advanced. For example:

- I predicted that adoption of comprehensive asset management plans seemed inevitable. Such plans are now, in practice, an essential part of complying with the requirements of the new financial management legislation (in practice, it will be impossible to prepare long term financial strategies without good asset management planning);
- At the time, the demand from local government for an additional source of revenue was quite strong. I commented that “it seems unlikely that central government will be prepared to listen to, or local government able to advance, an argument for an additional revenue source or sources until the potential of user charges to address the revenue issue has been fully explored”. This is now happening. Not only does the No. 3 Act encourage local authorities to look more closely at the appropriateness of funding mechanisms to the nature of the good or service involved; the major changes which could take place in respect of roading, and are likely to come for water and waste water, are really overtaking any argument for some kind of additional tax based revenue, whether revenue sharing or otherwise. Indeed, even without those the case for an additional revenue source has now really gone;
- I noted that the archaic framework for local government borrowing was likely to be reviewed. The No. 3 Act repealed the Local Authorities Loans Act and, with the exception of a ban on borrowing in overseas currency, gives local authorities broadly the same borrowing powers as private sector corporates;
- I predicted that there would be less emphasis on forcing reorganisation. This has been the case but, as I note below, we can expect to see a revival of interest in local government reorganisation as a consequence of other changes including those in roading;
- I predicted increased local government involvement in the delivery of what are now central government services.

From a late 1997 perspective, three factors seem likely to dominate the ongoing reform of local government. They are:

- Changes in the ownership and management of major infrastructural activity coupled with an increased role for local government in regulating infrastructure;
- A rethinking of the regulatory/service delivery split;

- A growing involvement, by local government, in the co-ordination and, perhaps, delivery, of social service activities of central government.

Infrastructure

The changes foreshadowed for roading, and likely to come for water and waste water, will have a major impact on local government. This will come about as:

- Many smaller and medium sized local authorities find that the major part of their activities and expenditure shifts from their operations to those of joint government/local government owned roading companies or to corporatised water and waste water undertakings;
- The nature of local authority revenue and expenditure streams changes and some, at least, find that they shift from dependence on rates funding to support their activities to generating a surplus from a shift to user pays.

This latter point may seem somewhat fanciful. However, if roading is stripped out of local authorities, water and waste water facilities are operated in accordance with efficient pricing principles (which includes earning an appropriate return on capital), there is a shift towards user charges as local authorities look more closely at how to match benefits of services with the allocation of costs, but rating remains (for reasons of accountability and equity) the preferred form of funding for genuine public goods, some local authorities at least will start generating surpluses which cannot be recycled within their organisation. This in turn will raise the somewhat unusual and unexpected question of who owns local authorities (that is who has the property right entitling them to claim a share in the surpluses which local authorities may start to generate).

Separation of Regulatory and Service Delivery Activity

At page 13 above I quoted the view expressed in the December 1987 economic statement which supported separation of service delivery functions and regulatory functions on the basis that “otherwise a regulatory authority could potentially guarantee its service delivery arm an unfair commercial advantage. Minimising conflicts of interest will ensure that authorities are less liable to capture by pressure groups”.

In retrospect, there is a certain irony about the statement. Although full separation was never achieved, the narrowly proscribed role of regional councils has meant that the majority of them have become, primarily, regulatory and planning bodies with little in the way of service delivery functions (at least outside their responsibilities for catchment control).

There is an increasing concern that, in a different way from that expected by the officials who drafted the December 1987 statement, there is a very real risk of the regulatory process being captured, if not by pressure groups, then by interest groups with a philosophical commitment to regulation and planning as a preferred means of achieving outcomes.

The relatively narrow focus of most regional councils means that they have a necessary bias towards recruiting people with a background in regulation and planning. In turn, the natural process of self selection which leads people to look for careers in organisations whose mission and values they find empathetic, is almost certainly resulting in a tendency for the staffing of regional councils, and the culture of the council themselves, to be building up an ethos supportive of intervention rather than of reliance on market mechanisms.

This is put forward more as a hypothesis rather than as conclusion; it is based largely on anecdotal evidence. However that evidence is sufficiently persistent to suggest that the issue is worth some more rigorous examination.

Central Government Social Services

Traditionally, local government has tried to keep away from any involvement with main stream central government social services. Occasionally the Council toe has been dipped in the water through the delivery of a range of community development activities and involvement in employment initiatives and housing. However, even in those Councils which have been most active in these areas, it is still by way of an exception to a general insistence that main stream social services are a central government (tax payer) responsibility.

At the same time, there is a growing concern that the functionally specialised nature of the central government bureaucracy does not sit well with the need to work across functional boundaries when addressing community, family or individual needs.

Along with that, there is also growing realisation that New Zealand's communities are not homogenous; that if social services are to meet local needs effectively, then those who plan and co-ordinate their delivery must have an intimate understanding of local circumstances.

This will fit well with the growing interest in "big" versus "little" government, the emphasis on village democracy, with a number of local authorities looking at how they can move more of their own decisions down to the communities they serve, and a renewed look at economies of scope and scale on the one hand but the importance of closeness to the community on the other.

This has seen a number of local authorities becoming proactive in research and advocacy in areas such as health, education and social services. The best known example is the "strengthening families" initiative which has been piloted in Waitakere, where the city council has been taking the lead in co-ordinating service delivery across education, health and social services.

Expect more of this as the Government increasingly develops initiatives which recognise the need to work with the local community, whether it is as a consequence of the recently announced initiatives in employment and income support, in trying to find ways to legitimate

decision making and the allocation of resources in the health sector, or in planning for the educational needs of different communities.

Some Likely Developments

For central government, the priority in respect of local government must now be tidying up the legislative framework. The Rating Powers Act, which is the back bone of local government financing (in the sense that rates represent the main non-trading source of income for local authorities) is increasingly out of step with recent changes such as the new financial management legislation. There is a need to review a number of specific areas and bring them into line with current policy settings. These include:

- The somewhat ad hoc set of exemptions from rates, some of which now provide a direct subsidy from local government to central government activities which, in terms of central government's own policy settings, should bear their own costs;
- Provisions in respect of postponement of rates on hardship or other grounds pre-date the changes in local government financial reporting and accountability requirements of the past 10 years;
- The discretions which local authorities have in setting rates, including the use of differentials, need to be integrated with the requirements of the new financial management legislation.

A larger task, legislatively, is re-writing the Local Government Act so that it moves away from being an extremely ad hoc but prescriptive piece of legislation towards the purposive approach which characterises modern legislation. The question of powers of general competence needs also to be revisited, as much as anything as part of reducing the extraordinary size of the Act.

There are also a set of subsidiary issues, important from a governance and management perspective, which are in urgent need of attention. The remuneration basis for elected members is now quite inappropriate. Elected members receive an annual allowance, related to the population of their district, supplemented by meeting allowances (similarly scaled). There is still confusion about the job for which elected members are being paid. The remuneration framework was developed at a time when, even in larger authorities, it was easy for Councillors to combine that role with full time employment. Increasingly, this is no longer the case with the result that numbers of people, who could make a very effective contribution to the governance of their communities, are effectively excluded from putting themselves forward.

The need is to re-write both the role of elected members, with an emphasis on their governance responsibilities (but recognising also the inherently representative nature of their position) so that it is explicit that elected members are primarily concerned with matters of policy and of monitoring the performance of management against agreed expectations. Within this change, the nature and level of remuneration needs also to reflect, better, both the increased burden on elected members and the importance of the positions which they hold.

The Government will also be concerned to ensure that the legislative settings for major activity, such as water and waste water infrastructure, are neutral as between different means of owning and managing these services.

Beyond this, though, I do not expect to see central government, of its own initiative, legislating for more structural change.

Instead, what does seem likely to happen is further and significant structural change driven from within the sector itself. Restructuring of the roading sector will raise, in a very direct way, the question of how viable a number of New Zealand's smaller, particularly rural, local authorities really are. But roading is not the only issue which is leading to a re-evaluation of the structure of local government. A number of territorial local authorities are re-considering the split between regional councils and territorial local authorities and wondering whether it is really in the interests of their own localities that they should have what, to them, increasingly looks like a doubling up with the twin effects of:

- Increasing the costs of administration;
- Fragmenting the ability of the locality either to advocate to central government or to come together in planning for the environmental, social and economic needs of the locality.

When this concern is set alongside the likely impact of roading reform, the possibility of significant restructuring of local government, driven by the sector itself, seems quite real. Anecdotal comment suggests that this kind of restructuring is or has been under consideration in at least the following areas:

- Southland;
- South Canterbury;
- Christchurch and surrounding rural areas;
- The West Coast;
- Nelson/Tasman (uniting two territorial local authorities which already have the status of unitary authorities, that is, they exercise the functions of a regional council within their respective boundaries);
- The Wellington urban area (where a major concern, certainly for the business community, is the disadvantage Wellington faces in promoting itself as a region because of the fragmented nature of territorial local government);
- Wairarapa;
- Hawkes Bay;

- Bay of Plenty;
- Taranaki.

There are also signs, within the Auckland conurbation, that some within its territorial local authorities believe that further amalgamation, amongst themselves, would assist with the management of the relatively strong growth of that area.

The growing awareness of the benefits which can come from the use of efficient pricing for major services will also have a significant impact; expect to see quite a marked shift away from reliance on rates as a means of funding local authority provided or purchased activities towards user pays. This will be driven by, amongst other things, a greater confidence in the ability to develop governance and monitoring structures able to manage the relationship between local authorities and arms length trading activities or previously in-house services which have been contracted out.

In summary, expect to see:

- A continuing trend towards the reduction in the number of local authorities and the emergence of units of local government which have the scale to act, quite genuinely, as the government of their localities or, alternatively an increased level of co-operation amongst local authorities in undertaking specific activities, perhaps through the amalgamation of business units or the creation of LATEs owned by several local authorities, in essence operational rather than political mergers;
- A shift away from the physical provision of the traditional core services of local government, towards corporatisation or contracting out (and within that, a process which, in the private sector, would be described as merger or acquisition. Increasingly, it is recognised that there are potential gains through economies of scale and scope in bringing together the infrastructure activities of several local authorities under common ownership and/or management).

This will also help accelerate another trend; an increasing devolution, from central government, of the delivery of central government funded social services. This is already happening as central government becomes increasingly aware of the limits it faces in ensuring effective delivery within New Zealand's differing communities. As local government increasingly develops the scale and capability to manage complex activities for large numbers of people, the Government is likely to have an increasing confidence in local government as an alternative means of delivery (this is not to argue that central government will be forcing service delivery functions on local government; for political and other reasons, this is much more likely to come about through negotiation, initially on a case by case basis. Indeed, political considerations - the resistance of ratepayers to central government compulsion - is not the only factor. It will also take time for central government to gain the necessary confidence in the competence of local authorities to handle a wide range of activities which have conventionally been provided by central government).

PART 6: THE ROLE OF CONSULTATION

This issue is at the heart of the difference between what was promised and what was delivered but in a way different from the matters discussed earlier in this paper.

Consultation, as provided for in the Local Government Act and related legislation, was clearly intended by the Government to put the teeth into the accountability mechanisms introduced in the course of the reform process. The attitude which the Government took, during the reform, was one of wanting to improve accountability, and its effectiveness as a means of controlling local authorities. In designing the proposed accountability arrangements, the Government was seeking to address what it regarded as weaknesses in the then accountability arrangements. The extent of the Government's concern was spelt out in a paper from Michael Bassett, as Minister of Local Government, to the Cabinet Committee on Reform of Local Government and Resource Management Statutes in March 1988. In respect of accountability he had this to say:

- There is generally poor turn out at elections particularly of single purpose local authorities;
- The quality of financial reporting and the provision of other information is variable.; In some classes of authority there is no direct link between electoral and funding accountability;
- The generally confused pattern of functions, structures, funding and organisation, particularly in metropolitan areas, weakens overall accountability.

What the Government was seeking to deliver was a set of arrangements, underpinned by requirements to consult, which would significantly constrain local authority activity. They were going to have to be much clearer about their activities and the resources required to deliver their various outputs. The public was to be permitted input before policies were adopted and expenditure undertaken, as well as before any significant undertakings were disposed of. It seems possible that ministers, and certainly the officials who advised them, expected the result to be tighter constraints on local government activity and less scope for the commitment of significant resources to new activity.

In an earlier version of this paper, I argued that the new accountability regime for local government could have an opposite impact from that intended by central government. I noted that, increasingly, local authorities were learning how to work with the new regime and use it as a means of eliciting citizen support for activities which they intended to undertake. It did seem, from reported experience, that local authorities were learning how to use the process of consultation as a means of obtaining a mandate for specific activities. Arguably, to the extent that this was happening, it was putting local government in a much stronger position than

central government which, at most, can argue that it has a general mandate by reason of having won an election. In contrast, it was starting to look as though local authorities could claim an explicit mandate for particular policies.

Several years on, this looks less likely to be the case. Instead of creating increased confidence in local government, the special consultative procedure in what may be something of a temporary hiccup is operating in a way which seems to be undermining public confidence.

A main reason for this, as this paper has already discussed, is the differing expectations with which the public, and local authorities, have entered the consultation process.

A number of local authorities, in response to this, are recognising the difference between consultation under Section 716A of the Local Government Act and communication. Increasingly, the former is being seen as primarily a means of legal compliance - where the act requires that the procedure be followed, it is necessary to go through it correctly in order to avoid legal challenge. However, if the objective is to engage the public and ensure, as far as reasonably possible that:

- Local government understands the preferences and priorities of its residents and ratepayers;
- There is a reasonable opportunity for residents and ratepayers to make their views known before major proposals reach the point of no return

then it will be necessary for local authorities to be proactive in working with their communities, well in advance of the point at which it would be normal to start the formal consultation process. To achieve this, local authorities are experimenting with a wide range of techniques including satisfaction surveys, focus groups, forums, use of community boards as a means of involving the public more closely than is possible with the Council itself and upgrading the way in which they handle their day to day affairs. It is not uncommon now when ringing a local authority to be answered by a customer service centre which is set up and trained to handle an inquiry through to the point of a definitive answer.

Paradoxically, the special consultative procedure may yet contribute to greater understanding between local authorities and the communities they serve in a relatively unexpected way. As part of the bargaining which took place over the introduction of the No. 3 Act, local government secured a provision intended, largely, to exclude the jurisdiction of the Courts. Thus, Section 122W provides that “where any person wishes to make a challenge ... that person shall make that challenge by way of a written submission to the local authority in the course of the special consultative procedure ...” in respect of the long term financial strategy or the funding policy.

Previously, major interest groups which have wanted to challenge the rating or funding decisions of local authorities, have regarded the special consultative procedure as a relatively minor matter and have concentrated, instead, on seeking a judicial review of the authority's

decisions.

This section seems intended to prevent this in favour of requiring challengers to present their case to the local authority. There is an irony in this. Typically, local authorities, when hearing submissions in the course of the special consultative procedure, have allocated submitters in the order of 10 minutes each to present their case, regardless of the complexity of the issue or the weight of the arguments the submitter has wished to put forward.

This may no longer be tenable. There is good reason to believe that, unless local authorities allocate time for hearing submissions taking proper account of the substance of the issue and the submission, that they may find themselves the subject of judicial review for failing to consult properly. Discussion with lawyers experienced in local government matters suggests that this is seen as a very realistic possibility. What it does suggest is that, when a major challenge is mounted to a funding policy or a long term financial strategy, instead of allocating the standard 10 minutes, a Council might find that it has to set aside two or three weeks to hear submissions including expert witnesses and so on.

Clearly, such an outcome would verge on the disastrous as few local authorities would have the ability to make that kind of commitment for submissions through their annual plan process, especially if there were a number of significant challenges.

There is only one rational way to deal with this. This is for local authorities sit down with potential challengers, well in advance of going to public consultation, in order to work through issues and try and reach not only an understanding but also, as far as possible, consensus. There is considerable evidence that this is happening. If it does, then it may finally provide a basis for effective and meaningful consultation (in the common rather than legal sense of the word) between local authorities and their communities.

PART 7: LOCAL AUTHORITIES AS LOCAL GOVERNMENT

Following on from the theme of the last part, I want to highlight what seems to me to be, for the long term, the most important consequence of the ongoing reform process. This is the emergence of local authorities as genuinely the *local government* of their districts.

Consider what has happened through the process of reform which has been going on in New Zealand since 1984. Central government, largely, has taken the view that it should be basically non-interventionist. This view infuses its approach in a wide range of areas such as employment, economic development, and those many services which, in theory at least, could be provided through the market.

At the same time, the private sector has been refocusing on ensuring that the activities it undertakes are inherently profitable in their own right. No longer is there scope for undertaking activity which, though inherently loss making in terms of the relationship between resource cost and returns, nonetheless generates financial profit because of a subsidy or tax break.

In broad terms (and I recognise that all generalisations have their exceptions) we now have a situation in which central government stands back from intervening in the economy and the private sector undertakes only those activities which generate a bottom line profit on their own merits.

These are the two ends of a continuum. In between, there is a range of activities which may generate positive social returns (social returns represent the sum of all gains, to all members of society, from any particular activity), but negative or inadequate private returns, and will thus not be carried out. The reason is usually that, because of transaction costs, or inadequately specified property rights, private sector actors are unable to capture sufficient of the total returns to justify undertaking the activity.

Aspects of local economic development provide an example. Many local authorities are establishing enterprise boards because they believe that the gains those boards will generate, for the community they serve, will outweigh the costs. Many of these gains are expected to come in ways such as increased economic activity through the community as a whole, or reduced impacts, on ratepayers, of the costs of such negative factors as unemployment. Immediate priorities will be activities such as tourism which are increasingly important to a number of local economies. Longer term, local authorities are likely to take a greater role in ensuring the ongoing viability of what were formerly seen as government supported institutions such as, for example, tertiary institutions in the education sector.

Previously, these are areas where a local authority would have ventured with some hesitation. The ability to get specific input, through the accountability/consultation procedures, provides a legitimating mechanism which can support local authorities filling the gap between central

government on the one hand and the private sector on the other. It also provides something of a spotlight on the way in which this is done. Ratepayers, particularly from the commercial sector, concerned to minimise the costs of local authority activity have the opportunity of ensuring that, when local authorities innovate in this way, they use least cost techniques, including, where appropriate, commercial structures and relationships, as the means of achieving their objectives.

This is a relatively simple and well known illustration of what is happening as local authorities start to think of themselves as the **local government** of their districts and not simply as the deliverer of a miscellany of services and regulatory activity.

As confidence builds, expect to see more significant shifts. As an example, local authorities are starting to realise that their traditional service activities represent potentially valuable businesses. In many instances, the efficiency gains from restructuring (say) a water and waste water function, as a commercial business earning a normal rate of profit, will be sufficient to offset the impact of applying full cost pricing, including an allowance for return on capital, to the service concerned (one major consequence of such a pricing policy is to restrict demand and hence the requirement that ratepayers pay for further and expensive capital investment).

This raises, for councils in this situation, the very interesting question of how they distinguish between their service objectives and the objectives they have for making best use of the community's capital for which they are stewards. Arguably, provided due care is taken in designing the structures involved, and with the assistance of the present accountability and consultation requirements, the potential exists to unlock very substantial amounts of community capital for re-deployment in quite new areas. In this respect it is worth remembering that, unlike central government, which has very little net equity in its balance sheet, most of our local authorities have very significant credit balances.

In the 1994 version of this paper, I was somewhat tentative in my judgement that local government was moving towards becoming the government of the locality. The three years which have elapsed since then have seen the strengthening of this process. In a number of areas, local authorities are now seeing themselves as, at the very least, advocates on the part of their communities. At the moment, health is the outstanding one with most local authorities specifically undertaking an advocacy role either to the health purchaser (the former RHAs or, now, the Transitional Health Authority) or to the Government or both. Local government is also increasingly active in areas such as employment and local economic development, still standing back from assuming any of the financial obligations which have traditionally been those of Government but increasingly claiming a right, on behalf of their communities, to be partners in the process of working through possible options.

Contributing to this, at a central government level, is a growing shift from supporting institutions or sectors towards one of ensuring that individuals (families) have at least a minimum level of access to desired social services. Traditionally, New Zealand governments have emphasised provision, through ensuring the availability of hospitals, schools, polytechs etc, as a means of

meeting their objectives for access.

This was an approach which virtually guaranteed institutional survival, regardless of capability or financial viability. In a departure from this approach, the Government now appears to be taking the view that, if institutions (hospitals, schools, tertiary institutions) cannot survive through attracting sufficient numbers of students, or contracting for the supply of services, then the reason is probably one or a combination of poor management, lack of critical mass, or substandard performance. From a government perspective, it now seems that the appropriate response in that kind of situation is to let the institution fail rather than use taxpayer funds to maintain an organisation which has demonstrated that it cannot perform to required standards.

From a central government perspective, that may make perfect sense. So long as individuals have at least some minimum ability to access services, why should New Zealand have (say) 25 polytechnics rather than (say) 10? The issue is a very different one seen from a local perspective. Retention of a hospital (or equivalent service) or the local tertiary institution may be a critical factor in the health of the local economy and society. What this points to is an increasing role for local authorities, working with their communities, to determine the range and scope of services which should be available locally and how they should be supported.

These kinds of considerations point to local government playing an increasing role in deciding what services should be available locally and how they should be structured, not in the sense of trying to subsidise service provision but rather in looking at ways in which services which the community believes need to be retained or provided locally can operate viably and in a way which supports local goals.

These changes are amongst trends which, in my view, suggest that the shift in the locus of governing activity from central government to local government has now become irreversible.

PART 8: CONCLUSION

In this paper I have spent some time working through the detail of the reform process in terms of what successive governments intended to achieve and what they actually put in place. I have done this as I believe it is important to bring together a number of the threads which have developed during the reform process so that, as it continues to unfold, we have a proper sense of where we have come from and what the main influences have been.

The ongoing process of reform will be more evolutionary than imposed (although central government has much to do in tidying up the legislative framework). It will, as a result, be better grounded and be likely to have far greater popular support than did the 1989/90 reforms.

It will, though, be a difficult time because the changes are likely to be so profound. Few of those who were in local government, at the time of the 1989/90 reforms, could have predicted that, 10 years later, the question of ownership of local government would be emerging as a real issue, not because of any ideological agenda on the part of central government, but simply because the role of local government, and the way it goes about undertaking its activities, has changed so much that it has become a distinct possibility that at least some local authorities will be generating surpluses from their activities which cannot legitimately be recycled within their organisations.