Putting the Community into the Community Trust of Southland

This is the text of an address that Peter McKinlay gave, by invitation, to the 1999 annual general meeting of the Community Trust of Southland. It was based on Peter's book 'Public Ownership and the Community'. Its purpose was to stimulate debate within the Community Trust on issues of governance, accountability and co-ordination with other local public entities.

Introduction

Your trust is going through a process of change of great importance for the Southland community. Three years ago it had available a little over a million dollars a year for distribution. Today in a good year it can distribute upwards of $10 million and it manages investments with a value of approximately $180 million.

Trustees in their report to you will be telling you of their plans for the future of the trust and how they want to see it work with the community. I have been invited to speak to you for a somewhat different purpose: to put the trust in the context of the changes taking place both in New Zealand and internationally in the role of governments (both central and local) and how we now think about governance and the relationship between communities and those entities who exist to serve them.

In the Southland community, this roll call is a long one. You have 3 local authorities, a regional council, one of the country's largest community trusts, 2 licensing trusts, including the country's largest and most successful, an energy trust owning significant electricity assets, a port which is substantially in public ownership, New Zealand's largest financial mutual, and I am sure much more besides.

Each of these various bodies, in different ways, sees itself as charged with in the interests of the community. Each, I am sure, sees itself as making an essential contribution to the well being of the people of Southland and yet each is under threat. Central Government is in the midst of a series of reviews (rating powers act; roading; water and waste water services) which could significantly affect the powers and reduce the functions of local government. A number of business interests have been arguing that the role of local government should be restricted to the delivery of local public goods.[1] Licensing trusts have been described as an anachronism which have no place in a market oriented society. Increasing competition in financial markets casts a question mark over the future of small players. The role of community trusts (and by extension energy trusts) has come under strong attack with the suggestion that they are essentially inefficient intermediaries between individuals and assets which they should be able to manage on their own behalf. This was described in a recent article by the well known economist Gareth Morgan in these terms:

> "What should be done? The asset base of the trusts is the property of the community - past, present and future. Ring-fencing the asset base and undertaking investment and distribution decisions both today and in future, which bear no relation to what would ensue were the individual members of the community to make decisions over their own entitlement, has no objective rationale. Worse, it is sub-optimal and welfare decreasing.
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> The only defensible course is to distribute the proceeds to the members of the community and let them allocate them for themselves and future generations."

Today, we are essentially concerned with the future of your community trust and the role which it should play in your community. In this address I want to do 3 things. First, I want to set a context internationally and nationally for what is happening in Southland, including a look at changing understandings of government and governance. Secondly I want to acknowledge the strengths of the arguments against the continuance of the trust (and similar bodies). Thirdly I discuss what will be needed if you want to be sure of retaining the trust.

Context: International and National

Obviously, something has been happening to Southland over the past few years and it has not all been good. A recent features article in "The Press" includes statements such as:

- The Population of Invercargill is dropping faster than any other city in Australasia. It fell 2.2% last year to 48,200, and there are predictions it might fall to just 40,000 by 2003.
- It is hard to escape the conclusion that Southland's loss is the rest of the South Island's gain, and that the region's geographical location at the bottom of the country is increasingly compounded by an encroaching economic isolation.

Why should this be happening to what has been historically been one of New Zealand most prosperous regions? What can be done about it?

For the first question, the answer begins with the word "Globalisation", hardly an elegant term but one whose implications are increasingly important.

It brings together a number of different influences such as the impact of multi-national treaties dealing with trade and investment, liberalisation of global capital markets, the information revolution, the size and reach of multi-national organisations, the fact that markets for skilled labour are now international rather than national or local and changing ethnic and culture priorities.

There has been comparatively little discussion, in New Zealand, of the impact of globalisation but it is widely recognised overseas. Three quotations, one from an academic, one from the World Bank and one from a recent policy paper of the Blair labour government in the United Kingdom demonstrate this:

- "The operation of states in an ever more complex international system both limits their autonomy ….. and impinges increasingly on their sovereignty. Sovereignty …[is] divided amongst a number of agencies - national, regional and international - and limited by the very nature of this plurality" (quote from David Held *"Democracy and the Global Order: from the Modern State to Cosmopolitan Governance"*).
- "Globalisation of economic activity poses special challenges to the constitutional assignment discussed above. With globalisation, it is increasingly becoming apparent that nation states are too small to tackle large things in life and too large to address small things. More simply nation states are fast losing control of some of their areas of traditional control and regulation such as regulation of external trade, telecommunications and financial transactions. National governments are experiencing diminished control in their ability to control the flow of goods and services, ideas and cultural products."

  "In the emerging borderless world economy, interests of residents as citizens are often at odds with their interests as consumers. In securing their interests as consumers in the world economy, individuals are increasingly seeking localisation and regionalisation of public decision making to better safeguard their interests. With mobility of capital, and loosening of the regulatory environment for foreign direct investment, local governments as providers of infrastructure related services would serve as more appropriate channels for attracting such investment than national governments."

- "Between countries at the same level of economic development and with similar innovative capacities, it is likely that firms' decisions to locate will increasingly depend on factors such as the tax and regulatory system, macroeconomic stability, infrastructure, the education system, and non-economic factors such as crime levels, climate and culture (from the analytical report prepared for the Blair Labour government's 1998 Competitiveness White Paper.)

Whether we like it or not, these influences are seriously restricting the options open to central government within New Zealand. The old style industry protection measures are no longer available (there are some apparent exceptions - it is still lawful to put up barriers against dumping or for phyto-sanitary reasons to combat the risk of pest or disease.) Generally, our industries - both export and domestic - now need internationally competitive cost structures. If our export industries do not, their products and services will be uncompetitive. If the cost structures of domestic firms, providing them with goods and services, are not internationally competitive, then exporters will either be made uncompetitive by passing on the increased costs or will be squeezed through paying more for inputs than is appropriate.

There are a number of other implications. For example:

- As Southland's farmers know only too well, the days of agricultural subsidy have long gone.
- If New Zealand is to be an attractive destination for investment, then it needs a competitive tax structure (as the Blair Government is clearly recognising for the United Kingdom). This puts a very strong limit on the

ability of governments to tax in order to redistribute.

- The fact that the market for skilled labour is now international means that there are very real limits on our ability to pay skilled people salaries which relate to the average New Zealander's view of what is fair and reasonable rather than to ruling rates overseas - at the moment we have quite a serious brain drain because salaries for skilled people are not competitive.
- The information revolution is rapidly transforming businesses - it is not only one of the main drivers of branch closures in the banking industry, it is also making education one of the world's most competitive industries - something which looks likely to provoke a crisis for our polytechnics and universities in the not too distant future.

What all this adds up to is that we can no longer look to central government as the answer for local problems. At best, we can hope that it does a good job at the things which central governments can still do - such as setting the rules through legislation for the way we order our affairs; looking after defence and law and order; within the constraints of a competitive tax policy, providing an adequate safety net for individuals; funding core public services such as health, education and welfare.

This is not an easy message to explain to New Zealand's communities, especially those which have been falling behind. We have been used to seeing central government as responsible for ensuring minimum levels of prosperity and living standards. Walter Nash's 1936 budget defined the role of government in terms of free healthcare and education, adequate housing, and an income sufficient to support a man, his wife and 3 children. That established a pattern of mutual reliance on government as our means of achieving those goals and for decades it appeared successful.

Government and Governance

Many of us still operate on the assumption that government should continue to play this role, seeing the past 10 - 15 years as something of an aberration. Unfortunately, this is not the case. The first part of the answer to the question "what can be done about it?" is to understand the limits on the role of central government. The second part paints a more optimistic scenario which starts from acceptance that "nation states are too small to tackle large things in life and too large to address small things." It goes on to recognise the power of communities, if only they are prepared to exercise it, to address many of these things themselves. Internationally there is a new interest in what is termed "community governance" - the process of communities deliberating on, choosing and achieving their preferred future(s). This explicitly recognises that government has changed from being the universal instrument through which as citizens we work to achieve our desired outcomes, to being simply one of a number of different players. The Governance Co-Operative, a group of Canadian government and non-government organisations, describes the new understanding of governance in this fashion:

- **"Governance has to do with the institutions, processes and traditions for dealing with issues of public interest**. It is concerned with how decisions are taken and with how citizens (or stakeholders) are accorded voice in this process. The need for the concept of governance derives from the fact that today, government is widely perceived as an organisation. In its early form government was seen as a process whereby citizens came together to deal with public business….Today, government is viewed as one of several institutional players, like business or labour, with its own interests. …The emergence of government as a free-standing organisation in society with its own agendas and interests has created the

> need for a word to describe a process distinct from government itself."

This puts a heavy emphasis on finding instruments which can be used, locally, for engaging citizens in decision making. Desirably this would include a way of bringing together different groups and views, rather than ending up with a series of competing and, possibly, non communicating ones. One obvious possibility in any New Zealand community, but one which still needs a good deal of improvement, is the local authority. Why do I say this? Principally because the local authority both has a local democratic mandate (although it would be nice if it was stronger) and the resources and the responsibility to plan for the community. A close look at the planning processes which local authorities are now required to follow shows that this role is actually evolving to become one of strategic planning not just for the local authority but for the community it serves.[2] The point I want to make here is that community governance is not about instruments of government, such as a local authority, imposing its own views on the community. Instead, it is about developing the means whereby the community itself develops its understanding of its preferred future(s) and the means of realising those. It is a process which needs to recognise the diversity within individual communities as well as the need for a robust process which can do the difficult things such as identify trade offs between different groups or different options and bring together the plans and policies of the various key actors through whom the community will want to work in order to achieve those futures.

The Case Against the Trust

The arguments against the continuance of community trusts (and for that matter energy trusts) are strong. Furthermore, they are very firmly based in the policy framework which successive New Zealand governments have developed over the past 15 years. The fact that the trusts were created in the first place, and that they have so far survived, is more a tribute to political influence than to rational argument. If you believe that these trusts should continue, then you need to recognise and deal with 2 facts:

- the arguments against their continuance are strong
- the case for their abolition needs to be won only once - the case for their continuance needs to be won continuously.

The quote from Gareth Morgan which I used earlier is an example of the case against continuance. He makes the point that the assets held by trusts are held on behalf of the community - they do not belong to the trustees, they belong to the beneficiaries. He argues that the people best placed to make decisions about how to use those assets are the people to whom they belong. Trustees, without any mandate, applying their own judgements, are highly unlikely to make decisions which fairly reflect the interests and preferences of all their individual beneficiaries.

He is critical, as well, of the lack of accountability - the absence of any effective means by which trustees are required to determine and then comply with the preferences of the communities they serve.

The same arguments have routinely been advanced by a number of business groupings, most obviously, but not only, the Business Round Table. The argument of business critics is a variant of that put forward by Gareth Morgan; that these various trusts are best thought of as broadly the equivalent of a company and beneficiaries as share holders. They use this model to argue that trusts (and local authorities) should do what companies are now expected to do: return to their shareholders any capital which they can not make better use of than the shareholders themselves. They go on to argue that the lack of accountability of trustees, the inability of beneficiaries to exercise any effective influence, and the relative lack of skill of trustees who are elected or appointed through a political process rather than selected for their relevant skills and experience, all make the case that it will be virtually impossible for trusts to put the money/assets they hold to better use than their beneficiaries could. They conclude that distribution will increase efficiency and lead to better outcomes for beneficiaries.

It would, of course, require action on the part of government to force trusts to distribute their assets. So far, this has not happened but the possibility is always there and is probably increasing as government realises the size of the resources trusts control and looks on, in the energy sector, as trusts explore different options for life after the death of electricity restructuring.

At this point I probably need to add a Wellington emphasis to underline the point that these arguments need to be taken seriously. The hallmark of this government, and of its advisors (who will continue in office regardless of the election outcome) has been an emphasis on what is called micro-economic reform. This is all about improving the efficiency with which resources are used in the economy. It is influenced by a belief that economic outcomes are strongly influenced by such things as the nature of the structures through which economic activity is carried out and the incentives facing the people involved.

Privatisation of government assets, as an example, has been justified on the ground that public owners lack both the knowledge and the necessary incentives required for efficient performance.

This approach is also characterised by a belief that people responsible for managing significant business and other undertakings will typically put their personal interests ahead of those of the true owners (shareholders; "the community") unless there are very specific measures in place to prevent this from happening.

Trust structures, both community and energy trusts, break virtually all of these rules. They contain virtually none of the structural constraints, incentive measures or accountability/performance requirements which are seen within the micro-economic reform framework as essential to promote efficient resource use.

As government becomes more focused on the scale of resources held within trusts, so it will become more concerned with the risks arising from under-performance. Poor decisions by your trust on the distribution of its income, or inefficient use of capital, will eventually impose costs back on the tax payer (if only because more people in Southland need to make use of the tax payer provided safety net). Poor decision making by energy trusts could have the affect of pushing up costs and making local businesses less competitive.

For these reasons, my own view is that it is only a matter of time before government moves to act on the kinds of arguments which have been put forward against the continuance of community trusts and energy trusts. The prudent community will ensure that it has acted first, not just to counter these arguments, but to demonstrate the value which these trusts can add.

Retaining the Trust

What should the community do if it wishes to retain the community trust? My first point is that the arguments for termination should be taken seriously. As I said earlier they need to be won only once. From a community perspective, the risk that the arguments for termination will succeed may seem relatively slight - that is the trap of complacency. If the arguments are successful, it is almost certain that it will be at a national level treating community trusts as a category rather than locally on a case by case level. They will succeed through winning central government support for the arguments such as that the trusts lack accountability, can give no assurance that they are distributing their funds to best effect, make ineffective use of capital in the interests of the community and are too often driven by what Gareth Morgan describes as "a desire to forever provide the "community" with fruit from its self perpetuation activities."

In considering whether to take these kinds of issues seriously I recommend what I call the "house insurance" test. Most of us insure our houses against fire, not because we are expecting the house to burn down but because we recognise that, although the risk is slight, the potential impact is huge. The same approach should govern the Southland community’s approach to the community trust (and other community institutions) if it wishes to keep them in place.

How should the community approach managing this risk? The first rule, particularly if you are committed to continuance, is to stand back and look as objectively as you can at the arguments for and against. Unless you do this, the risk you run is that your own belief gets in the way of building the arguments needed to convince people who may not be believers.

My second message is that you should not approach this in defensive mode - the real issues for community is not so much one of answering negative criticism as one of making the positive case for the contribution the community trust and other community bodies can make to your future.

Start, as this paper did, by setting the changes which have affected Southland in their domestic and international context. That gives you a compelling argument that your future is substantially in your own hands. You can reasonably assume that central government will continue to maintain law and order, the development of the legal and economic framework within which economic activity is carried on, and its (cost constrained) approach to the provision of major social services. What you cannot expect is interventions designed to address the particular problems of Southland - that will have to be done here locally.

Furthermore, you will be dealing with more than just the downsizing/withdrawal of central government activity. To build your prosperity, you will need to deal with changes affecting the private sector also. Deregulation of capital markets, and the technology revolution, have forced major change on financial institutions and intermediaries.

One consequence is a growing risk of financial exclusion as banks withdraw services from less profitable customers. This is happening as financial institutions are forced, by competition, to understand the true costs and revenues associated with dealing with each category of customer and are rapidly losing the ability to cross subsidise. Their natural response is to eliminate services which do not deliver their required rate of return. Hence not only branch closures but the probability that the bottom 10 - 20% of the population may find themselves without access to a bank. There is an equivalent impact on the business sector. Competition, and the narrowing of margins, is leading providers of both debt and of equity to focus their investment on large rather than small businesses, on metropolitan rather than provincial areas, and on large economies rather than small ones. Taken together, these 3 factors mean that Southland businesses face a significant handicap in access to capital - as one acquaintance of mine in the local business community puts it "merchant bankers do not come to Invercargill".

At the moment this is compounded by practices which see your community based institutions joining in the export of capital from the province. I personally see this as one of the most serious problems arising from the present structures - or perhaps management practices - of bodies such as the community trust. In this respect, I believe that Gareth Morgan makes a very strong point - would individual owners of that capital be quite so ready to export it from Southland rather than look for local opportunities for investment? In practice, the answer is probably both no and then yes. No in that they may have a preference to invest locally. Yes in the fact that the opportunities may not be there - local financial institutions face the same imperative to export capital and the alternative of direct investment faces major obstacles including securities regulations and the lack of any local capital market which would allow investors to exit easily.

Perhaps one of the positives for which the community should be working is to find means of enabling local owned community capital to be reinvested within the community. The usual answer to this question, when I put it to community organisations is "we are trustees and bound by the provisions of the Trustee Act". Presumably, the same sort of answer would have been given, at the turn of the century, by people who had a legal obligation to make sure that a man waving a red flag walked in front of a motor car. The proper question is not whether there is a formal legal requirement restricting a desirable activity - the question is whether the activity is desirable and, if it is, how you deal with the legal requirement. I personally believe that we can take great comfort from the steps which have been made in recent years in developing effective means of ensuring that public bodies apply quite robust techniques to managing funds, even when they are being invested in a business mode rather than a trustee mode, so that we really should be looking at finding legal means for using the community’s capital within the community. Do this effectively and you have a strong response to the criticism that capital in the hands of trusts is capital withheld from the community.

A second potential positive is really the flip side of much of the criticism made of bodies like community trusts. At the moment, they fall remarkably short both in terms of mandate and of accountability. To the credit of your trustees, they have been trying to address both of these problems within the confines of their present legislation and trust deed.

Currently, trustees are appointed by the Minister of Finance - hardly a local mandate even though the current minister comes from Southland. Not only is this almost the opposite of a community mandate for trustees - it is subject to real political risk and very much at the whim of who happens to be Minister of Finance (and which party he or she comes from).

Nor is there anything remotely approaching what we now thing of as effective accountability. When the Trustees Banks Restructuring Act was passed, the general standard for accountability was that you published a set of audited accounts - and in the case of community trusts you also published a list of donations and you held a public meeting (but not a meeting giving the public any right to vote). Views have changed dramatically since then. For public bodies we now recognise that accountability requires a great deal more. Specifically, accountability is about reporting outcomes against agreed intentions. This can only be achieved if the body being held accountable has spelt out its plans and policies, negotiated with the communities it serves what its objectives should be and set out how its performance in pursuing those should be measured. The best current example of this - which is still evolving - is the annual and strategic planning process of New Zealand’s local authorities - and even that has been criticised as inadequate for effective community involvement, a concern which many local authorities are now actively addressing.

The same arguments, locally, apply not only to the community trust, they apply also to your licensing trusts as they work through the question of what their future role should be[3]. The same issues exist for the local energy trust and will no doubt arise if the board of the Southland Building Society were to look at what it means to be a mutual rather than a share holder organisation.

I now want to return briefly to the discussion of governance earlier in this paper. There I discussed the growing interest in community governance with its emphasis on communities deliberating on choosing and achieving their preferred futures. From this perspective governments themselves (whether central or local) and other public institutions are best seen as being among the means through which communities work to achieve their preferred futures. It is a concept which puts community first but which also needs to recognise (again as Gareth Morgan stresses) that "the local community is not readily identifiable, being more an informal collective of personal and sector interests which populate some geographical boundary". That diffuseness makes it easy for focused entities, such as a local authority or trust, to act as though they can properly speak for the community. This is not a practice which I would recommend. One consequence is that it lacks genuine legitimacy. It is all too easy to see councillors or trustees as self serving or at the very least dismissive of community concerns - when their views are not well grounded in a community governance process.

How do we cope with the diffuse nature of community? Currently, the best answer is by ensuring that we have in place processes which allow people to engage, and which, given goodwill (essential for running any community related process) has a reasonable prospect of bringing out and giving due weight to the different and potentially conflicting interests which make up the community.

There is an obvious prerequisite to all of this. The clear need is a means for bringing together not just the different views which may emerge from the community but the different plans and policies of those various bodies each, in their own way, seeking to serve it.

What is needed is something along the lines of the planning process of local authorities but which brings together not just the local authority's own proposals for its activities but the proposals of other entities which exist to serve the community. Is it possible, for example, that the local authority planning process could evolve into a planning process for the community as a whole with each major community body - the community trust, licensing trusts and so on - feeding their plans and policies into it as a means not just of co-ordinating their separate intentions in respect of the community but also of providing an overall means for the community, and the entities serving it, to debate, decide on and then pursue the preferred futures for Southland.

What I am suggesting here is that a community governance approach to the mandate for the community trust and to accountability will give the trust a legitimacy which it currently lacks. When developed, such an approach should see the trust not only recognised as an integral component of the governance of the community but able to show that it was acting through a process which had general, widespread and informed community support (much the same issues of mandate and accountability also apply to the other trusts within the community).

In other writings I have suggested that the mandate could be based on the democratic mandate of the local authority and that the need for accountability could be met by "piggy backing" on local authority processes. Here I want to the point that it is not so much the specific means chosen which is important as the need to ensure that the mandate is well grounded in the local community and that accountability is effective in the terms in which it is being discussed in this paper - that it is seen in terms of the trust reporting performance against plans and policies which have been agreed through a community process before they have been implemented, and which have been adequately co-ordinated with those of other key actors within the community.

Conclusion

Last years organisational audit of your trust included the assessment that "the trust has as much if not more capability than anyone else in the region to have a significant impact". I share that assessment. However I would also encourage your trustees to recognise that there is much to be done if the trust is to realise its full potential and manage the risk posed by those who would argue for a winding up and distribution of trust assets.

Questions of mandate and accountability must be addressed and brought into line with current practice. This should include ensuring that trustees are appointed not just because they have standing in the community but because they have relevant skills and experience (a view which I understand your trustees share). Accountability must be based on an open public discussion of the trust's plans and policies. Its role in community governance is to act on behalf of the community, not to determine what the future shape of the community should be.

The trust needs also to look to means for ensuring that the capital it holds on behalf of the community can be a resource working on behalf of the community and not simply a source of income for distribution.

Your trustees are already well advanced in addressing many of these issues. So, I understand, are those who lead some of the other major organisations within your community. With good will, co-operation, and a clear understanding of what community governance implies, you should have every chance of showing that Southland is still the spirit of New Zealand.

FOOTNOTES

1. This is happening as a, probably unintended, consequence of the 1996 legislation which now requires local authorities to prepare a series of planning documents including not just an annual plan but a funding policy and a long term financial strategy. A close look at these requirements makes it clear that a local authority can only do this - and in particular only prepare a long term financial strategy - if it first has a very clear understanding of the long term plans and policies of other key actors within the community.

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3. Interestingly, the Liquor Advisory Committee in considering the impact of changes to the sale of liquor legislation on licensing trusts, recommended that the statutory objectives of the trusts be expanded and they become community trusts, along the lines of trust bank trusts.