

26 July 2012

Submission on the Local Government 2002 Amendment Bill

To the Chairman and Members
Local Government, and Environment Select Committee
Parliament Buildings
WELLINGTON

1. INTRODUCTION

1.1 This submission is from the Local Government Centre within the Institute of Public Policy at AUT University, with the support of the Institute itself. The Centre is New Zealand's first university-based think tank focusing on research, teaching and research-informed consultancy for the local government sector. It has extensive international linkages, is an associate member of the Commonwealth Local Government Forum and is represented on the forum's Research Advisory Group.

1.2 We have been assisted in the preparation of this submission by:

- Dr Grant Hewison (PhD in Local Government Law), Special Counsel, Kensington Swan.
- Dr Phil McDermott, Adjunct professor Regional and Urban Development Institute of Public Policy and principal of CityScope Consultants.

The Local Government Centre wishes to appear before the committee to speak to its submission. We can be contacted as follows:

Peter McKinlay
Director
Local Government Centre
Institute of Public Policy
AUT University
Phone 64-9-921-9999 extn 6237
Mobile 64-21-614-115
Fax 64-9-921-9190
E-mail: peter.mckinlay@aut.ac.nz

David Wilson
Director
Institute of Public Policy
64-9-921-9999 extn 8322
021 763 085
64-9-921-9768
dawilson@aut.ac.nz

Level 4, 120 Mayoral Drive
Private Bag 92006
Victoria Street West
Auckland 1142
Web: www.ipp.aut.ac.nz

2. OBJECTIVE OF LEGISLATION

- 2.1 The government in the explanatory note to the Bill acknowledges the significance of local government within the New Zealand economy:

New Zealand's 78 councils make up 4% of Gross Domestic Product, spend \$7.5 billion per year of public money, and manage \$100 billion of public assets. They also perform a huge range of important regulatory functions for households and businesses. Councils must be able to play their part in creating an environment conducive to sustained economic growth.

- 2.2 We support the government view this requires that the local government sector is able to make a full contribution to creating an environment conducive to sustained economic growth. It means also that the sector must be able to make a full contribution to the quality of life in the communities for which it is responsible - something which is increasingly recognised internationally as crucial in supporting economic competitiveness.

- 2.3 We also acknowledge that there is significant potential for improving the performance of the local government sector. Especially in a sector as contentious as local government can be, this requires careful and evidence-based analysis of proposed interventions.

- 2.4 Accordingly, we are extremely concerned that the regulatory impact statement prepared by the Department of Internal Affairs includes the following acknowledgement:

The timeframe for development of these proposals has precluded any assessment of evidence or analysis to confirm the impact of these features of the legislation on the fiscal or governance performance of the local government sector.

- 2.5 We have some sympathy for the Government in this respect. Public criticism of local government through channels such as letters to the editor, and talkback radio, can very easily become its own justification for change, with pressure on governments to legislate before doing the basic analysis to understand what is really happening, and assess the likely impact of proposed interventions.

- 2.6 However, especially for a sector as important as local government, there is no substitute for evidence-based policy-making, supported by strong analytical input, to minimise the risk that legislative intervention will actually worsen, rather than improve, the situation it is attempting to address.

- 2.7 Our review of the evidence put forward in support of the proposed changes, and our reading of developments within local government both in New Zealand and internationally, suggests there is a very real risk that much of what is proposed in the Bill will at best be ineffective, but more likely undermine the very objectives the government is seeking to pursue.

- 2.8 In the balance of this submission we first consider a number of the examples put forward to justify change; next propose a different and more evidence-based interpretation which points to a major problem with governance which requires different and urgent attention; look in some detail at the proposed changes to amalgamation provisions and finally discuss the proposed powers of ministerial intervention.

3. A LOOK AT EXAMPLES

- 3.1 We consider a number of the examples put forward in either or both of the original discussion document, Better Local Government, and the Regulatory Impact Statement. These included:

- The relationship between rates and the CPI.
- Local government engaging in non-core activities such as running Lotto outlets cited as inappropriate for local government.
- The Hamilton V8 supercars and Kaipara Mangawhai wastewater treatment plant cost overruns.

Rates and the CPI

- 3.2 The inference is drawn that, because rates have been increasing faster than the CPI (but not faster than all CPI components), local governments are profligate in their spending. This inference makes sense only if rates and CPI measure the same things for the same purpose.

The differences are major:

- First, the key drivers for local authority expenditure are inputs such as bitumen and other oil related products, which have been increasing in price much faster than the basket of goods measured by the CPI.
 - Next, and critically, rates do not just fund the operational expenditure of local government; they also fund capital expenditure - this inevitably means that if local government is playing its part in developing New Zealand's infrastructure and supporting economic growth, then rates will rise faster than the CPI (and the use of tools such as debt financing and/or public/private partnerships don't solve this problem, they simply alter the timing and the mode of payment).
- 3.3 We also note that rates are probably the least desirable form of tax amongst all those used by New Zealand's public sector. In contrast with central government's major taxes such as GST and income tax (PAYE) rates are very much "in your face", not directly related to ability to pay, and paid from an individual's "after tax" income - local government gets the blame for this, but it is directly a function of the revenue sources which central government has decided should be used to fund local government.

Non-core activities such as running Lotto outlets

- 3.4 This example is a very good illustration both of the need to take great care in drawing inferences without a good understanding of what has actually happened, and of the kind of issues councils are called on to resolve for their communities.
- 3.5 In this case the Bluff community asked its community board to do something about the lack of banking facilities in Bluff. The board along with the Invercargill City Council investigated options for bringing banking services to Bluff. The one viable option was for the Council to take up a Kiwi bank franchise package which included a Lotto outlet (an essential part of sustaining the viability of the franchise).
- 3.6 The reality of this example is the Council acting creatively to bring a much-needed service to a community which was not able to get the service in any other way.
- 3.7 This example also reflects what will increasingly be a situation confronting many of New Zealand's councils; the need to ensure that communities with declining or no-growth economies or populations can still obtain reasonable access to the services which, in more prosperous or growing communities, would readily be provided by the private sector. In order to reverse a downward spiral of disinvestment and economic decline, responsible Councils must address local resource and capacity issues for the community's economic and social sustainability..

V8 supercars and the Mangawhai wastewater treatment plant

- 3.8 These two examples have both attracted high-profile media and other attention as apparent examples of councils failing to exercise due prudence, with the implication that further legislative intervention is required in order to ensure that elected members properly discharge what are seen to be their responsibilities. The Regulatory Impact statement for the Bill comments:

While some councils and elected members seem to understand and manage complex financial matters prudently, this is not consistent across the sector. Recent worst case examples include the handling of the V8 supercars event in Hamilton, and the high cost of a wastewater treatment plant in Kaipara District.
- 3.9 The examples are both serious, but the interpretation that this is a failure on the part of elected members is a misunderstanding. As a consequence, the proposed interventions are likely to be ineffective, and the underlying cause - structural failure in terms of governance - will not be dealt with.
- 3.10 In each case the immediate cause was the way in which a strong chief executive handled the project involved. It seems clear that in each case councils were not given all the information they required, and the chief executive was actually driving the project.
- 3.11 This is a structural failure of governance which applies to local government as a whole, and needs to be addressed. We turn to this in the next section.

4. GOVERNANCE

4.1 The governance structure for local government was established more than 20 years ago as part of the 1989/90 reforms of local government. The governance structure introduced then was intended to parallel what was seen as the normal private sector separation between governance and management, which the then government was also implementing within the core public service.

Under the changes, elected members were to be responsible for policy, and the chief executive for implementation. Critical features included:

- The chief executive is the sole employee of the Council, and the employer of all other Council staff.
- The chief executive is also by statute responsible for providing advice to elected members.

4.2 Because of the way these changes were expressed and implemented, there are now significant differences between councils as a governing body and either private sector boards, or cabinet within central government. These include:

- There is no contestability of advice.
- Elected members have no separate resource available to them if they wish to test the advice provided by their chief executive.

4.3 Within central government, any proposal placed before Cabinet will go through significant review, including interdepartmental consultation, and review within the sponsoring minister's office, by ministerial staff, of departmental advice. None of these checks and balances are available within local government because of the different statutory framework.

4.4 In the private sector it is well understood that the directors have final responsibility, including the discretion if they think it is necessary to seek independent advice. Indeed recent case law has made it clear this is not just discretion but a legal obligation if directors have significant concerns.

4.5 Examples such as the Hamilton V8 supercars, and the Mangawhai waste water treatment plant, essentially highlight the imbalance between the powers of local authority chief executives, and the power/discretions of elected members. It is this imbalance which needs to be addressed.

4.6 Part of this requires statutory change to ensure that elected members have the ability to obtain independent advice when they think it necessary to do so. Part of it requires developing good practice so that members understand, as a matter of course, the need to take particular care in areas such as risk management.

4.7 The governance issue is compounded by another change which has taken place since the 1989/90 reforms. This is the gradual change in council practice so that it is extremely difficult to combine being a councillor with continuing a separate career. Council business, in virtually every council, is now run so that the position of councillor cannot be combined with full-

time employment. The result is that many of the most suitable people - high performing individuals in full-time employment in the public, private and third sector, and in the age range of 30-55, 60 - are unable to put themselves forward unless they consciously set aside their career.

- 4.8 It is irresponsible to accept an arrangement which places a sector as important as local government at a serious disadvantage when it comes to attracting competent people to put themselves forward in a governance role.
- 4.9 The reaction of successive governments to the consequences of less than ideal governance in local government has been to see this as a case for further regulation, whether it is the increasingly detailed requirements local government has to meet in terms of long-term planning, or the proposals in the present legislation in areas such as ministerial intervention, and the power of councils to set remuneration and employment policies (any competent Council already has all the powers required in this area- it is simply something to work through with the chief executive when agreeing that Council's budget).
- 4.10 We strongly recommend that the select committee in its report back attach priority to resolving governance issues within local government from a first principles approach.

5. THE PURPOSE OF LOCAL GOVERNMENT

- 5.1 The Bill proposes that the 'well-beings' purpose be replaced with the following purpose:

"to meet the current and future needs of communities for good-quality local infrastructure, local public services, and performance of regulatory functions in a way that is most cost-effective for households and businesses."
- 5.2 We have a number of reservations about both the desirability of changing the purpose, and the drafting of the proposed purpose.
- 5.3 I. Local government is an extraordinarily diverse sector. Different councils face very different economic, social and environmental considerations. New Zealand, whilst predominantly urban in terms of population, is geographically spread out with distinctive rural communities, cities and towns; communities that often serve the rural base of our key exports. Attempting to apply a 'one size fits all' framework is likely to be quite counter-productive, both in terms of local governance and in supporting healthy vibrant communities and local economies. It is important that councils remain free to make choices which best fit the circumstances of their own local communities.
- 5.4 Procurement provides a simple example. As a first principles approach, most would argue that councils should look to purchase their required inputs at the least cost, ideally joining in multi-Council procurement arrangements in order to benefit from the bulk purchasing and other advantages such arrangements can provide.
- 5.5 Practice is not so straightforward. A real-world example will illustrate this:

A sizeable rural Council, located in its district's one substantial town, declined to join a multi-Council procurement arrangement for stationery, electing instead to remain as the principal customer of the town's only stationer. As a result, the council pays more for stationery, but the community retains an essential facility which would otherwise not be viable.

- 5.6 This is not an isolated example. A significant proportion of New Zealand's local authorities are responsible for communities which have been losing both public and private sector services partly because of declining population, or relatively weak local economies, and partly because innovations in provision have been gradually replacing local outlets with regional or national suppliers. Local authorities are one of the few entities able to take the decision that an apparently expensive option will in fact give the community overall a better outcome.
- 5.7 II. It is difficult to understand how the proposed changes will result in local authorities being, as a matter of law, required to confine their activities to what the government might regard as 'core' activities. The expression 'local public services' has the potential to be interpreted very broadly.
- 5.8 Historically, attempts to require local authorities to justify their activity in terms of conventional public good theory have proved, to put it kindly, extremely challenging. Very few local government services are conventional public goods. Most are either merit or club goods - essentially goods or services which the community as a whole is prepared to accept that local government should provide because reliance on other providers is unlikely to result in the level and/or quality of service the community regards as acceptable.
- 5.9 It seems very likely that the term 'local public service' will actually mean in practice any service which is unlikely to be provided to the service level standards, and the level of activity, the community desires unless the local authority is the provider. It is also likely that the term 'public' will be interpreted as a service which contributes to the well-being of the community, thus taking us back to where the present purpose leads
- 5.10 III. The wording "in a way that is most cost-effective for households and businesses." does not focus on the cost of individual services. Instead, it focuses on what households and businesses are required to pay in relation to the services they receive. This has consequences including:
- Perversely, an inherent bias towards funding activity through debt, as this will reduce the cost impact on today's households and businesses of providing any given level of service.
 - Failing to address the issue of whether individual services are being provided in the most cost-effective manner, having regard to present and anticipated future circumstances.
- 5.11 The alternative, if a purpose of this kind is to be included, is to change the wording so that it focuses directly on the costs of individual services. This could be achieved by shortening the purpose to read:
- "to meet the current and future needs of communities for good-quality local infrastructure, local public services, and performance of regulatory functions in a way that is most cost-effective."

- 5.12 This would not, however, result in a problem free outcome. There is enormous scope for debate on what "is most cost-effective", especially if regard is to be had to the expression "appropriate to present and anticipated future circumstances."
- 5.13 Again, a simple example makes the case. It is now widely accepted that there are a number of services, both back-office and customer facing, which would benefit from a shared services approach **provided that** such an approach could be implemented in a cost-effective way. Moving to a much increased reliance on shared services is not just a purely technical problem; it has a number of obstacles to overcome including organisational capability, the impact of legacy systems, arguments that there are cases where local authority should retain capability individually - or procure services locally order to maintain local infrastructure and so on.
- 5.14 Our submission is that the proposed change in purpose is in fact another sub- optimal response to issues of good governance - in essence the belief that if local government is not performing as well as central government would like, then more micromanagement will solve the problem. In practice the exact opposite is the case. What is required is a more flexible operating environment but coupled with a strengthening of governance.

6. PROPOSED CHANGES TO AMALGAMATION PROVISIONS

- 6.1 Another concern is the much greater weight given by the Bill to restructuring and amalgamation. Unlike the reforms of 1989, which were geared towards increasing the effectiveness of local government the objective of these measures is not clear.
- 6.2 A preoccupation with amalgamation again raises the spectre of a solution looking for a problem. The evidence that better governance or enhanced efficiencies are delivered by larger units of local government is decidedly mixed. Internationally research suggests that efficiencies may be increased by moving from very small to medium-sized units of local government. But there is little evidence that moving from medium to large units will deliver the intended efficiencies.
- 6.3 Evidence to support such an approach across the board in New Zealand doesn't exist in the Department of Internal Affairs Regulatory Impact Assessment for the current Bill, which acknowledges an aim to facilitate more interests and more communities moving on the "union or abolition of councils or the creation of unitary authorities" (Paragraph 158).
- 6.4 *Technical efficiencies* may be available from merging, sharing, or jointly purchasing particular functions or services across jurisdictions. That hardly requires amalgamations. There is scant evidence of *administrative efficiencies*. Mergers that lead to multiple tiers of management simply pile up the challenges of internal consistency and cultural alignment within enlarged bureaucracies already struggling to engage with their communities.

7. POWERS OF MINISTERIAL INTERVENTION

- 7.1 Under Part 10 of the Local Government Act 2002, the Minister of Local Government currently has the power to review the performance of councils, replace elected councils or call fresh elections.
- 7.2 Clause 21 of the Bill proposes to go much further. There are six powers proposed in clause 21, based on the notions of assistance and intervention. They are: Minister may require information from local authority; Minister may appoint Crown Review Team; Minister may appoint Crown Observer; Minister may appoint Crown Manager; Minister may appoint Commission; Minister may call General Election. Threshold tests apply to each power linked to the new fiscal responsibility requirements.
- 7.3 Given that we do not agree with the view that councils' fiscal performance has been reckless, we believe that the proposals for intervention are not only unnecessary, they are constitutionally untenable and strike at the heart of the notion of a separate institution of local government.
- 7.4 We submit the current regulatory framework governing fiscal performance by local authorities is working. It consists of requirements that councils:
- adopt a financial strategy stating planned rates increases
 - exercise their powers principally for the benefit of their districts (s 12(4), LGA02).
 - assess each activity to ensure it benefits councils' communities and to estimate the costs and benefits of funding the activity (s101(3), LGA02))
 - are assessed by the Auditor General ('OAG') who then reports to Parliament. The OAG reports on councils' financial sustainability and will publicly flag concerns should circumstances require it.
 - hold triennial elections which ensure that elected members who act without the support of the majority of local citizens will almost definitely be punished once citizens have been to the polls.
- 7.5 Nonetheless, should the Government remain intent on introducing clause 21, it is submitted that a proportionality test should also be introduced such that the powers under clause 21 shall be exercised in such a way as to ensure that the intervention of the Minister is kept in proportion to the importance of the interests which the power is intended to protect.

8. CONCLUSION AND IMPLICATIONS FOR AMENDMENT BILL

8.1 Key points:

- The arguments made for changes to Local government legislation are not supported by evidence,
- Local authorities, as a sector, are not profligate spenders, are not debt burdened, and have not extended outside of their brief
- The funding of Local government is not fit for purpose
- The geography, economy and diverse, sometimes isolated, nature of communities in New Zealand support greater subsidiarity, not greater centralisation of powers.

- The so called “widened” powers in the LG Act 2002 have not seen an undue increase in LG “soft” expenditure, in fact recent evidence suggests the reverse is true. The real problem is the promise of the LG Act 2002 has not been matched by an appropriate sharing of roles, responsibilities and funding from central government.
- International evidence suggests that strengthening local governance strengthens communities and supports economic growth
- Local Governments can play convening and facilitating roles for the welfare of their citizens as well as providing hard infrastructure provision (all of which support economic growth)
- A shift, rather than an increase, in public expenditure is needed to get *better local government* (the level of Central Government transfers to Local Government in New Zealand is one of the lowest in the OECD)
- Amalgamation is only one option for communities to consider in improving efficiency and effectiveness in Local Government.
- Communities should opt for, rather than opt out of, changes to their local government structures.

8.2 Implications for Amendment Bill:

- The proposed change to the purpose of local government should not proceed.
- There should be a greater emphasis on improving the quality of governance, with a focus on means which will address the problem of the conflict between being a councillor, and having a separate career. The required measures are fundamentally development of good practice, rather than statutory change.
- Any decision on amending the provisions in respect of restructuring and amalgamation should be deferred until there has been a full opportunity to consider both the evidence for and against the effectiveness of amalgamations, and the potential alternatives for delivering efficiencies. It is simply unacceptable that such a major change to the structure of local government should be implemented when the weight of international evidence is at best equivocal about the benefits of amalgamation, and the sponsoring department itself acknowledges that it has neither an evidential nor an analytical basis for the proposed changes.
- The proposed extension of powers of ministerial intervention should either not proceed, or be made subject to a proportionality test specifically designed to minimise the potential for the use of intervention powers. Instead, the government should focus more on the evidence that strong autonomous local government is a significant contributor to economic and social development and that government micromanagement can seriously undermine this.