NEW ZEALAND BUSINESS ROUNDTABLE

SUBMISSION ON THE DISCUSSION DOCUMENT

PATHWAYS FOR AUCKLAND

CONCERNING THE FUTURE OF THE AUCKLAND REGIONAL SERVICES TRUST

AUGUST 1997

SUBMISSION ON 'PATHWAYS FOR AUCKLAND'

1 Summary

1.1 The Auckland Regional Services Trust ('the Trust') was established as a temporary structure and is an anomaly in local government. No comparable structures exist elsewhere in the country. The net assets of the Trust as at 31 December 1996 were $1,249 million - or $1,160 for each resident (about $3,500 for each household) in the Auckland region. The Trust is New Zealand's fifth largest business.

1.2 The fundamental issue in the review should be whether the Trust is undertaking activities which are a proper role for local government. Local government is part of the public sector and its role is to ensure the provision of local public goods, including necessary local regulation. The Trust is essentially engaged in commercial activities which are the proper role of the private sector. Accordingly they should be transferred to the private sector as rapidly as possible. The Trust was established by parliament essentially as a transitional vehicle for this purpose, and it has no ongoing rationale.

1.3 Proposals for financing the Trust's activities and other unspecified infrastructure investments from surpluses generated from the Trust's assets lack merit when judged against the criteria set out in Part 5 of the discussion document. In particular:

- providing concessional finance will distort the appropriate pricing of services and lead to an inefficient use of resources. The underlying causes of what are presented as pressing infrastructure needs will remain. Reforms would therefore be unsustainable in the longer term;

- the use of the fund to subsidise investment will crowd out other, commercially-based, funding options;

- the cost of subsidising any public good element of a project through concessional finance is non-transparent. The proper approach is the payment of annual subsidies funded by rates, so that local authorities are more directly accountable to their electorates; and

- an entity undertaking such activities will confuse, rather than clarify, the roles of established central, regional and territorial within the region. This would detract from an integrated approach to strategic planning and decision making within the Auckland region.

1.4 These outcomes are more likely because the Trust or any replacement entity would:

- be accountable to stakeholders through cumbersome electoral processes;

- be subject to weak performance monitoring by stakeholders;

- have conflicting objectives to provide sound stewardship of commercial investments while assessing and undertaking investments in projects that are deemed to have some public good element;

- have no direct connection with electors;

- be subject to weak capital market restraints; and

- be incapable of reflecting individual ratepayer preferences.

1.5 As a consequence of these weak incentives, the Trust will, over time, be prone to making politically popular but commercially doubtful investment decisions simply because finance is available. Risks to ratepayers will increase significantly if the Trust or any replacement regional entity is released from its current tight legislative framework and the commercial disciplines imposed by external debt no longer apply to the same extent.

1.6 The Trust is an enthusiastic promoter of a replacement entity to concessionally fund infrastructure projects, despite the almost certain costs such an approach would impose on current and future residents of the Auckland region. The present Trust has already displayed a less disciplined approach than its predecessor, which was firmly focused on debt repayment. It has been slow to discharge its mandate to sell assets. In the case of the Yellow Bus Company, the impetus finally had to come from central government. Politics has intruded into the Trust's decision making, for example with the extraordinary number of changes in the directors on the board of Ports of Auckland Limited. The Trust has suggested its surplus funds should be used in activities in which it has no expertise, such as Auckland International Airport Limited. These factors lend weight to our view that the assets of the Trust should be distributed to residents sooner rather than later to reduce risks that their value will not be maintained and enhanced.

1.7 Accordingly, the New Zealand Business Roundtable submits that:

- entitlements to the commercial assets of the Trust other than Watercare Services should be distributed to ratepayers/consumers as soon as possible, following a consultation process in the case of Ports of Auckland Limited. The consultation process could include a referendum once the electorate is well informed on the issues. The form of the distribution (whether as shares in individual companies or as the cash proceeds of a sale) should be subject to the over-riding goal of prompt distribution of the Trust's assets;

- Watercare should be restructured as a LATE and made subject to more conventional financing and ownership arrangements;

- immediate consideration should be given to the merits of separating the ownership of the existing water and wastewater reticulation network (which could reside with territorial authorities) and of water and wastewater facilities (which could remain with Watercare). An appropriate light-handed regulatory regime would also need to be put in place; and

- the next logical step would be to work towards privatising Watercare once relevant regulatory and other issues had been resolved. Various forms of privatisation of water supply and wastewater disposal are possible, including franchising and contracting for services.

1.8 In the interim, the Trust should be constrained from trying to find further infrastructure projects in which to 'invest'.

2 Introduction

2.1 This submission is made on behalf of the New Zealand Business Roundtable (NZBR), an organisation of chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall national interests.

2.2 As noted in Part 1 of the discussion document, the Trust was created by statute in 1992. It arose from a reform of the Auckland Regional Authority, which at the time had accumulated debt with a market value of $224 million. With the reform, the Auckland Regional Council retained regulatory functions while the Trust was given the responsibility to manage and ultimately eliminate its debt through a programme of asset sales.

2.3 The Trust was established as a temporary structure and is an anomaly in local government. The key elements of local government in New Zealand are regional councils and territorial local authorities. Regional councils assume regulatory functions, including resource planning, and some funding activities, for example of public transport subsidies in Auckland and Wellington. Territorial local authorities (city and district councils) have primary responsibility for the delivery of services.

2.4 The only assets the Trust is required to retain under current legislation are shares in Watercare. Among other things, section 707ZJ of the Local Government Act 1974 obliges the Trust to sell its shares in Transportation Auckland Corporation Limited (TACL), Northern Disposal Systems Limited and Regional Forests Limited as soon as is practicable and prudent. After five years the Trust is finally moving to dispose of these assets. Under the same provision, the Trust may hold shares in Ports of Auckland Limited and must adopt special consultative procedures in relation to any proposal by the Trust to sell the shares. The other original shareholder in the port company has quit its shareholding. In effect, the Trust will be essentially the owner of a water business and the part-owner of a port company in the near future.

2.5 The Trust must apply its revenue to meeting its costs, to reducing its debt (where this is considered appropriate and consistent with its functions) and, subject to other priorities and at its discretion, to paying any surplus revenue to a Community Trust. The Trust has paid derisory amounts to the Community Trust since its inception.

2.6 The total public equity in the Trust at 31 December 1996 was $1,249 million. This represents over $1,160 for each resident in the Auckland region, or about $3,500 for each household.[1] The Trust is New Zealand's fifth largest business. The efficiency of its operation in the medium to long term is therefore likely to have a significant impact on the regional and national economy.

2.7 The discussion document invites submissions on four options:

Option 1: Give the Trust an additional function, to enable it to contribute to the efficient development of infrastructure in the Auckland Region.

Option 2: Require the Trust to pay a dividend to:
- (a) Auckland territorial authorities; or
- (b) Auckland electors.

Option 3: Abolish the Trust and distribute the resources (either through a sale process or the issue of shares) to the:
- (a) Auckland territorial authorities; or
- (b) Auckland Regional Council; or
- (c) Auckland electors; and

Option 4: Abolish the Trust and transfer the resources to a holding company with responsibility for developing infrastructure in the Auckland Region owned by the:
- (a) Auckland territorial authorities; or
- (b) Auckland Regional Council; or
- (c) Auckland electors.

2.8 Part 5 of the discussion document states that options will be assessed according to the extent to which they:

- allow for an integrated approach to strategic planning and decision making in the Auckland region;
- promote the efficient allocation of resources;
- balance the interests of present and future generations of Aucklanders, and ensure that there is an equitable and efficient allocation of financial benefits, risks and resources;
- are sustainable in the long term;
- allocate resources in a way which is transparent and accountable to the people of Auckland; and
- provide for appropriate transitional arrangements.

2.9 Debate on the options raised in the discussion document has been clouded by the agenda of some groups (including the Trust itself) to employ the cash and

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[1] Statistics New Zealand reported in the 1996 census that there were 356,648 occupied dwellings in the Auckland region. The population of the Auckland Regional Council area at the time of the 1996 Census was 1,077,205.

commercial assets of the Trust to fund what are presented as pressing infrastructure needs. The Trust is undertaking a high profile campaign to convince the people of Auckland that they should own an 'infrastructure bank' for this purpose. In the foreword to the discussion document, the Minister of Local Government expresses the view that "there are two significant inter-linked issues facing Auckland - the future use of resources of the Auckland Regional Services Trust and the need for urgent strategic decisions on Auckland's growth and infrastructural needs".

2.10 While the merits of using the existing resources of the Trust to finance infrastructure apply most directly to Option 1, they also relate to other options. For example, there may be a view that the assets of the Trust should be distributed to territorial local authorities to fund infrastructure (Options 3(a) and (b)), or that a new holding company should be set up for this purpose (Option 4).[2] Equally, however, any necessary 'infrastructure' could be funded in the same way that, say, telecommunications or rail services are financed, including by voluntary investments on the part of Aucklanders. The capacity to make such investments would be facilitated by a distribution of the Trust's assets to the residents of Auckland who could then decide whether they wished to do so or whether they preferred others to bear the risks and rewards of ownership.

2.11 It is therefore necessary to examine the issues of infrastructure and its funding in order to make a dispassionate evaluation of the options raised in the discussion document. Critical questions in this context are:

- is there anything special about 'infrastructure'?
- is there a problem in the funding of appropriate infrastructure, and if so, what is its cause?
- would a publicly owned body that holds commercial assets to fund infrastructure be properly accountable? and
- would the Trust or a replacement entity facilitate or impede strategic planning and coordination in the region?

3 Is there anything special about infrastructure?

3.1 In the debate about Auckland's future requirements, the term 'infrastructure' is commonly used but seldom defined. The discussion document asserts that the key areas of infrastructure are urban transportation, water supply and wastewater reticulation. To this list, the Trust has added tourism infrastructure and roading (the former, presumably, to cover its promotion of the America's Cup Village venture).[3]

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[2] The aspirations of the Trust to set up a new holding company in which the assets of the Trust would be vested broadly conform with Option 4(a).

[3] Auckland Regional Services Trust, (1997) 'Meeting the Needs of a Growing Auckland Region', Summary of L/E/K Report, Auckland, p. 7.

3.2 If the current review had been undertaken a decade ago in similar circumstances, the funding of electricity reticulation, telecommunications, ports and airports would probably also have been included in the list of priority infrastructure assets that required substantial additional investment. The fact that these services are not now included in the list of 'pressing' infrastructure needs reflects changes in the regulatory environment, ownership structures and incentives in those sectors to make appropriate pricing and investment decisions. These changes addressed the root causes of difficulties in raising finance to fund necessary investment. Adopting a similar approach to other services like water and wastewater would yield similar benefits, for the reasons outlined below.

3.3 The ease with which investments can be added to or dropped from the list implies the need to examine more carefully the types of services in which the public sector needs to be involved. Most utility services can be provided by the private sector. Internationally, central and local governments are exiting from such activities. The only justification for government involvement is in respect of services that exhibit significant 'public good' characteristics.[4] The main candidates that have been suggested are water and sewerage, and land transport.

3.4 However, few, if any, of the future infrastructure requirements for water and sewerage represent investments with significant public good characteristics. Water and sewerage services are largely private goods that can be provided by corporate entities not necessarily owned by the Trust, or even by local authorities. The private supply of water and sewerage services is clearly feasible.

3.5 Roading (and land transport more generally) is also largely a private good. It is already financed mainly by user charges. State highways are currently owned by Transit New Zealand, with territorial local authorities providing local roads. Reform of the existing institutional arrangements, including of road pricing, offers the best prospects for ensuring that the appropriate mix and level of investment in roading occurs. The recently released Land Transport Pricing Study endorses moves to more efficient road pricing. Commercial options for the supply of roading are also contemplated. In our view, the corporatisation options should be supported. Accordingly, there seems little role for a regional funding body. The Trust has no expertise in roading.

3.6 The case for a specialist agency to fund public transport projects, such as light rail, is also weak. Light rail is one example of an apparently politically popular project that has assumed a life of its own. It would be a likely candidate to be funded by an 'infrastructure bank'. However, we are not aware of any respected international research that suggests that such a proposal would be economic for a city of Auckland's size and geography. The May 1996 *Light Rail Transit Evaluation* showed that light rail was the least viable of the three rail options examined. It then made the somewhat bizarre recommendation that bus operators would need to be controlled to stop them from competing with light rail! The case of light rail perfectly illustrates the potential for politically motivated enthusiasm for high profile projects, encouraged by the availability of a funding source, to lead to wider costs, including a discriminatory

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4 Public goods are those which are non-excludable (i.e. where it is not possible to exclude a person from using the service) and non-rivalrous (i.e. where the use of the service by one person does not reduce its value to another person).

regulatory regime. If prices for road usage are set on an efficient basis, as is envisaged in the Land Transport Pricing Study, there is no case for subsidies for public passenger transport.

3.7 Even where some services display an element of public good, it should not be presumed that funding by a public authority is automatically necessary. Many goods and services have some 'public good' features but are not subsidised - shopping malls and supermarket car parks are examples.

3.8 If, however, the public good characteristics of a service suggest that its provision should be subsidised, this should be done transparently through rates rather than through concessional or dedicated finance. This would place decisions on public good expenditure where they belong - in the hands of political representatives directly accountable to the electorate.

3.9 A regional body that holds a mix of commercial and infrastructure investments is inferior to other arrangements because its roles of owning commercial investments and of subsidising public good elements of projects conflict. The poor incentives of political structures that manage commercial assets suggest the need for insulation from political pressure. Hence, the L/E/K proposals promoted by the Trust attempt to put a wall between the regional holding company and its shareholding local authorities. But insulating such a body from direct political accountability is quite inappropriate in respect of its role as a funder of any public good element of projects.

4 Is there a problem with funding infrastructure, and if so, what is it?

4.1 Implicit in much of the debate about infrastructural needs are the views that:

- the growth rate of investment in infrastructure is inadequate to meet Auckland's future needs; and
- the problem can be solved only by finding new sources of finance.

4.2 The Trust, has promoted the view that its existing resources offer the opportunity to fund badly needed infrastructure investment at no cost to ratepayers. For example, the chairperson of the Trust recently commented that the assets of the Trust represent "a huge cash resource to be used for funding the infrastructural assets that this region needs, so that the ratepayer doesn't have to repeatedly put his hand in his pocket", and that, since "everything in the Trust" is owned by the people of Auckland, "why make them pay again?"[5]

4.3 These views are disingenuous in the extreme. The Trust is merely a legal entity. The resources that it controls are managed on behalf of Auckland ratepayers. Whether or not investments are made by the Trust or directly by ratepayers, they pay once, not twice. Other councils sometimes display a similar misunderstanding of the economic cost of investments.[6] The key point is that, as residual stakeholders, the

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5 *Metro*, July 1997, p. 84.

6 For example, the Auckland City Council in relation to the Britomart venture. Since the

electors and ratepayers of Auckland bear the opportunity cost of the capital that is tied up in the Trust's assets. As noted in the introduction, this capital investment, at over $1,160 for each individual or $3,500 per household, is not trivial. Many might well prefer to apply the resources they own to other purposes.

4.4 It is almost certain that the returns on funds invested by a regional entity that invests in infrastructure will not meet market benchmarks. The Trust contemplates an overall return on funds equivalent only to the rate of inflation.[7] This is an extraordinary investment criterion. There is no point in investing (forgoing current consumption) for an expected zero real return. This implies forgoing current consumption for no gain in consumption in the future. Accordingly, current and future ratepayers will bear significant, but non-transparent costs in the form of lower returns than would be obtained from other private or public investments. Regional political leaders seem to be oblivious to this elementary point.

4.5 There is little basis for talk of an 'infrastructure crisis' in Auckland. The same comments were made about routine failures in telecommunications services in Auckland, prior to the corporatisation of Telecom. The establishment of an 'infrastructure bank' a decade ago would have been an absurd response to that 'crisis'. Auckland is currently growing at a rate no faster than in the 1960s. In addition, the figures of upwards of $6 billion of infrastructure needs that have been quoted are undiscounted costs that span 20 years. This is hardly the stuff of an infrastructure funding crisis. A more rational response is to examine the potential for more commercial means of delivering services and for more efficient pricing. This is particularly important for roading, and water and wastewater services.

4.6 In respect of roading, it is currently central government's responsibility to ensure that road user charges - through petrol taxes, road user charges on heavy vehicles and licence and registration fees - are set in the most efficient way. Sub-optimal outcomes would occur if concessional funding of roads using the Trust's resources interfered with the government's aim of putting in place an improved road pricing regime.

4.7 Whether investment in wastewater and water supply and reticulation is optimal is impossible to determine given the current inadequate industry structures and the high level of subsidies to water and wastewater consumers. The impediments to the appropriate pricing of water and to capital raising arise from the existing regulatory framework and ownership arrangements. The Local Government Act 1974 specifically provides that Watercare is not to pay a dividend or distribute any surplus to its owner or any other shareholder. Watercare must first seek funding for investment from the territorial authorities. Only if the territorial authorities decline to subscribe is Watercare able to fund capital requirements from outside providers.[8]

Council's contribution to the project was originally to be funded principally from the sale of existing properties, the mayor of Auckland argued that the venture would be undertaken at no cost to ratepayers.

7 Auckland Regional Services Trust (1997), p. 8

8 This problem is compounded by the unusual requirement that the equity subscribed by local authorities must be non-voting and non-dividend-bearing.

4.8 These arrangements mean that the owners (the Trust) who bear the risks of investment and who have responsibility for the management of the company are unable to retain income from surpluses generated. Watercare's operations and investment programme are subject to territorial authority agreement. Customers enjoy the rights to residual earnings but are unable to directly influence performance. They can, however, restrict Watercare's ability to invest or increase prices. Since the Trust cannot retain or distribute any of the surplus generated by Watercare, it cannot obtain a return for any risky investment it undertakes. This must affect its incentives to undertake such investment. An infrastructure fund would not solve any of these problems. Moreover, it has the potential to make matters worse if concessional finance is provided to fund expansion. Only a fundamental review of regulatory, ownership and pricing structures offers the prospect of creating an environment in which sound decisions on the optimal level of investment in water and wastewater facilities can be made.

4.9 Of course, getting prices for infrastructure 'right' also means that ratepayers will not need to be called on to 'put their hands in their pockets' for finance. There have been major innovations in the financing of infrastructure projects, particularly by commercial banks. They include:

- non-recourse financing where the lender has no, or limited, recourse to the cash flow or capital assets of the sponsors of the project. This allows project sponsors to better manage their risk, and enables lenders to view the project as a self-contained business with repayments having a specific source;

- fixed price turnkey contracts with appropriate penalties to manage commercial risks, such as cost over-runs; and

- take-or-pay contracts to manage the risk of declining demand.

4.10 An 'infrastructure bank' (or an equivalent) which is subject to political influence to fund favoured projects will crowd out more efficient market-based financing approaches. Of course, some local body politicians will argue that if a regional fund is not available the private sector may not step in to 'fill the gap'. They may point to the absence of takers to fund projects they are keen to promote. This argument has been used in the past to justify government investment in a host of activities. The main reason for a lack of private sector interest is that the projects in question have not been economically viable.[9] Often councils have gone ahead and lost ratepayers' money. Potential private promoters are unlikely to be forthcoming if they perceive that a public body with money burning a hole in its pocket is likely to stump up with the finance instead.

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[9] Such reluctance may be prudent in the case of the most prominent project promoted by the Trust: the America's Cup Village. As yet, no syndicates have been reported as having signed up to rent sites. This is despite reported assurances by the Trust in early December 1996 that commitments would be required of syndicates by 20 December of that year. Not surprisingly, a trustee with business experience expressed concern at the time that the Trust planned to proceed with the development without firm commitments from Cup syndicates.

5 Would a publicly owned body that holds commercial assets to fund infrastructure be properly accountable?

5.1 The approach favoured by the Trust suffers from a lack of accountability. There would be significant risks that the electoral process would be more in the nature of a lottery than a considered choice by electors. This would make it easier for special interest groups to lobby the Trust to undertake politically popular but commercially doubtful investments. These problems arise because the Trust or any replacement entity would:

- be accountable to stakeholders through cumbersome electoral processes;
- be subject to weak performance monitoring incentives by stakeholders;
- have no direct connection with electors;
- be subject to weak capital market restraints; and
- be incapable of reflecting individual ratepayer preferences.

5.2 The sheer size of the electorate makes it difficult for candidates to communicate their viewpoint and for potential electors to influence outcomes through the electoral process. It is therefore relatively costly for ratepayers to act directly on information they receive about the Trust's performance. Ratepayers have few options to protect themselves against bad decisions by the Trust, other than to move to another local government jurisdiction with a sounder financial policy.

5.3 Electors know that they are likely to bear the full cost of any initiatives they take to improve outcomes, but receive only a pro-rata share of any benefit. Accordingly, the incentives that ratepayers have as ultimate owners of Trust-owned assets to monitor the performance of the Trust and its management are relatively weak.

5.4 There is no direct connection between electors and the Trust. Unlike territorial authorities, the Trust does not extract any rates, tax or other funds explicitly from individual electors. Nor does it deliver any services directly. Few Aucklanders are likely to be aware of the range of the Trust's services or their cost. The equivalent to retaining ownership of the Trust's commercial investments in some form of public ownership to fund infrastructure would be to distribute the Trust's assets to individuals and subsequently tax all households to raise the same amount of money for the same purpose. Since the latter approach involves a more direct connection between electors and taxing decisions, it is less likely to receive a mandate from the electorate. This calls into question the case for a Trust structure.

5.5 Capital market constraints on the performance of the Trust are relatively weak and do little to offset these other weaknesses in accountability. For example, management is not exposed to the threat or reality of takeovers, and information generated by the sharemarket that would reflect management performance is absent. While this applies particularly to the Trust as a holding entity, similar problems arise for subsidiaries owned or controlled by the Trust which it is reluctant to sell.

5.6 The Trust cannot reflect the preferences of each ratepayer, which are unlikely to be uniform because they face vastly different circumstances. Some may be hard-pressed to pay for necessities, such as food, housing and clothing. They could be expected to put a low priority on the accumulation of investment funds compared to receiving cash distributions or the proceeds of selling the assets, which would increase their disposable incomes. Likewise, the willingness of ratepayers to take financial risks differs. The sale of the Trust's business assets and the return of the proceeds to ratepayers would reduce the risk they face, or would enable them to manage their own risk according to their preferences.

5.7 The above problems are reflected both in voting behaviour and in consultation on the draft Annual Plan. The plan reveals that:

- at the last election, there was a voter turnout of a little over 31 percent. This contrasts with the average voter turnout for local authority elections of 45 percent, indicating that electors were generally much less interested in voting for the Trust than they were for their local authority; and

- there were only 16 submissions on the Trust's 1996/97 Annual Plan.

5.8 In our view these considerations should rule out of contention Options 1 (continuance of the Trust, but with a new function to fund infrastructure) and 4 (transferring the Trust's assets to a holding company with responsibility to fund infrastructure in the Auckland Region). Options 3(a) and (b), which would enable the commercial assets to be held by a regional or territorial authority to fund infrastructure, should be dismissed on the same grounds.

6 Would the Trust or a replacement entity facilitate or impede strategic planning and coordination in the region?

6.1 The discussion document raises the issue of whether the Trust, or a replacement body, would contribute to strategic planning and coordination of infrastructure and other regional services. In this context we would note that:

- there will always be issues concerning coordination across local government boundaries. These are unavoidable unless there is a single jurisdiction. The factors that have to be weighed up in defining local government boundaries include the need to reflect a reasonable community of interest, the ability of voters to make informed choices about their representatives, and any economies of scale; and

- while the problem of coordination in the Auckland region is acknowledged, putting a new agency in place (or retaining the existing Trust with its enhanced aspirations) in a way that cuts across existing local government structures and their forms of accountability to the electorate is the wrong response. Superior options are the corporatisation and privatisation of utilities so that coordination would occur through normal market mechanisms, and the amalgamation of existing territorial local authorities, which would be facilitated if non-public goods functions were shed.

7 The Future of Watercare and the Trust's Other Commercial Assets

Assets other than Watercare

7.1 The conclusion of the foregoing analysis is that the need for infrastructure funding is not a reason to retain assets in the Trust or a replacement vehicle. The only question that remains is whether valid grounds exist for the Trust to continue to own commercial investments. The Trust is essentially a holding company for five principal businesses (plus the America's Cup Village). Once the Trust has completed the sale of TACL, Northern Disposal Systems Limited and Regional Forests Limited, it will essentially be the owner of a water business and the part-owner of a transport terminal. There are no valid grounds for holding these commercial investments in a politically elected body. This diverts attention from the proper role of local government which is to provide local public goods.

7.2 Continuing political control would erode the wealth of the current generation of Aucklanders. There are signs already of the effects of weaknesses in capital market incentives on the Trust's decision making. A common device that shareholders use to exert discipline on managers is the requirement to pay a minimum level of dividends. This is reflected in an increasing trend for shareholders to demand that firms with surplus funds release them through share buybacks or special dividends to reduce the scope for managers to invest in non-core activities. However, in return, shareholders are often called upon to subscribe for fresh issues of capital to fund profitable expansion. The Trust has sought to retain free cash flows and accumulate surpluses rather than to subject itself to such disciplines. This is likely to lead to inefficiency and uneconomic investment decisions over time.

7.3 The Trust has been successful in repaying the debt it inherited, due partly to favourable external economic conditions, a tight legislative framework and incentives created by the existence of the external debt itself. Now that the debt constraint is no longer present, the Trust's commercial focus is clearly becoming weaker. This is a typical pattern with businesses subject to political control. As the Trust's experience shows, some public enterprises can perform well for a period (and it is also true that some private firms can fail spectacularly). However, the differences in the incentives faced by an entity that is accountable through political processes and one in which stakeholders directly hold ownership interests mean that, on average, and over time, private enterprises outperform public enterprises. While all firms make wrong decisions, private firms face disciplines which mean they make fewer and correct them faster than firms owned by governments, which tend to cover up bad decisions. Governmental authorities should not play against such odds and gamble with taxpayers' and ratepayers' funds.

7.4 Accordingly, the New Zealand Business Roundtable submits that Option 3(c) is in the best long-term interests of Aucklanders and New Zealand. The smaller businesses should be disposed of over the next 1-2 years as currently planned. A consultation process aimed at the sale of Ports of Auckland Limited should be initiated in a way that fully informs Auckland ratepayers about the issues involved and allows ample time for them to be considered. Key issues to bring out would include the constraints on the ability of the company to develop a sound long-term strategy and grow its business while remaining in majority public ownership, and the risks to ratepayers of retaining a shareholding in a business operating in an increasingly competitive environment. Contrary to the position of some members of the Trust, there are few significant problems of market power in today's port industry, and any that do arise can be dealt with under normal competition law. Therefore, we consider that the Trust should relinquish control of the three smaller businesses and Ports of Auckland Limited either by way of direct sales with the proceeds being returned to Auckland ratepayers or by way of a share giveaway.

7.5 The choice between these two options should turn on which one enables the assets to be distributed as quickly as possible and yield the highest value to ratepayers. This would ensure the minimum adverse effect on the value of the investments due to uncertainty during the transitional period. Allocating shares or cash to individual stakeholders will require:

- identification of eligible recipients for the shares and/or cash. Recipients may not just be electors and could include ratepayers and consumers; and

- the development of procedures for making the distribution. Like the distribution of shares in power companies, shares could be allocated to each ratepayer, or on a per capita basis, or by reference to a formula which combines both.

7.6 In the case of a share giveaway, individual stakeholders would be able to decide whether to hold the shares or quit them. This is a more democratic procedure than leaving the decision in the hands of politicians. A further possible short-term option is the partial sale of shares in Ports of Auckland Limited so that a majority of the shares of the company are held by the public.

7.7 Until mechanisms are available in legislation to distribute the business assets of the Trust, the Trust should be constrained from using its surpluses to undertake new and risky investments in infrastructure projects or commercial activities.

Watercare Services Limited

7.8 The special legislative provisions relating to Watercare should be repealed. They result in a confused ownership and accountability structure for the organisation, and impede its ability to raise capital and price water services appropriately. This has adverse environmental as well as adverse economic consequences. The perverse effects of existing arrangements are evident from the 1996/97 strategic plan of the Trust which forecasts negative value added of $67 million for the Trust's investment in Watercare.

7.9 Immediate priority should be given to restructuring Watercare as a LATE with more conventional financing and ownership arrangements. In addition, consideration should be given to the merits of separating the ownership of the existing water and wastewater reticulation network (which could reside with territorial authorities) and of water and wastewater facilities (which could remain with Watercare), and the development of an appropriate light-handed regulatory regime.[10]

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10 Such a regime offers advantages over alternative regulatory approaches. For further discussion on this issue, refer to CS First Boston (1995), *Reform of the Water Industry*, New Zealand Business Roundtable, Wellington.

7.10 Once these tasks have been completed, the new ownership and regulatory framework would provide an appropriate context to move towards privatising Watercare. Various forms of privatisation of water supply and wastewater disposal are possible, including franchising and contracting for services. While there is likely to be public resistance to privatisation, much of this is misinformed. Major gains have been realised in New Zealand and in other countries when activities were exposed to competition and privatised. Internationally, the privatisation of water supply and wastewater disposal has produced similar benefits. A recent study by the Reason Foundation of private (investor-owned) and government water systems in California found, among other things, that:

- investor-owned water companies provide comparable water services to consumers at the same price as government-owned water companies, even though they pay taxes;

- investor-owned companies are substantially more efficient in their operation of water services than government-owned water companies;

- it is likely that government-owned water companies spend more on facilities than investor-owned water companies; and

- governments can better regulate an investor-owned water company than a government-owned water company.[11]

7.11 It is sometimes argued that water is an essential commodity which should not be provided by a profit-making business. This ignores the fact that most essential goods and services, like food, are produced in the private sector. Water is an economic product like any other. People derive benefit from its consumption. If water is priced correctly, they will trade off the benefits of using additional water against those of other goods and services that they may prefer. Sufficient revenue should be raised to pay for water services, including an amount to cover the costs of capital. At issue, therefore, is whether the revenue is raised efficiently, not whether it is raised.

7.12 Another objection is that because they have natural monopoly characteristics, water businesses cannot be privatised for fear that they will abuse their market position. However, if monopoly pricing is a concern with private ownership, it is equally a concern if the assets of Watercare are retained in public ownership. Experience in New Zealand has shown clearly that cost padding and monopoly pricing were far more serious problems in utilities such as ports and electricity supply authorities when they were under political control, and the same is almost certainly true of water. The effective monopoly of Watercare and existing pricing policies mean that lower cost alternative suppliers of water, and of wastewater processing facilities, face substantial barriers to entry.

8 Conclusion

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[11] Neal, K, Maloney, P J, Marson, J A and Francis, T E, (1996) *Restructuring America's Water Industry: Comparing Investor-Owned and Government-Owned Water Systems*, Reason Foundation, Los Angeles.

8.1 Few people would argue today that all households in Auckland should be levied for around $3,500 so that a regional Trust could be set up to engage in risky business activities, such as port, transport and waste disposal companies, or other 'infrastructure' investments. No other region has found a need for such a structure. By the same logic, holding on to assets such as the majority of shares in a port company for the same purpose makes little sense.

8.2 Using returns on commercial investments to finance water, wastewater, roading and public transport services may appear to be a short-term palliative for Auckland. However, unless the more pressing issue of an appropriate ownership, regulatory and pricing structure for infrastructure services is addressed, problems of financing additional capacity will remain. There is clear evidence from the electricity and telecommunications sectors in New Zealand, and water services overseas, that adequate investment in infrastructure will occur if an appropriate regulatory framework is in place and conventional investor-owned companies are permitted to enter the market. The approach promoted by the Trust, which is based on political planning and control, is outdated and seemingly driven by political motivations rather than the best interests of Auckland citizens. Any suggestion that arguments for privatisation are driven by business interests are easily countered. Given a competitive sale process, investors could not expect to obtain higher returns from such investments than alternatives open to them, and an equally acceptable option, as argued, would be a share giveaway.

8.3 The Trust's enthusiastic promotion of a replacement entity to fund infrastructure projects ignores the almost certain costs such an approach would impose on current and future residents of the Auckland region. These costs are non-transparent and arise in an environment of weak accountability. A replacement entity would contribute to greater confusion of roles between central, regional and local government. Given that the ultimate destination of commercial assets should be in the private sector, the preferred strategy should be to move towards that goal in as direct a manner as possible, not through a circuitious route which re-invests control of the assets in other territorial or regional authorities. In the interim the Trust should be constrained in the uses to which it can put its earnings.

8.4 The case for the distribution of the Trust's commercial assets, and eventually of the assets of Watercare, is compelling if clearly articulated. Only a failure of political leadership would present an opportunity for special interest groups to derail a reasoned debate. The distribution of the Trust's assets is the strategy which would be most consistent with parliament's intention of establishing the Trust for a transitional period only. No new evidence has come to light to suggest that this decision was unsound. The opportunity is now available to wind up a branch of local government that has become superfluous.

8.5 If there is a significant risk that debate will be captured by special interests seeking to preserve a role for themselves, we consider that the electors of Auckland should be allowed to decide the issue themselves by way of a referendum. To make an informed decision, electors would need to have access to all relevant information, including the value of the entitlement they would receive if the Trust's assets were distributed, and an assessment of the risks of relying on politicians to continue to manage those investments. Armed with this information, electors could make more informed voting decisions about the trade-off between retaining the assets 'in trust' on their behalf and the benefits of receiving a direct ownership stake.

8.6 To ensure an objective presentation of the issues, an independent panel of disinterested persons, with no connections to the Trust or its businesses, should be set up to administer the consultation process, including the preparation of relevant information. If distribution of the Trust's assets is favoured by a majority of the electorate, the independent panel could also oversee that process.