

New Zealand Business Roundtable

**Submission on the Auckland City
Council's 1997/98 Draft Annual Plan**
This is Your City

June 1997

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Executive Summary

- This submission on the Auckland City Council's 1997/98 draft annual plan *This is Your City* (the Plan) is presented by the New Zealand Business Roundtable.
- A key weakness in the Plan is the absence of a valid analysis of the proper role of the public sector and, in particular, that of territorial local government. The role of government at any level differs from that of the private sector. It needs to be established on the basis of a proper public policy analysis. Consultations with the public and interest groups are no substitute for this process.
- As argued in previous submissions, the Council should be working more actively to shed non-core activities and thereby reduce rates. The Council's core business should be funding and - in justifiable circumstances - providing public good outputs which cannot be better provided by firms, households or non-profit organisations.
- There are no valid grounds for the Council to own shares in Auckland International Airport Limited, to engage in the promotion of commercial property development and tourism, and to own and operate off-street parking facilities and the Britomart transport centre.
- The corporatisation of the City's water supply and waste water operation is supported as a step in putting it on a more commercial footing. The experience with all network industries owned by central government is that major efficiency gains have resulted from fundamental reform.
- The Council has not explained why it believes that continuing government ownership and management of its water supply business is in the interests of the community. Various forms of privatisation of water supply and wastewater disposal, including franchising and contracting for services, have produced major benefits for consumers and the wider community in other countries. Other New Zealand councils are adopting them or considering doing so. We recommend that the Council involve the private sector as soon as possible in its corporatised water supply.

- The Council's examination of transport issues should start from the presumption that it should be acting in the wider community interest, clearly distinguishing this from the perceived interests of non-motorists and other special interest groups. It should seek to get prices right and establish a level playing field for competition between transport modes, departing from this only when there are sound reasons for doing so. The creation of dedicated lanes for buses, for example, involves special treatment for a mode of transport that is often substantially subsidised relative to commercial road users and private motorists.
- One benefit of higher living standards and technological advances is greater mobility. Instead of adopting a central planning and control approach, the Council should respond to consumer demand for roading services where it is economic to do so. A performance measure for the roading network - that 20 percent of residents surveyed agree that the level of traffic congestion on city roads is similar to that of the previous year - indicates that a perceived deterioration in the quality of its roading services by the vast majority of citizens is acceptable to the Council. This measure, together with an objective aimed at limiting the increase in demand for transport services up until 2015, indicates that the Council is not responsive to consumer needs.
- The Council proposes to use its regulatory powers to support public transport and roading infrastructure. It should enable the preferences of its citizens to be satisfied rather than constrain them in order to artificially stimulate demand for existing public transport and roading infrastructure.
- Despite public statements alleging that the Auckland region is facing a transport crisis, the Council is substantially cutting its spending on major roading projects.
- A long-term objective is to put light rail in place in Queen Street and on the rail corridors. We are not aware of any respected international research which suggests that such a proposal would be economic for a city of Auckland's size and geography. If the project were viable without subsidies, the private sector would undertake it.
- The effective rate differential for CBD non-residential ratepayers was 218 percent in 1996/97. We are not aware of any information which suggests that

such a differential has been justified by a proper analysis of the relative costs of the services supplied to each sector. The proposed differential, which reflects the 'ring fencing' proposal, is a massive 345 percent. It is up to the Council to justify such a large differential. If it is unable to do so, it should not proceed with the 'ring fencing' proposal.

- We are opposed to the planned increase in the average level of rates payable in respect of each dollar of rateable property. The Council proposes an increase of 2.5 percent to fund its activities and a further 2.8 percent to fund Watercare Services. The value of new improvements will contribute an additional 1.25 percent increase in rates revenue. These changes seem to imply a cumulative increase in rates revenue of 6.7 percent. There are ample opportunities for the Council to cut spending and increase user charges so that rates can be reduced substantially rather than increased.
- The Council should fully fund the goods and services that it produces from user charges or use-related charges whenever this is an economically efficient strategy. On both efficiency and equity grounds the case for funding private outputs from user charges is very strong. Economic efficiency generally requires prices that reflect the marginal cost of producing a good or service.
- The redistribution of income by subsidising services is not an appropriate role for the Council. A superior strategy is a combination of lower rates on all households, more efficient service provision, and appropriate central government tax and welfare policies.
- It is often argued that public goods should be funded by rates. Although this is reasonable in some situations, in general there should be no such presumption. Similarly, the existence of external benefits does not, by itself, create a case for rate-based funding.
- Because external effects are easy to assert and difficult to refute or quantify, councils are exposed to opportunistic and exaggerated claims by direct users of such services about the magnitude of such effects. The use of models by City Promotions and some consultancy firms which appear to generate implausibly large external benefits illustrates this risk.

- Rate-based funding should apply when the benefits from a service exceed its costs but it is not economic to fully recoup the costs from user charges and use-related fees and levies.
- Once the Council has focused its role on funding and/or providing core activities that cannot be funded through user charges or proxies for user benefits, it should consider options for efficient taxation (rating) of ratepayers.
- The level and quality of disclosure should be improved. The omission of data that would enable a meaningful comparison to be made of the Council's planned performance for 1997/98 with at least the previous year is a serious oversight. It calls into question whether the Plan conforms with acceptable standards of financial disclosure and provides an adequate basis for consultation.
- The Council's objectives need to be clarified, discrepancies between performance indicators and outcomes identified, corrective action noted and major changes from the previous year's plan explained. The level of disclosure generally compares unfavourably with that of central government.
- The Council can make the best possible contribution to the welfare of the citizens of Auckland by focusing on its core activities, exiting those that are inappropriate, and keeping its rate and regulatory burdens as low as possible.

1 Introduction

- 1.1 This submission on the Auckland City Council's 1997/98 draft annual plan, *This is Your City* (the Plan), is presented by the New Zealand Business Roundtable (NZBR). The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.
- 1.2 In our submissions on the Council's 1995/96 and 1996/97 draft annual plans, we concluded that the Council should be working more actively to shed non-core activities and reduce rates. The Council's core business should be funding and - in justifiable circumstances - providing public good outputs which cannot be better provided by firms, households and non-profit organisations. The Council continues to engage in the supply of private goods and services that should be undertaken in the private sector. While some investment property is to be sold, this policy is motivated by the desire to fund major projects, such as Waterfront 2000, without increasing rates and debt rather than a firm commitment to focus on those activities where government action is justified. Moreover, some recent activities, for instance the Britomart project, extend well beyond the core activities of the Council.
- 1.3 In last year's submission we argued that the 1996/97 draft plan did not comply fully with the requirements of section 223D of the Local Government Act 1974. Although the Council's chief executive argued in a letter to *The National Business Review* that this was not the case, the Audit Office and the Department of Internal Affairs upheld our complaint. While most of the deficiencies noted, such as the omission of the Britomart project from financial projections, have been addressed in the Plan, it does not provide all the information required by the Act. Furthermore, it is not consistent with the Act to argue, as the chief executive did, that the required information will be included in the final plan.
- 1.4 More importantly, there are significant shortcomings in the quality of information provided in the Plan. It is not possible, for example, to determine on a meaningful basis the proposed growth in the gross or net cost of activities, or revenue. The comparability of such data is distorted by the decision to form MWL and the absence of information on its effect on key fiscal parameters. The omission of comparable data raises the question of

whether the Plan conforms with acceptable standards of financial disclosure and provides an adequate basis for consultation.

- 1.5 The balance of this submission is presented in seven sections. The next section (section 2) discusses the scope of the Council's activities. Sections 3 and 4 discuss water and transport activities respectively. Council activities that are not examined elsewhere (other activities) are reviewed in section 5. Section 6 addresses the Council's funding policy. The disclosure of financial information in the Plan is examined in section 7. Our conclusions are presented in section 8.

2 The Scope of Council Activities

2.1 Background

- 2.1.1 The Council's gross spending, revenue and surplus budgeted for 1997/98 is compared with similar items for 1995/96 (actual) and 1996/97 (budget) in table 1. The analysis suggests that revenue and spending are expected to fall sharply in 1997/98. This result is, however, distorted by the formation of MWL. There may be other inconsistencies in the data because a summary statement of financial performance prepared on a gross basis which was included in the 1995/96 annual report and the 1996/97 plan has been omitted from the Plan.
- 2.1.2 Information contained in the Council's budgeted balance sheet is similarly distorted. Term investments, for example, are expected to increase by \$344 million while infrastructural assets are expected to fall by \$432 million compared with the budget for 1996/97. Ratepayers' equity is forecast to fall slightly despite the expectation of a surplus. These changes presumably reflect the establishment of MWL but no explanation is provided.

Table 1
Summary of Financial Performance

Financial Performance	1995/96	1996/97	1997/98
	Actual	Budget	Budget
	\$000	\$000	\$000
Revenue from activities	216,613	224,306	152,174
Rates	205,713	197,573	188,805
Other income	13,500	12,627	12,667
Total revenue	435,826	434,506	353,646
Gross cost of activities	398,104	413,737	325,144
Other expenditure	28,277		
Debt servicing	17,114	19,547	20,502
Total expenditure	443,495	433,284	345,646
Surplus (deficit)	(7669)	1,222	8,000

Note. Excludes Regional Council and capital charges.
Source: 1996 annual report, 1997 annual plan and the Plan.

- 2.1.3 A valid analysis of the trend in gross revenue and spending by the Council and of proposed changes in its balance sheet is critical to an informed assessment of the Plan. The omission of data that would enable a meaningful comparison to be made of the Council's planned performance for 1997/98 with at least the previous year is a serious oversight. It calls into question whether the Plan conforms with acceptable standards of financial disclosure and provides an adequate basis for consultation.
- 2.1.4 The confirmation by Council staff that comparable data are not readily available suggests that councillors have not adequately considered the overall trend in gross spending and revenue in preparing the Plan. It is possible that the planned restructuring of the Council's water business disguises a significant increase in spending.

2.2 Role of the Council

2.2.1 A key weakness in the Plan is the absence of a valid analysis of the proper role of the public sector and, in particular, that of territorial local government. Such an analysis was omitted from the Council's draft and final strategic plan, *Outstanding Auckland*.

2.2.2 The role of government at any level needs to be established on the basis of a proper public policy analysis. Consultations with the public and interest groups are no substitute for this process. The demand for ratepayer-funded services will generally be excessive from an efficiency perspective because people and groups that lobby for particular services do not face the marginal social costs of the services that they demand. Tightly focused groups are able to obtain services that they value by imposing costs thinly over the majority of ratepayers who face excessive costs in representing their views. The absence of information on the real value to ratepayers of particular services makes it impossible for the Council to accurately assess the preferences of ratepayers. Furthermore, ratepayers are compelled to bear the costs that are imposed on them. Their opportunities to move to a more fiscally attractive territory are constrained.

2.2.3 In past submissions to the Council, we have outlined a framework for improving the efficiency of Council activities. The framework suggests that goods and services are best produced by the private sector rather than the Council where this can be done on a commercial basis. In general, private providers have the best incentives to ascertain and satisfy individuals' needs at least cost. If the Council determines that greater provision of particular goods and services would be in the community's best interests, there may be a case for subsidising private provision rather than for public sector provision. The Council should exit from the production of private goods unless there are special reasons for continuing Council involvement.

2.2.4 The Council's core business is funding and - in justifiable circumstances - providing public good outputs which cannot be better provided by firms, households or non-profit organisations. There should be no presumption that Council provision and/or funding is justified simply because particular goods or services have public good characteristics and/or provide community benefits which extend beyond those enjoyed by direct users. The Council is just one of a multiplicity of agencies which can assist in the provision and

funding of such goods and services and it should not step in to assist when other arrangements might be more efficient and more equitable.

- 2.2.5 Private provision of outputs with public good elements is possible. It may be the case that users value the service to the extent that private providers can recoup all their costs by user charges. Thus, private bookshops do not need, or attempt, to charge people who browse and/or borrow books and magazines bought by someone else. Public spaces and car parks are provided in privately-owned shopping malls with the costs recovered from those who shop at such facilities. Passers-by may derive pleasure from well-maintained private gardens. This does not justify council subsidies to private gardens. People who regularly attend the movies may be more interesting conversationalists. Councils do not subsidise movies on the basis of this public benefit.
- 2.2.6 People are willing to donate time and money to private non-profit organisations which provide outputs with public good or externality characteristics. Private museums draw on donations and volunteer labour to provide services to the public. Many charitable organisations funded by donations and from central government grants exist to provide assistance to people who have special difficulties and needs.
- 2.2.7 We acknowledge the 'free-rider' argument that public goods will be under-provided without governmental action to force individuals to contribute through taxes and rates. However, where individuals can see that a library, swimming pool or museum will be closed down or not constructed unless they contribute, their failure to contribute is an indication of their lack of enthusiasm for the expense. Councils have no sound alternative basis for determining true preferences and may be vulnerable to exaggerated claims of external benefits by vested interests.
- 2.2.8 In many cases it may not be efficient and/or equitable for local government to become involved in funding public goods or social services, particularly when ratepayers may be divided over the Council's involvement and when those who wish to assist can readily do so directly. The Council should not lightly use its coercive powers to force all ratepayers to support activities which they could readily fund themselves. Rates distort behaviour and impose economic

costs on the community which are additional to the losses in well-being from forcing some ratepayers to spend money against their will.

- 2.2.9 Although the Council could subsidise low income individuals, social assistance is more efficiently provided by central government through the tax and welfare system. Central government has better access to relevant information and more powerful and effective means of raising the necessary taxes to redistribute income to those in need through the welfare system. Local Government New Zealand has stated that it does not see an income distribution role for local government.
- 2.2.10 Where monopoly considerations are serious, there is room to debate the case for regulation or, in exceptional cases, public sector provision. In general, though, protection against monopoly pricing can be provided by a 'light-handed' regulatory regime, and efficiency gains achieved by privatisation or franchising. Serious monopoly problems are rare provided markets are open to entry and competition.
- 2.2.11 To summarise, the costs and benefits of Council intervention need to be assessed and, if Council action is justified, the most appropriate form of intervention should be employed. This may involve regulation, subsidisation of particular outputs provided by a private organisation, matching of private donations to a non-profit organisation, Council provision of the outputs, or other options.
- 2.2.12 The above principles suggest that the promotion of commercial property development and tourism, and the ownership and operation of off-street parking facilities, the proposed transport center and present arrangements for operating and/or funding libraries, museums, the art gallery, swimming pools, halls and entertainment facilities (the Aotea Centre, the Civic Theatre, the Town Hall and community halls) and water assets could not be justified by a valid public policy analysis.
- 2.2.13 The Council can make the best possible contribution to the welfare of the citizens of Auckland by focusing on its core activities, exiting those that are inappropriate, and keeping its rate and regulatory burdens as low as possible. There is little indication in the Plan that the Council intends to do this. We recommend that the Council review rigorously its activities in finalising the

Plan. Such an exercise should be a first step in applying the Local Government Amendment Act (No 3) 1996.

3 Water Supply and Waste Water Disposal

3.1 The Case for Reform

- 3.1.1 In April the Council resolved to establish a LATE to own and operate the Council's water and waste water assets. The idea had been raised in the 1996 review of *Outstanding Auckland*. The Plan indicates that MWL is likely to be awarded a contract to manage stormwater disposal but that relevant assets are not to be transferred to MWL and that stormwater services are to be financed from rates.
- 3.1.2 The Plan has been prepared on the assumption that MWL will commence its activities on 1 July 1997. However, the mayor's introduction to the Plan indicates that whether the Council should organise its water and waste water business into a LATE or keep it in a council-owned business unit is a key issue to be addressed by submitters.
- 3.1.3 The Council's water and drainage activities constitute a large business by any measure. The Council's 1995/96 annual report put its water supply and drainage assets at \$694 million or 29 percent of total assets. A breakdown of assets by activity is not contained in the Plan, nor is the value of assets to be transferred to MWL disclosed. The draft establishment plan proposes a purchase price of \$180 million which was recommended after considering massively different valuations of the business. A write-down in the value of the Council's assets and a reduction in ratepayers' equity appears to be involved.
- 3.1.4 The experience with all network industries owned by central government is that major efficiency gains have resulted from fundamental reform. The corporatisation of the City's water supply and waste water operation is supported as an important step in putting it on a more commercial footing and achieving such efficiency gains.
- 3.1.5 The Plan states that one of the Council's objectives for 1997/98 is that "Public ownership of the City's water assets is retained". The continued government

ownership of the City's water supply business is either in the interests of the community or it reflects an ideological stance. The Council has not explained why it believes that continuing government ownership of the business is in the interests of the community.

- 3.1.6 Major gains have been realised in New Zealand and in other countries when activities were exposed to competition and privatised. The privatisation of water supply and wastewater disposal internationally has produced similar benefits. There is a good deal of material on this subject, including specific findings which point to the superior performance of privately owned water utilities in the United States compared with government-owned water businesses.
- 3.1.7 It is sometimes suggested that because water businesses have natural monopoly characteristics they 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 with LATEs which also have commercial goals. Thus monopoly pricing must be considered in both situations, and no additional issues are raised by privatisation. Experience 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 for water.
- 3.1.8 A further objection which has been raised by people opposed to the corporatisation and privatisation of water is that water is an essential commodity which should not be provided by a profit-making business. 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 and, if it is priced correctly, will trade off the benefits of using additional water against those of other goods and services that they may prefer. The Council must generate sufficient revenue to pay for the water services that it provides, including an amount to cover the costs of capital. At issue therefore is whether the revenue is raised efficiently, not whether it is raised.
- 3.1.9 Structural reforms of the delivery of water have been implemented in many other countries, including the United Kingdom and Australia. There are

many issues to be addressed in effecting improvements. These include the control of leakages, improved contracts with customers, pricing - including bundled pricing of supply and disposal - and infrastructural management. MWL's draft statement of corporate intent is notable for its lack of coverage of such issues. Instead the focus is on meeting imprecise quality standards.

- 3.1.10 Various forms of privatisation of water supply and wastewater disposal, including franchising and contracting for services, have produced major benefits for consumers and the wider community overseas. We recommend that, like the Papakura District Council, the Council should involve the private sector in its corporatised water and wastewater business as soon as possible.

3.2 Specific Comments

- 3.2.1 According to the draft statement of corporate intent, the suggested mission statement for MWL is:

To be an outstanding provider of quality water and drainage services at minimum prices, on demand, reliably and efficiently.

The Plan says that MWL will be required to operate as:

An outstanding provider of quality water and wastewater services at the minimum price to the consumer consistent with economic efficiency.

A potential conflict between a requirement to operate at minimum prices and efficiently is apparent in the first statement. For example, charges for water could be held down artificially for political reasons. This encourages over-use and discourages conservation, and is thus economically inefficient and environmentally harmful. Inappropriate charging is a problem with Watercare Services. The second statement appears to overcome this problem by focusing on economic efficiency. The key objective of corporatised businesses, however, should be to be profitable. A gross revenue performance target for the proposed holding company is inappropriate and will lead to inefficiencies such as the pursuit of revenue growth rather than higher profits.

- 3.2.2 The Council is seeking to establish MWL as a charitable organisation for tax purposes. This is to avoid the normal obligation of a LATE to pay income tax.

While acknowledging that the requirement to pay tax has impeded the formation of LATEs, we believe that the Council's proposal is inappropriate. LATEs should, as far as possible, be established on a competitively neutral basis relative to commercial enterprises. Such a move would impede private sector competition. Secondly, future income should accrue to ratepayers and not be dedicated to a particular purpose. We would regard an approval of the Council's proposal by Inland Revenue as an undesirable precedent. In that event the government should reexamine its relevant tax policy.

- 3.2.3 No reason has been given for the decision to transfer the management of stormwater to MWL but retain the assets. Unless there are sound regulatory reasons, we suggest that MWL should assume ownership of the relevant assets.

4 Transport

- 4.1 Despite public statements alleging that the Auckland region is facing a transport crisis, the Council is substantially cutting its spending on major roading projects. Provision was made for \$26 million to be spent on such projects in the 1996/97 plan compared with \$11 million for all transport projects in the Plan. Almost half of the budget for 1997/98 is devoted to the Britomart centre, which will not address congestion problems efficiently, and the related purchase of land for roading. Thus the real reduction in spending on major roading projects is substantially larger than first appears. While the completion of the South Eastern Arterial project may be a factor, a change in the Council's priorities appears to be the main explanation for this trend. The Council is planing to reseal 650,000 m² of roads compared with a target of 957,000 m² in 1996/97 and 1,165,000 m² 1995/96. No explanation is given for this reduction.
- 4.2 A proposed performance measure for the roading network - that 20 percent of residents surveyed agree that the level of traffic congestion on city roads is similar to that of the previous year - indicates that a perceived deterioration in the quality of its roading services by the vast majority of citizens is acceptable to the Council. The Council will have performed as intended even if up to 80 percent of residents report greater traffic congestion. This is perverse. The proposed measure, together with an objective aimed at limiting the increase

in demand for transport services up until 2015, indicates that the Council is not responsive to consumer needs.

- 4.3 One benefit of higher living standards and technological advances is greater mobility. In managing utilities such as roads, it is the Council's responsibility to satisfy higher demand in the same way that other utilities strive to satisfy market demand. It would be bizarre to encounter the argument in the electricity, telecommunications, water or any other network system that growth should not be satisfied where it is economic to do so. The implication would be that, with rising demand, users should have to put up with brown-outs, persistent 'busy-signals' or a loss of water pressure. The relevant objective is inconsistent with the overriding goal of maximising the welfare of the City's ratepayers and citizens.
- 4.4 There is an absence of any focus on creating a level playing field between any competing transport mode - bus, train, car, taxi and bicycle, and pedestrian traffic. Neutrality is important for optimal resource allocation. The establishment of dedicated lanes for buses, for example, creates advantages for a mode that is often substantially subsidised relative to commercial road users and private motorists.
- 4.5 The council proposes to use its regulatory powers to support public transport and roading infrastructure. The Council should enable the preferences of its citizens to be satisfied rather than constrain them in order to artificially stimulate demand for existing public transport and roading infrastructure. The purposes of the Resource Management Act 1991 reflect this view. Its aim is to ensure that the use, development and protection of natural and physical resources is managed in a way, or at a rate, which enables people and communities to provide for their social, economic and cultural well-being. The Act requires environmental effects such as safeguarding the life-supporting capacity of air, water and soil, and avoiding or mitigating adverse effects on the environment, to be taken into account. However, they are not paramount and must be balanced against other requirements. The Council's concern to contain 'urban sprawl' within metropolitan limits is also misplaced. It is a central planner's approach which fails to focus on the preferences of individuals and is predicated on the mistaken belief that overall welfare is advanced by slowing the expansion of the city.

- 4.6 A long-term objective included in the Plan is to put light rail in place in Queen Street and on the rail corridors. We are not aware of any respected international research which 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 contained the bizarre recommendation that bus operators would need to be controlled to stop them from competing with light rail. If the light rail project were profitable without subsidies, the private sector would undertake it. There is no proper role for the Council in this area beyond its broad regulatory one which should not include the elimination of competition.
- 4.7 The basic approach to transport planning in Auckland should be to create a level playing field and to get prices right across all modes. This responsibility is shared among central, regional and local government. When road congestion is a problem, two things should happen. First, if it is commercially practicable, congestion pricing should apply for all peak-time road users, including bus operators. Appropriate congestion tolls should be considered in the first instance. Second, more road capacity should be built when the benefits from doing so exceed the costs. Where peak-time traffic volumes are too great because roads are under-priced at peak times, providing capacity too early to ease that congestion could be uneconomic. However, in principle these issues should be taken into account in Transit New Zealand's cost-benefit analyses of capital expenditures.
- 4.8 As a general rule there is no sound case for subsidising the alternatives taken by those who choose not to go to a restaurant, the beach, the supermarket, or anywhere else at peak times. Taxis, buses, trains, motorbikes, bicycles, walking, mail-order shopping and communication over the telephone may be alternatives to the use of a private car. How close people choose to live to shops, schools and their place of work also affects their choice of transport mode. To encourage the best use of scarce resources, people should face the true economic costs of the decisions they take.
- 4.9 With economic growth it is only a matter of time before new road capacity would be required. Once provided, any case for bus and train subsidies to ease congestion would disappear. Winding back an over-expanded bus and train system could be painful. As traffic volumes grew, congestion would

eventually reappear, but in this timeframe electronic pricing is likely to provide a much superior solution to the problem.

- 4.10 An issue that is raised by the Plan is the optimal level of charges levied on users of the road network. Currently road users pay much more than is spent on the roads by central and local government combined. The fact that central government rations the funds it collects from road users and passes on to local government does not justify requiring road users to pay more to make up the deficiency. 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 optimal from a user-pays efficiency perspective. Sub-optimal outcomes would occur if local government attempted to recover any funding deficiency from central government by adding to those charges - in that situation an element of double charging would fall on road users. Rather than distort intermodal pricing signals in this way, it might be more efficient for local government to cover such a deficiency from rates. This contrasts with the Council's intention to recover a larger proportion of roading costs from users.
- 4.11 The Council's examination of transport issues should start from the presumption that its role is to act in the wider community interest, which should be distinguished from the perceived interests of non-motorists and other special interest groups. It should identify those transport issues that clearly lie within its jurisdiction. These may be more limited than the Council envisages. Most importantly, it should seek to ensure a level playing field for competition between transport modes, departing from this only when there are sound reasons for doing so.

5 Other Activities

- 5.1 The Council could improve its efficiency and effectiveness by exiting commercial activities. On average and over time, government-owned businesses have been shown to perform less efficiently than privately owned firms. Council participation in commercial activities involuntarily exposes ratepayers to unnecessary commercial risks. The Britomart project is an example of a policy that is increasing such risks; the many assertions to the contrary have been shown to be not credible. The Council's own estimates

show that the transport centre is unlikely to pay for itself within 100 years. The Council should reexamine its commitment to the project on a first principles basis.

- 5.2 There are no valid grounds for the Council to own or operate off-street parking facilities. They provide private rather than public services. Nor is it valid for the Council to argue that "ownership is necessary to ensure that such [short stay/visitor] parking is appropriately priced to meet transport objectives". There are no valid grounds for subsidising such parking and, if the Council persists in doing so, it should subsidise private providers. The Council's argument indicates that its objectives are confused and it is inconsistent with the related performance measures.
- 5.3 The Council stated in its 1996/97 plan that its shareholding in Auckland International Airport Limited would be reviewed. There is no discussion in the Plan of the outcome of the review but the Plan states that around \$30 million is to be released from the airport investment "in a way which causes minimum loss to the strategic value of the Council's shareholding". The proposed policy is unclear but may imply that some shares are to be retained. There are no grounds for government ownership of a transport business. Central government has indicated its intention to sell its shareholding in Auckland International Airport Limited and the federal government in Australia is divesting its ownership of international airports. The Council should sell all its shares.
- 5.4 The Council needs to recognise that a subsidy for one business or ratepayer requires an equivalent tax to be imposed on other ratepayers or businesses. Tourism promotion is an example of a policy which subsidises some businesses and ratepayers at the expense of others. The Council can best contribute to the local economy and encourage business by reducing its expenditure and rates, and by keeping regulatory burdens low. It should not provide special favours to the tourism industry.
- 5.5 The activities of City Promotions should be severely curtailed, if not disbanded altogether. This unit is promoting major events that are claimed to provide benefits for the national and regional economy which are implausibly high. Its performance measure includes the achievement of an average multiplier of 50 for sponsored events. The unit is using an inappropriate

economic model and not analysing in sufficient rigour whether subsidies to some activities, and hence taxes on all other activities, are justified.

- 5.6 The subsidy for the Aotea Centre of \$4.4 million is excessive and could be expected to be highly regressive. Some councillors have previously defended the subsidy on the grounds that it benefits the arts and cultural activities. We doubt that such activities justify public subsidies. However, if the Council wants to subsidise the arts and cultural activities it should do so transparently rather than by funding the operating losses of facilities such as the Aotea Centre.
- 5.7 The Council should examine the possibility of reducing the size of the Council and Community Boards as suggested by the mayor. The Council is comparable in size to the Cabinet but has lesser responsibilities.

6 Funding Policy

6.1 Funding Policy for 1997/98

- 6.1.1 A key question raised in the Plan is whether the residential sector should bear a larger share of rates following a revaluation of property which recorded a larger average rise in the value of residential property than other property. Assuming that there is no significant change in the level of services provided to each category of ratepayer, the issue depends on whether the previous allocation of rates was optimal. If it were, a case could be advanced for 'ring fencing' the proportion of rates paid by each group. On the other hand, if rates were previously imposed disproportionately on non-residential ratepayers, for instance because inappropriate factors such as claimed tax benefits had been taken into account, then the revaluation would provide an opportunity to adopt a more appropriate allocation of the rate burden. In this case, the capacity of ratepayers to adjust may need to be taken into account in determining the extent of the reallocation that should apply in 1997/98.
- 6.1.2 The effective differential for CBD non-residential ratepayers was 218 percent in 1996/97 - that is to say, 68.5 percent of rates revenue would come from non-residential ratepayers and 31.5 percent would come from residents if there were only the two rating categories. We are not aware of any

information which suggests that such a differential was justified by a proper analysis of the relative costs of services supplied. The proposed differential, which reflects the 'ring fencing' proposal, is a massive 345 percent. This would mean that non-residential CBD ratepayers will pay 77.5 percent of total rates payable by non-residential CBD and residential ratepayers. It is up to the Council to justify such a large differential. If it is unable to do so, it should not proceed with the 'ring fencing' proposal.

- 6.1.3 We are opposed to the planned increase in the average level of rates payable in respect of each dollar of rateable property. The Council proposes an increase of 2.5 percent to fund its activities and a further 2.8 percent to fund Watercare Services. The value of new improvements will contribute an additional 1.25 percent increase in rates revenue. These changes seem to imply a cumulative increase in rates revenue of 6.7 percent. As noted above, there are ample opportunities for the Council to cut spending and increase user charges so that rates can be reduced rather than increased.
- 6.1.4 The Council appears to regard an increase in rates to fund its activities equal to the annual movement in the CPI as acceptable. This view is mistaken. Central government is working to reduce taxes. Moreover, the Council is proposing a total rate increase which is well in excess of the rate of inflation. The Council should have greater regard to the damage to the economy of rate and other increases in public sector charges.
- 6.1.5 Statistics compiled by the Reserve Bank show that inflation emanating from property prices and the sheltered sectors of the economy, including local government, is forcing it to keep interest rates (and therefore the real exchange rate) higher than would otherwise be necessary. High real interest rates and a high real exchange rate are squeezing the profitability of exporters and import competing businesses (the traded goods sector), and contributing to slower economic activity and reduced business confidence. Monetary policy impacts particularly on the traded goods sector and investment whereas fiscal policy - including the operations of local government - affects consumption and the non-traded goods sector the most.
- 6.1.6 The only way that pressure can be taken off the traded goods sector on a sustainable basis, given an inflation objective, is by reducing the rate of

inflation in the non-traded goods sector. Policies that increase the efficiency of that sector and lower spending by governments at all levels are required.

6.1.7 There is a further reason for opposing the view that rate increases that reflect changes in the CPI are acceptable. Over the longer term, changes in the value of property generally reflect the rate of inflation. Thus an increase in the level of rates applied per dollar of rateable property reflects a real increase in rates rather than an inflation adjustment.

6.1.8 The following additional observations on the Council's funding policy are made:

- the Council's proposals to investigate the greater use of user charges with less reliance on rates and to move away from the use of rates to achieve "other policy goals" are supported;
- the abolition of a preferential rate for residential CBD ratepayers is supported. The policy was poorly conceived and should not have been implemented. The uncertainty generated by such temporary policies is undesirable; and
- given present arrangements for the funding of roads, the proposal to shift roading costs to road users is unlikely to be efficient for the reasons noted above.

6.2 Efficient Recovery of the Cost of Council Activities

6.2.1 The Council is to review its funding policy during 1997 as required by the Local Government Amendment Act (No 3) 1996. The broad principles that we believe should be taken into account in the review are outlined below.

6.2.2 The Council should fully fund the goods and services that it produces from user charges or use-related charges whenever this is an economically efficient strategy, as envisaged by the new legislation. Such charges help to balance the cost of providing the service against the benefits that users derive. The weighing up of costs and benefits leads to a better use of society's resources. Under-pricing a good or service leads to its over-provision since the value

derived by users from the excess production is likely to be less than its cost to society.

- 6.2.3 The case on both efficiency and equity grounds for funding private outputs from user charges is very strong. User charges enable consumers to directly express their preferences for goods and services through their spending decisions. They provide important information on the quantities and quality of services that consumers would prefer. Users are encouraged to conserve resources when they directly bear the costs of goods and services. Producers other than the Council are encouraged to enter the market and provide a greater diversity of services when user charges are levied. User charges impose the costs of services on the user whether or not he or she is a resident or visitor. This would address on an efficient basis the complaint that facilities such as the Council's zoo and art gallery are regional amenities.
- 6.2.4 The redistribution of income by subsidising services is not an appropriate role for the Council. The Council does not generally possess the information required to assess the income or wealth of individual ratepayers. It is very difficult to believe that subsidising all users of Council-provided services could be efficient or equitable. A superior strategy is a combination of lower rates on all households, more efficient service provision, and appropriate central government tax and welfare policies.
- 6.2.5 Economic efficiency generally requires prices that reflect the marginal cost of producing a good or service. The marginal cost of using Council services may be relatively low where capacity is not constrained. Where fixed costs are high and the cost of supplying an additional user is low, it may be efficient to apply a low use-related charge (covering marginal costs), with fixed costs recovered through a fixed charge, such as an annual subscription fee. This is particularly applicable where it is feasible to exclude people who are not prepared to pay. In this case, there are no obvious grounds for government (Council) involvement. Fixed charges should be set at a level that does not discourage consumers from choosing to use the service if they are prepared to pay the marginal cost and make some contribution to fixed costs. Many services provided by the private sector are priced on this basis.
- 6.2.6 Where services are funded from rates, consumer preferences must be expressed indirectly through the political process. Decisions on the

appropriate quantity and quality of goods must be made by politicians and administrators who cannot know what all individuals would prefer or how to weight their preferences. Where goods or services are funded by rates, there are strong incentives to lobby politicians and administrators for favourable treatment. The administration and compliance costs incurred in collecting rates may also be substantial.

- 6.2.7 User-pays arguments apply in respect of both public and private goods. It is often argued that public goods should be funded by rates. Although this is reasonable in some situations, in general there should be no such presumption. For some public goods direct user charges may not be efficient, but proxies for use may provide an efficient substitute. It may be excessively costly for a territorial local authority to measure the discharge of sewage from a residential property but, given a reasonably strong correlation between a household's water consumption and the volume of effluent discharged into sewers, it may be efficient to base the sewerage charge on water usage. The Council proposes to apply this approach to its waste water operation.
- 6.2.8 Similarly, the existence of external benefits does not, by itself, create a case for rate-based funding. Many private sector activities create external benefits for society in such forms as better informed, more educated, more healthy and better adjusted individuals. But private gymnasiums, swimming pools, skating rinks, bookshops, producers of healthy foods, recycled paper and organically-grown vegetables, golf and tennis clubs and a myriad of other providers simply charge their members, customers and users for the services provided and commonly do not obtain government funding.
- 6.2.9 Because external effects are easy to assert and difficult to refute or quantify, councils are obviously exposed to opportunistic and exaggerated claims by direct users of such services about the magnitude of such effects. The use of models by City Promotions and some consultancy firms which appear to generate implausibly large external benefits illustrates this risk. Opportunistic direct users would prefer lower user charges and higher rate-based funding for services. Councils may find it difficult to resist such self-interested pressures, but it is important for community welfare that they do so.

6.2.10 Rate-based funding should apply when the benefits from a service exceed its costs but it is not economic to fully recoup the costs from user charges and use-related fees and levies. Civil defence, open-access parks and reserves and the costs related to the democratic activities of local government are likely to be cases in point. In such cases, no related services are provided to self-selecting customers or users who could be charged directly, thereby testing their willingness to pay against the costs incurred. In other situations, there may be a case for partial rate-based funding where the willingness to pay by direct users falls short of the costs of providing the service.

6.2.11 Once the Council has focused its role on funding and/or providing core regulatory and related public good activities that cannot be funded through user charges or proxies for user benefits, it should consider options for efficient taxation (rating) of ratepayers. With this approach, there are no compelling grounds to impose differential rates on particular classes of ratepayers such as businesses for the following reasons:

- any differences in the quality and quantity of services provided to each class of ratepayers would be reflected in user charges to the extent that it is efficient to do so;
- the alleged tax advantages that businesses obtain by claiming a tax deduction for rates and a GST input credit are illusory; and
- rates imposed on businesses are ultimately borne by individuals such as consumers, employees and shareholders. There are no efficiency or equity arguments for imposing a higher or lower rate burden on property used for business purposes than that applied to other property.

6.2.12 The Local Government Amendment Act (No 3) 1996 places some emphasis on the benefit principle. The idea that those who benefit from council services should bear the related cost has much to commend it in terms of efficiency and fairness. But it should not be pushed too far since there is often no objective basis for determining who is, in fact, the ultimate beneficiary of services provided by a council. Just as the seller of a book or magazine does not know who or how many people will read and benefit from it, a council does not know who ultimately benefits from its activities. It may be one or more of the landlord, the tenant, the employee, the proprietor, the customer

or a visitor, or even the person who sold a property to a current owner at a price which reflected the net benefits of Council-provided services.

- 6.2.13 There is a further problem in that the benefit and efficiency principles outlined above may conflict in some situations. Where marginal costs are below average costs, efficiency requires that use-related charges be limited to marginal costs. The benefit principle might imply higher user charges. Another example arises where an identified group benefits from services and rating does not affect output or the costs of production. In these circumstances the efficiency principle, unlike the benefit principle, would not support the levying of the beneficiaries. It would suggest that the services should be funded from rates.
- 6.2.14 In our view, the difficulties of applying the benefit principle reinforce the case for the Council recovering the costs of private goods from users and minimising reliance on rates as a funding mechanism. The Council should divest activities that involve the production of private goods and services. If the Council wants to retain such activities it should fund them entirely through user charges, levied in accordance with efficient pricing principles. There is scope for the Council to increase net revenue from user charges and/or lower subsidies and to reduce its reliance on rates. We believe that there is sufficient flexibility within the Local Government Amendment Act (No 3) 1996 to accommodate this approach.

7 Disclosure of Information

- 7.1 There are deficiencies in the information produced by the Council that should be addressed. They are noted below:
- the establishment of MWL has affected the comparability of information presented for 1997/98 and the following years with that provided in previous years. Information should be provided which enables a valid analysis of trends in key financial parameters to be made;
 - Section 223D of the Local Government Act 1974 requires every council to include in its proposed annual plan indicative costs and sources of funds in general terms for the last two years of the three-year forecast

period. The Council provides little information for the last two forecast years. It provides indicative costs for what it classifies as activities, thereby omitting debt servicing costs, the net costs of business units and other revenue. It is not possible to compute the expected surplus or deficit and trends in debt. The only source of funds provided for the two years is an estimate of rates. Such information is unlikely to be sufficient to comply with the Act;

- the Council's performance measures need to be developed further. Too much emphasis is given to general surveys of opinion rather than to quantitative analysis. For example, instead of measuring whether 75 percent of water users are satisfied with the quality of water, quality targets based on scientific analysis of water samples could be specified;
- the performance targets for the Council's business activities should focus on achieving profit objectives. Performance measures for parking facilities previously related to gross revenue, earnings and occupancy rates. They have been replaced by opinion surveys and an absolute number of fee-paying carparks to be provided by the Council. It is not possible to determine the budgeted revenue and costs of the city's parking facilities from the Plan. The performance targets for the Council's commercial activities are generally not specified. They require, for example, that revenue and profit targets be achieved but the targets are not disclosed. In other cases the target survey result is described as "5 percent over the previous survey" but the previous results are not stated. More reliance should be placed on target rates of return on ratepayer equity and assets, along the lines of those contained in statements of corporate intent agreed between the government and state-owned enterprises;
- the Council has little or no control over whether some performance targets will be met. The most questionable examples in this category relate to City Promotions. It is to be judged on whether the *Auckland region* maintains its share of national GDP and international visitor numbers. Elsewhere there is a target for the number of tourist nights spent in the region. These targets reflect the fact that a proper role for the Council in the related areas has not been rigorously established;

- another performance target is that there should be no growth in per household waste production. Unless the Council applies user charges for waste collection, which it is to examine, how can its policies affect the production of waste? Moreover, from an economic perspective it does not matter if households produce additional waste provided that they bear the costs involved. The Council's user charge policy affects whether household bear appropriate costs; and
- the Council is setting low standards in some areas. An example is in transport. One of the five key goals of *Outstanding Auckland* is "A place where it is easy to get around". The overall performance target for transport is that "25% of residents agree that Auckland City is a City where you can easily move around in comfort and safety." Apparently a 75 percent failure rate is acceptable.

7.2 While similar criticisms could be made in respect of many plans, some smaller district councils have made a better fist of their plans than Auckland. Moreover, there has been limited improvement in the quality of the Council's plan in the past couple of years. The quality of information provided falls well short of that disclosed by central government.

7.3 The Council is obliged by section 223D of the Local Government Act 1974 to prepare a draft plan for LATEs and other entities in which it has a significant interest. This would appear to include MWL and the holding company. The draft establishment plans do not provide the information required to be disclosed by section 223D. We understand that the required plans have not yet been prepared.

8 Concluding Comments

8.1 The key weakness in the Plan is the absence of a valid analysis of the proper role of the public sector and, in particular, that of territorial local government. We believe that the Council should be working more actively to shed non-core activities. The focus of its core business should be on funding and - in justifiable circumstances - providing public good outputs which cannot be better provided by others. This would enable rates and debt to be reduced and would advance the welfare of ratepayers.

- 8.2 The Council could improve its efficiency and effectiveness by exiting commercial activities. There are no valid grounds for Council to own shares in Auckland International Airport Limited, to engage in the promotion of commercial property development and tourism, and to own and operate off-street parking facilities and the proposed transport centre.
- 8.3 We support the Council's decision to establish a LATE, Metro Water Limited, to own and operate its water and waste water business. This should enable the city's water supply to be run on a more commercial basis. The key objective of corporatised water businesses should be to be profitable.
- 8.4 We recommend that the Council, like the Papakura District Council, seek private sector involvement in its corporatised water and wastewater business as soon as possible. This could take a variety of forms such as franchising and contracting for services. Similar reforms have produced major benefits for consumers and the wider community overseas.
- 8.5 The Council's examination of transport issues should start from the presumption that it should be acting in the wider community interest, clearly distinguishing this from the perceived interests of non-motorists and other special interest groups. Most importantly, it should seek to get prices right and establish a level playing field for competition between transport modes, departing from this only when there are sound reasons for doing so. This may require the Council to obtain the support of other responsible agencies. The creation of dedicated lanes for buses involves special treatment for a mode of transport that is often substantially subsidised relative to commercial road users and motorists.
- 8.6 One benefit of higher living standards and technological advances is greater mobility. It is the Council's responsibility as a roading operator to satisfy higher demand for mobility in the same way that other utilities strive to satisfy market demand where it is economic to do so. The Council is planning for a perceived deterioration in the quality of its transport services. A long-term objective to limit the increase in demand for transport services up until 2015 indicates that the Council intends to ignore consumer needs. Despite public statements alleging that the Auckland region is facing a transport

crisis, the Council is substantially cutting its spending on major roading projects.

- 8.7 The effective rate differential for CBD non-residential ratepayers was 218 percent in 1996/97. We are not aware of any information which suggests that such a differential was justified by a proper analysis of the relative costs of services supplied. The proposed differential for 1997/98, which reflects the 'ring fencing' proposal, is a massive 345 percent. It is up to the Council to justify such a large differential. If it is unable to do so, it should not proceed with the 'ring fencing' proposal.
- 8.8 We are opposed to the planned increase in the average level of rates payable in respect of each dollar of rateable property. There are ample opportunities for the Council to cut spending and increase user charges so that rates can be reduced rather than increased.
- 8.9 The level and quality of disclosure should be improved. The omission of data that would enable a meaningful comparison to be made of the Council's planned performance for 1997/98 with at least the previous year is a serious oversight. It calls into question whether the Plan conforms with acceptable standards of financial disclosure and provides an adequate basis for consultation.
- 8.10 The Council's objectives need to be clarified, discrepancies between performance indicators and outcomes identified, corrective action noted and major changes from the previous year's plan explained. The level of disclosure generally compares unfavourably with that of central government.
- 8.11 The Council can make the best possible contribution to the welfare of the citizens of Auckland by focusing on its core activities, exiting those that are inappropriate, and keeping its rate and regulatory burdens as low as possible.