

## Transcript

00:00:03 Eric Crampton

Welcome to The New Zealand Initiative podcast. I'm Dr Eric Crampton, Chief Economist with the Initiative and with me today I have the great fortune... I've got, Peter Nunns. Peter Nunns is with the Infrastructure Commission. He's an economist there, kind of head of research type.

00:00:17 Peter Nunns

Director of Economics.

00:00:18 Eric Crampton

Yep. That's the one. And previously has a number of stints in local government. Auckland Council, Wellington Council and a lot of work on local government and infrastructure financing. So today we're here to talk about some work that Peter and Nadine Dodge had done on the size and scope of local government really. So, here at the Initiative, we've been worried about local government. We like the idea of smaller being better, competition among local councils, better reflecting local preferences. And the usual view in Wellington is that local governments are just too incompetent to be trusted with anything. If anything that should be gotten rid of, everything should be centralized and that didn't really seem to accord with the international evidence as we'd seen it. And Peter's done some substantial work, taking a look at those internationally is smaller, better, and what's happening in New Zealand. So maybe walk us through your report, what'd you find and actually before that, why is the Infrastructure Commission even interested in this?

00:01:17 Peter Nunns

Yeah, so there's a couple of drivers for doing this report.

One was the fact that in the recent release infrastructure strategy we had a recommendation around looking at local government boundaries and whether they're actually well suited for managing the types of issues that we're seeing in growing, growing urban areas, which often entail the need for greater coordination... the need for some degree of consistency in areas that are growing and spilling across established boundaries.

So, we thought that there was something in there that we needed to understand better.

The second driver, which relates a little bit more to a lot of the analysis we did in the paper is that New Zealand faces a rather large infrastructure challenge ahead of us over the next generation. We have more needs that are driving spending. Then we have the ability to fund those needs, and there's a range of things that we need to do in response to that, including looking at funding and financing mechanisms.

But none of them work particularly well unless you look at the efficiency of what you're doing first, and so we wanted to dig into that and say in local government, you know, which is an important provider of infrastructure, probably providing about one quarter of the public infrastructure that the country has. In terms of value and in terms of new spending, what can we learn about how they do that? How cost effectively local government does it, and whether there's anything that links back to the structure of local government that relate that that can improve cost efficiency.

00:02:45 Eric Crampton

So, the usual story, at least that we'd hear in Wellington, and I remember when I was in Christchurch we heard it too when they were looking at the Auckland amalgamation, is that the problem is - look there are too many local councils, they're too small, they get no efficiencies of scale. They aren't able to manage the back offices because they're all fragmented. They don't have the capabilities to do anything. When you had to look at it, were the larger councils better able to provide services or was there kind of a mishmash?

00:03:13 Peter Nunns

Pretty much a mishmash, right? So, some small councils provided services, quote the services that we looked at quite efficiently. Some large councils provided them equally efficiently and there were out, you know, examples of sort of relatively inefficient provision at both the small and the large council area, but on average what we found was no clear relationship between cost, efficiency and scale. We didn't look at everything. I do want to just say that we looked at three areas that cumulatively comprise about 50 per cent of council operating expenditure represent them. One of those, road maintenance costs. One was building consent processing, which was a bit of a proxy for regulatory services, and then the third was the overhead and back office costs like governance annual plans, that kind of thing. And in all three areas the finding was consistent. It wasn't a clear relationship between size and cost efficiency.

00:04:04 Eric Crampton

Now, when you're saying there was no clear relationship, this was just taking an average. I've gone through the report, obviously rural councils with lots and lots of miles of roads are going to have a different kind of cost structure than an urban council that's pretty tightly packed and a few roads to be dealing with. How you were able to just run the econometrics on this, adjust them for the number of miles. How did this all work?

00:04:28 Peter Nunns

Yeah, so I'll dive into methodology a little bit. There are some things that you can do that would be somewhat naive and in my view sort of improper to do that would give you a spurious relationship between size and cost efficiency. One of those things is not controlling for those other factors like the the population density of the council and the extent of the road network. Right? Because we know in New Zealand smaller councils tend to have lower population densities because they tend to be more rural. Larger councils tend to have higher population densities and when we investigated those relationships using about 15 years' worth of data for all the councils in the country and testing all those different variables, what we found was that the population density factor mattered for road maintenance costs but it, you know, once you controlled for that size it didn't matter.

00:05:16 Eric Crampton

Nice, now when you were looking at the cost of consents that was just the monetary cost, right? You wouldn't have had any measure on there for the amount of time it took to process because whenever we talked to industry on this stuff, it's not just the monetary cost of the application fees, it's the back and forth over months or possibly years and getting something done. This wasn't something you were

able to pick up. Do you have any, or at least I didn't see it in the report, is it something you had any intuitions on or that might be future work?

00:05:44 Peter Nunns

Well, so we found this area just totally puzzling. Processing building consents is a standard service, right? Councils are required to do this under legislation, and they're required to charge no more than the costs to actually get the work done right? You can't actually sort of make a profit on it. You can choose to subsidize it out of rates if you want. So, we looked at the costs to process a standard consent for standard sized residential house, and we gathered that data from what councils published online. 51 councils published information on what they charge, the remainder didn't publish it but would make that cost available on request, if you did want to request it. Some councils charge as little as \$1,000 for that service. Some councils charged as much \$7,000. There was a wide range. And what we found was that we couldn't identify any factors that made sense of that range, you know. So, population size of the council didn't seem to matter. The amount of building consent work that they have doesn't seem to matter. The population density didn't seem to matter. How much they insource versus outsource the regulatory services didn't seem to matter. How much of their costs they recovered from users rather than rates also didn't seem to matter. There was nothing really in there that we could point to and say this is why some councils do this cheaply and this is why some councils do this expensively. And I think this sort of number... one thing that I took away from that is that's really, that's a rock that needs to be turned over properly, right? Looking at aspects like what you mentioned, right? Not just the cost to do it, but the quality of what gets done, the timeliness and so on and so forth. There seems to be this wide variation in performance, that is maybe important.

00:07:24 Eric Crampton

Yeah, you can imagine some localities deciding that they'd have a fairly low cost service, but they would take a long time to process things. Other ones keep a lot of surplus staff on site just in case a consent comes through, they'll charge a lot to keep that redundancy in place and then be able to process things really quickly. It would be nice if that's what were driving it, but I'd be a little surprised. You hear, at least when you listen to people in the sector, kind of all over the place on stories of how long places might take, so you'd look beyond just New Zealand though, right? So if I think back to my undergraduate study, we first heard of Tiebout's theory, and then we saw it again when I was in grad school, in theory there's some reasons to expect that local government might work well. You looked beyond New Zealand to see what is going on internationally. What sorts of things were you seeing there, and how New Zealand stacks up relatively?

00:08:15 Peter Nunns

So what we found, and this was a surprise to us and I think it's a surprise to a lot of the people that we've given the research findings to, New Zealand already has quite large local governments relative to the OECD average, so I think we're running at an average of about one local government, you know at that at that bottom layer of local governments, one local government for 75,000 people. The OECD average is about one local government for 38,000 people, and there's some places that have as few as one per, say 2,000 people, right? So there's a wide variation in structure. We're at the relatively large local government and we're also at the relatively little responsibility for local government end of things, right? So if you look at the sheer of overall public capital investment done by local and state

governments, New Zealand's right down the bottom of the list in the OECD. The average is that local and state governments or provincial governments whatever do about 50 per cent of the capital investment by government, right? So 50 per cent of the infrastructure. New Zealand's at about 25 per cent and we're not necessarily the only people over at that end of things, but we are at one end of the scale. I think that there's a really interesting paper to be written, and we only sort of started gesturing in this direction that actually says, well, since there's such wide variation around OECD countries that have similar levels of income, similar levels of economic development, different sizes, right? So you've got a bunch of countries that have the same population size as New Zealand. Think Finland and Norway. Why don't we go and actually look at what those different structures actually get you, right, in terms of quality, infrastructure, good public services and so on and so forth. I think that could be super important for informing the debates we're having here about these issues, is actually going and doing that benchmarking exercise.

00:10:04 Eric Crampton

When you were looking internationally, you also had some data, right? So you were looking at the effects of size of local governments, on a variety of outcomes, were the results consistent, with larger being better or smaller, being better, or kind of a mismatch.

00:10:18 Peter Nunns

So we looked at how that local government average size of local governments, and you know, share of infrastructure, public infrastructure, investment that was done by local governments, looked at how that related back to an earlier measure that we had of sort of infrastructure efficiency scores, and what we found there was that there was no clear relationship between average size of local government and efficiency, but there did seem to be a correlation between having more infrastructure investment done locally and higher levels of efficiency of provision right? Which could... you know, I want to stress it's a correlation, right. We don't know what's causing what, but that's certainly another thing where we took out... what we would take out away from the paper is this is an interesting rock to turn over on.

00:11:00 Eric Crampton

New Zealand has had one fairly recent experiment, right? We amalgamated a whole pile of councils in the Auckland area. I remember being kind of annoyed with Rodney Hide when he was pushing this, because I don't... libertarians know about Tiebout Competition, so what's going on with this? The argument at the time had been, it was a mix of things. One there is an argument around amalgamation giving you economies of scale and scope, and that you'd be able to provide better services and reduce costs. I never found that one particularly plausible. The other argument was that when zoning is left to a very small layer of government, it's easier to accommodate NIMBYs, and when you broaden it out to a city-wide thing like the unitary plan that ended up coming of it, it is harder for local groups to block growth. So, I would have thought there would have been some kind of review of this. The experiment was a decade ago now has it been evaluated?

00:11:55 Peter Nunns

Well, so there were a couple other things that were in the Royal Commission report as well, right? One of those was the administrative cost savings, so the Royal Commission report, I think, had a number on this. It was somewhere in the order of \$100 million of savings a year, which is which is, well, measurable

right after the fact. The second thing that they wanted to achieve was higher levels of democratic participation, right? So if you think about kind of voter, turn out. That's again something that's pretty measurable, and then there was as well an objective around improving the quality of infrastructure provision and the, you know, coordinating provision of a better level of infrastructure for the region than otherwise would be possible. And that's a bit harder to measure, but you could still think of some ways to measure it. Unfortunately, we've never done a post implementation review of this, or if one has been done, it hasn't been published, and so it's very difficult to say did this stuff happen in practice, and if not, why not?

Just getting on a soapbox for a second when we go and do exercises like that and significantly change what we're doing, how we're doing it, the agencies that are doing it... It is so important to do that post implementation review, because we're not going to have perfect foresight over these things, we're going to get things wrong, and the only way that we adjust and do better the next time or tweak the structures so we get the outcomes we need that we said we wanted is if we go and find out what happened we did not do enough of.

00:13:15 Eric Crampton

I had thought that they promised that one of these was going to happen, I haven't seen it. When was it scheduled to have been done?

00:13:23 Peter Nunns

I don't think it was ever in the schedule. There's a couple papers on the website that set out of monitoring and evaluation plan. I think they were intending originally, intending to do one sort of relatively early on in the life of the institution, but there's no time like the present.

00:13:36 Eric Crampton

It's always depressing when we set-up experiments and then don't follow through with the evaluation. There's been a few cases that we have done it well. I really liked that when Helen Clark set up the accredited employer scheme for the RSA workers coming in, they baked evaluation into the framework and they actually followed through with it. They had very rigorous work done on it that really seems to be the exception while it, rather than the rule though.

00:13:59 Peter Nunns

This is something we're trying to promote for infrastructure projects. Te Waihanga at the moment has released sort of stage one of the Transmission Gully review that we were commissioned to do and we're underway with stage two of this sort of post completion review. So, you know, for major infrastructure projects we've got a significant interest in actually doing that work and doing it ourselves where necessary. But you know, there's going to be a whole bunch of stuff that will fall below our threshold for getting involved or fall below, you know, outside of our resourcing, and I think what we rely on there is probably a culture across the public service and provider agencies of wanting to do this and valuing it well.

00:14:39 Eric Crampton

It's all derived demand, right? If there isn't much pressure from the ministers that it actually be done because sometimes they don't want to find out the answers or to be, if they get an answer, it might be difficult to deal with and it might be better just to not know right? So to me, all of this seems to be derived demand, and if there isn't public appetite for it that won't feed through to Cabinet and then Cabinet pushes back down to the agencies. So that's a little bit depressing.

00:15:05 Peter Nunns

I mean, this is actually one where, I think if you talk to people out there in the world right, as opposed to you know in the agencies that are providing this thing, there is a good deal of public appetite for understanding what's worked well and how to do more of it, right? You know, I think that a lot of people do this, sort of as a matter of course in their own lives and reflect on what they've been doing. What's been going well, how to improve and I don't think it's an alien concept to us.

00:15:28 Eric Crampton

I agree we should be demanding better when I start thinking through some of the implications of the work that you've done here, and you probably wouldn't want to get into some of this. If there aren't really the sort of back office gains in administrative burden when you amalgamate smaller entities into much larger ones, and we don't see big efficiencies, and we see a big reluctance to actually review what's happened. It makes me a little bit more nervous about some of what's going on in the water side. Now I'm expecting that the Infrastructure Commission wouldn't want to be going there too much, but to me, one implication of this is that we shouldn't be expecting huge efficiencies in back office savings if we take a whole pile of small water companies and turn them into four big water.

00:16:15 Peter Nunns

So what we've said in the water space that's really important is the role of economic regulation in driving, first of all, driving transparency in terms of who's doing what well and secondly in setting incentives to do better, right? If you reflect upon, you know, our findings in this research report in other areas outside of water, right? The remarkable thing in say, an area like building consent processing, is the degree of variation in cost, right? You know there's some local governments that it seems similar to other neighboring local governments that charge very different rates for doing this and I think what that says to me is that there's a really important system role for somebody providing that transparency and asking those questions about well, if you're doing this thing at twice the price, the price of your neighbor, can you just please explain this to us and maybe give us a plan for getting down to their level right? That's something I think is happily part of the reform proposal in the water space. Probably going to be very important to getting those outcomes.

00:17:24 Eric Crampton

Nice. And of course, the amalgamated entities will also have potentially greater access to funding and financing, and to me that's been the bigger problem in the water sector that councils just haven't been able to fund the infrastructure that they need to support growth because they hit up against their debt limits and they haven't had reasonable ways of ring fencing those costs to those who are benefiting from it, maybe the amalgamated entities will be better at doing that. Maybe it'll be because of a massive

backstop provided by taxpayers if anything goes wrong. But we at the Initiative, we're doing a little bit of work looking at this and the history of infrastructure, funding, and financing other ways that projects could get funded, and perhaps that as alternative in the three water space, but I'm sure we'll have you back at some point to talk through some of those issues once a little bit more progressed in it. Well, I mean, one thing, I'll talk about another sector, right? If we look at the example of electricity reform, right?

00:18:17 Peter Nunns

Well, that probably took 30 years here to sort of iterate through all the design of it right. You know we commenced the reform process and then had to sort of keep going and adjusting bits of it to make sure that we were actually getting the outcomes we want. So it took us a long time to go from the idea that we should move to a market model in electricity were appropriate in generation, not necessarily, to the reality of having that working well and I think that as you, as you sort of go and significantly reform... try to reform a sector that's not working as well as it could be, you're always going to run into that same problem of needing to actually go and adjust and tweak because you know it will be difficult to get all the details right out in the outset, and I think what's important in that context is that you're continually actually learning about how things are going. And your understanding where there are areas that you need tweaks, and I think secondly, and this is where an organization like the Initiative is so important, is actually having some ideas about what are some different ways we could approach some of these things right? Where we find that that there's a need to sort of go and play.

00:19:24 Eric Crampton

Well, we're gonna have some fun doing that playing. I'm really looking forward to that.

We've now got Matthew on who's going to be looking through some of the history of this with us, so a few bottom lines then for me on this... Local government in New Zealand seems to be underrated. It does not have as large of a role as it could have. Other places have greater reliance on smaller local governments. Fewer people per local government, each authorized with more responsibility. They don't have, there's no, we're not seeing large evidence of economies of scale and scope when you amalgamate entities and some benefits potentially of letting things be done at a smaller scale so it would be great if eventually the post implementation review could be done on Auckland if DIA ever got around to that, I hope that we wouldn't have to end up doing it for them. And we should perhaps be a little bit more skeptical about amalgamation in general, whether in local government, in total, or perhaps in thinking through some of the touted benefits for other sectors like water.

00:20:27 Peter Nunns

Well, I'd probably nuanced that last one a bit right, around skeptical of amalgamation. I think that we've found that there isn't a slam dunk case in terms of cost efficiencies.

00:20:37 Eric Crampton

Yep, but there are some other areas that really bear a careful examination, right? One of those is probably the coordination of infrastructure that crosses boundaries right?

00:20:49 Peter Nunns

Sure, and I think what I would say there is that that's something that's very difficult to measure, right? It's probably very important for good infrastructure provision, and it's also probably one where a range of institutional forms can get that done, and I think that you know you go to the rest of the OECD, right? And we should be looking around to figure out what we can learn about how to coordinate.

00:21:12 Eric Crampton

Sure, oh, that's one of the reasons that I understood that we had local government and regional government, right? So regional government was basically set around watersheds for man. Judging the externalities of water use that flow across local government boundaries, local governments much smaller than that, for internalizing much more local effects and then national for much larger things. Unfortunately, too much has been brought up in my view. It's being brought up to the national level rather than being left with local councils and we've kind of let them deteriorate over time and lose capabilities. It may be time for real, holding them, but that's enough of my soapbox on that, but I look forward to chatting again once we're a little bit further progressed on some of our work on infrastructure, and especially in the history side, will bring Matthew in on that. I understand that you've got a bit of an interest in this as well, so it'll be it'll be interesting. Give it a couple of months.

00:22:02 Peter Nunns

Thanks very much for having me, Eric.

00:22:03 Eric Crampton

It's been a pleasure. Thank you, Peter. I've really enjoyed learning a lot more about local government and I'll look forward to more chats in future.