New Zealand Business Roundtable

Submission on the Wellington Regional Council's Long-term Strategy: *Facing the Future 1997-2007*

May 1997

TABLE OF CONTENTS

EXECUTIVE SUMMARY

- This submission on the Wellington Regional Council's proposed long-term strategy *Facing the Future: The Next 10 Years 1997-2007* (the Strategy) is presented by the New Zealand Business Roundtable (NZBR).

- The key weakness in the Strategy is the absence of a valid analysis of the proper role of the government and, in particular, that of regional 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, we believe that the Council should be working more actively to shed non-core activities and thereby reduce rates. The Council should focus on its core regulatory and public good activities.

- Bulk water supply is a major commercial activity. The Strategy offers only limited assurance that the Council is about to adopt a more commercial approach to the management of its water supply business.

- 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 move its water supply business into a commercial structure with private sector involvement as soon as possible.

- The Council has not adequately defined its proper role in transport. It should be acting in the wider community interest, clearly distinguishing this from the perceived interests of special interest groups. It should seek to identify which, if any, issues in relation to the road network clearly lie within its jurisdiction. These may be more limited than the Council envisages.

- Although the stridently anti-motorist tone of last year's plan has been softened, the Council's policy stance is little changed. There are no sound reasons for imposing the full costs of the road network on people who commute by car during peak traffic. For efficiency and equity reasons peak charges should, in principle, apply to all road users, including bus operators, during the congested period.

- The Council's transport strategy needs to recognise that roading operators should respond to consumer demand where it is economic to do so. The Council should encourage the adoption of economically efficient pricing of road usage.

- Passenger transport subsidies are a major departure from a level playing field approach to inter-modal competition. No valid grounds for departing from a neutral approach are set out. The case for the subsidisation of bus and rail services to ease road congestion seems particularly weak. Ratepayer subsidies for passenger services should be phased out as contractual obligations expire.

- We recommend that the Council sell its shares in the Port of Wellington and its investment property. It should also review its decision to own the premises occupied by its head office.

- The Council should cease its involvement in plantation forestry. Investments in risky commercial assets are not a proper role for the Council. We are confident that the Council's independent advisers would not basically differ with our conclusions on this matter.

- The sports stadium should be self-financing. To the extent that it generates external benefits for the region, individuals or firms deriving such benefits can contribute directly, without the intermediation of the Council. The Council is not an appropriate source of finance for the stadium project.

- 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 local government legislation. 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.

- The Council apparently takes the view that the provision of 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. Similarly, the existence of external benefits does not, by itself, create a case for rate-based funding. 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.

- Last year we commented that the level and quality of disclosure in the 1996/97 proposed plan appeared to be inferior to that provided in the previous year. We argued that objectives needed to be clarified, discrepancies between performance indicators and outcomes identified, corrective action noted and major changes from the previous year's plan explained. We noted that the level of disclosure generally compared unfavourably with that of central government. These points are still largely true. While the funding policy is a helpful step forward, few other improvements appear to have been made. A number of other local authorities are providing better quality information for ratepayers than the Council.

- The Council can make the best possible contribution to the welfare of the citizens of the Wellington region 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 Wellington Regional Council's proposed long-term strategy *Facing the Future: The Next 10 Years 1997-2007* (the Strategy) 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 The Strategy incorporates the Council's proposed annual plan for 1997/98. 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. We argued that the Council should focus on its core regulatory and public good activities.

1.3 Our submissions pointed out that bulk water supply is a major commercial activity. In 1995 we recommended that the Council should investigate the full range of issues associated with running its water supply business efficiently, with a view to its corporatisation as a LATE. Last year we observed that the Council appeared to be making, at best, only slow progress towards putting its operations on a more commercial footing.

1.4 In 1996 we argued that the Council's lack of clarity about its objectives in the transport area was reflected in statements of principle which appeared to be illogical, *ad hoc* and unresponsive to user demands. We commented that it was absurd to propose that road capacity should not cater for peak demand. Proposals that motorists should be taxed to subsidise bus and train services appeared to reflect an anti-motorist bias, rather than a structured approach to inter-modal issues. We noted that the case for such subsidies to ease road congestion seemed particularly weak.

1.5 We recommended that the Council should sell its shares in the Port of Wellington and focus on its regulatory responsibilities in respect of the harbour. We also considered that it should cease its involvement in plantation forestry, sell its investment property and review its decision to own the premises occupied by its head office.

1.6 We viewed the Council's decision to contribute to the proposed sports stadium as a further indication of its unwillingness to focus on core activities. This is a private activity since users who do not pay can be excluded. To the extent that events held in the stadium generate external benefits for the region, individuals and firms deriving such benefits can contribute directly, without the intermediation of the Council.

1.7 This submission comes to the same conclusions on these issues. There is no evidence in the Strategy that the Council has clarified its role or that it is committed to withdrawing from non-core activities to reduce rates. Such a strategy would benefit ratepayers.

1.8 While the Council's general manager assured us in September 1995 that that the Council was working through a full list of the commercial issues arising from the formation of the utilities services division, there is little in the Strategy which demonstrates that significant progress has been made. Although there are some indications that the Council is prepared to examine the establishment of a LATE for its water supply business and that it may sell some investments, the Council's plans are apparently too tentative and uncertain as to timing to be included in its 10-year budgeted financial statements.

1.9 Although the stridently anti-motorist tone of last year's plan has softened somewhat, the Council's policy stance is little changed. The policy of not constructing facilities to meet peak-time demand has been retained. Passenger transport facilities are still to be subsidised by motorists. We outline again in this submission the principles that, in our view, the Council should apply in formulating transport policy.

1.10 In its response to our submission on last year's proposed plan, the Council suggested that most of the transport issues that we raised would be more appropriately considered when its transport strategy was reviewed. The Local Government Act 1974 envisages that the annual plan should provide an opportunity for ratepayers and the public to comment on all significant activities and policies of councils. The Council's principles and policies are so inconsistent with the maximisation of the welfare of its ratepayers that they should be reviewed as a matter of urgency even if this requires the transport strategy to be re-considered.

1.11 The balance of this submission is presented in eight sections. The next section (section 2) discusses the scope of the Council's activities. Sections 3 and 4 discuss regional water supply and transport policy respectively. Investment activities are scrutinised in section 5 and Council activities that are not examined elsewhere (other activities) are discussed in section 6. Section 7 addresses the Council's funding policy. The disclosure of financial information in the Strategy is examined in section 8. Our conclusions are presented in section 9.

2 THE SCOPE OF COUNCIL ACTIVITIES

2.1 Background

2.1.1 The Wellington Regional Council was formed on 1 November 1989 as a result of the amalgamation process determined by the Local Government Amendment Act (No. 2) 1989. It inherited a number of regional parks, and public utility and trading activities. The latter included the supply of bulk water and forestry. The Council also owns 10/13th of the Port of Wellington Limited and the shares in Pringle House Finance Limited which owns the Council's head office premises.

2.1.2 In 1992, parliament extensively amended the law governing regional councils to clarify their role as regulatory authorities primarily concerned with resource management and related functions. In Wellington and Auckland these functions included public passenger transport planning. The Council is also required by the Transit New Zealand Act 1989 to prepare a regional land transport strategy. Other functions of regional councils generally include soil conservation and flood protection, control of pests and noxious plants, harbour regulation and marine pollution control, and the regional aspects of civil defence.

2.1.3 The financial forecasts contained in the Strategy, which have been prepared in constant 1997/98 dollars, show little change in key fiscal indicators. Total external operating expenditure is estimated to be $99 million in 1997/98 and is projected to decline slightly to $98 million in 2006/07. Regional rates are budgeted at $39 million in 1997/98 and $38.7 million in 2006/07. Other revenue, including the water levy, grants and subsidies, and external revenue, contributes over half of the Council's revenue. The Council expects to record an operating deficit of $0.2 million in 1996/97 and then surpluses of between $1.2 million and $6.4 million through to 2006/07.

2.1.4 In June 2007, the Council is expected to hold investments (including its interests in the port, plantation forests and commercial property) of $80 million (an increase of $15 million on 1996/97) and fixed assets of $359 million (up $12 million). Major fixed assets arise from its water supply business, flood protection infrastructure and lands and buildings. Net public debt is projected to rise from $103 million in 1996/97 to a peak of $115 million in 1997/98 before declining to $90 million in 2006/07. Ratepayers' equity is expected to increase from $310 million in 1997/98 to $348 million in 2006/07, an increase of 12 percent.

2.2 Role of the Council

2.2.1 The key weakness in the Strategy is the absence of a valid analysis of the proper role of the government and, in particular, that of regional government. The chairman notes in his introduction that the Council:

> ... always wants to do more, but we have to be mindful of your needs and preferences, as well as what you can afford.

This view is reflected in the "key drivers" that directed the Council's planning process: affordability, preference and value. The diagram on page 11 of the Strategy which summarises the Council's approach implies that the Council's function is to choose between dreams and achievable visions.

2.2.2 The Council's approach provides an inadequate basis for determining its proper role. 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. 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 region are constrained. For these reasons, the analogy between personal budget decisions, where individuals weigh up options within a total income constraint, and the prioritising of council services that is presented in the Strategy, is flawed.

2.2.3 The Council should focus on those activities that should be undertaken or funded by the government at the regional level because they satisfy accepted public policy criteria or are required to be carried out by central government. The Council's core regulatory functions - such as environmental and harbour management, transport planning (but not subsidies for passenger transport services), and the control of animal and plant pests - plus the provision of open-access parks and flood protection activities generally fall within these categories. On the other hand, the ownership and operation of a water supply business, investments in the Port of Wellington, plantation forests and commercial property, the funding of the stadium and the promotion of regional tourism could not be justified by a valid public policy analysis.[1]

2.2.4 The Council can make the best possible contribution to the welfare of the region's citizens 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 during the next 10 years. As in previous years, we recommend that the Council review rigorously its activities in this year's planning round and before the Strategy is finalised.

3 REGIONAL WATER SUPPLY

[1] While the Strategy does not include tourism promotion, this activity was noted as one that the Council would have liked to include.

3.1 The major influence on the Council's consolidated balance sheet is its water supply operations. The Council's 1995/96 annual report put water supply assets at $210 million or 44 percent of its total assets. (A breakdown of assets by business activity is not contained in the Strategy.) The Strategy forecasts water supply operating expenses to be $31 million in 1997/98 or 31 percent of total external operating expenditure. Logically, about one third to half of the Council's decision-making time should be devoted to its water business.

3.2 Unlike the Auckland Regional Services Trust, the Council is not required to conduct its water supply activities within a LATE structure. The Council committed itself to using a corporate model for the management of water supply in its 1995 10-year plan, *Facing the Future*. There is, however, little evidence that this approach is far advanced. Last year we commented that the lack of emphasis on commercial efficiency in the executive summary of the 1995 bulk water business plan and 1995/96 plan was remarkable. The same observation applies to the Strategy. No long-term commercial performance indicators have been included in the Strategy, with the possible exception of a qualitative commitment to maintain high standards of customer service (see pages 57 to 59 of the Strategy). Pricing policies, although constrained by inappropriate legislation, would be a key element of a commercial strategy.

3.3 The Strategy offers only limited assurance that the Council is about to adopt a commercial approach to the management of its water supply business. It states that:

> The Council is considering the formation of a company to own, operate and manage the Council's water supply business. The Council's objectives for corporatisation of the wholesale water supply operation include:
>
> - providing increased accountability and value for money by focusing more on commercial objectives; [and]
> - providing a framework for the integration of Wellington water services with a consequential increase in operating and financial efficiencies.

The 10-year financial forecasts have, however, been prepared on the assumption that the Council will continue to perform existing functions in accordance with present policies. Furthermore, the second reason cited for the adoption of a commercial framework appears to be related to the Council's desire to supply water at the retail level for the whole region. This is unlikely to happen because of opposition by councils and community interests to the establishment of a monopolistic structure.

3.4 The Council has restated its view that:

> ... its wholesale water supply operation or any integrated water entity should continue to be held in public ownership.

Continued government ownership of the region's bulk 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. The chairman's view (reported in *Management,* May 1997) that "there is absolutely no need for privatisation" does not constitute such a reason and his observation that "public sector managers can be efficient and avoid the worst excesses of private sector monopolies" is contradicted as a guide to policy by the average performance of firms in the two sectors.

3.5 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. Over the past couple of years, we have supplied the chairman of the Council with a good deal of material on this subject, including specific findings which point to the superior performance of investor-owned water utilities in the United States compared with government-owned utilities. We await a substantive response.

3.6 It is sometimes suggested that because water businesses have some 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.

3.7 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 treated as a profit-making business. However, 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 other goods and services that they may prefer. The Council must generate sufficient revenue to pay for the water services that it provides. At issue therefore is whether the revenue is raised efficiently, not whether it is raised. Most essential goods and services, like food, are produced in the private sector.

3.8 Structural reforms of the delivery of bulk 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 questions of the control of leakages, export of water, improved contracts with customers, pricing - including bundled pricing of supply and disposal - infrastructural management, integration, the regulatory environment, corporatisation and privatisation. As with last year's proposed plan, the Strategy's statements of objectives and performance indicators are notable for their lack of coverage of all these issues. Instead the focus is on meeting quality standards and providing security of supply.

3.9 The experience with all network industries owned by central government is that major efficiency gains have resulted from fundamental reforms. The overwhelming lack of interest shown in measures of commercial efficiency in successive annual plans suggests that efficiency considerations come low in the Council's priorities. The Council continues to lag well behind innovative councils like the Papakura District Council in its consideration of these issues.

3.10 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 the Council move its water supply business into a commercial structure with private sector involvement as soon as possible. We suggest the Council should commission independent consultants to review its operations and propose reform options along the lines of studies undertaken by Watercare Services Limited and the Auckland Regional Services Trust.

4 REGIONAL TRANSPORT POLICY

4.1 Total expenditure planned on transport activities in 1997/98 is $37 million. Funding for passenger transport services accounts for $33 million of this total, $28 million of which is for contracted bus and rail services. The Council is to spend a further $2 million on building passenger transport infrastructure and $1 million on transport planning in 1997/98. Presumably the former services could be user-funded. Slightly lower spending is proposed in the following two years.

4.2 The Council's transport activities are to be funded almost entirely by rates ($20 million in 1997/98) and central government subsidies ($16 million). The former element accounts for about 50 percent of total rates. An operating deficit of $1 million is projected for 1997/98, lower than the $3 million deficit expected in 1996/97. Smaller deficits are forecast in 1998/99 and 1999/00.

4.3 The Strategy states that the Council role is:

> To ensure delivery of a safe, fair, reliable and environmentally friendly transport system in the Region at least cost to the regional ratepayer.

This role differs from that cited last year in that "at least cost to the regional ratepayer" has been inserted. The omission since the 1995/96 plan of a requirement for the system to be efficient is disturbing. The concept of efficiency is much broader than that of least cost to the ratepayer - for example it requires the willingness of ratepayers to pay for facilities to be taken into account. It also requires the supply of services that ratepayers value and that are an appropriate activity for a government to undertake.

4.4 Of greater substance is the absence of any focus on creating a level playing field between competing commuter transport modes - bus, train, car, taxi and bicycle, and pedestrian traffic. Neutrality is important for optimal resource allocation and would appear to be entirely consistent with the requirements for a regional transport plan set out under section 23(3) of the Transit New Zealand Act 1989. (We acknowledge that section 32 of that Act requires regional councils to consider the transport needs of the 'transport disadvantaged.' Questions about the efficiency of this approach are also directed to central government.)

4.5 The *Wellington Regional Council Land Transport Strategy* (at page 7) appears to acknowledge the need for inter-modal neutrality when it comments that "... each modal component of the New Zealand transport system shall be treated on a consistent basis" under the heading "Consistency between Transport Modes". However, without any explanation of the reasons for departing from that important neutrality principle, it presents without preamble on page 10 a set of strategies based on non-neutral enhancements of passenger transport operations and restraints on the growth of commuter traffic.

4.6 The departures from a level playing field concept are illustrated by the following so-called "principles" listed on page 41 of the Strategy:

> ... those who choose to commute by car during peak hour traffic times should pay the full costs of this choice;
>
> ... that it is more important for the Region's road system to meet the needs of commercial, recreational, rural and off-peak users rather than those of rush-hour car commuters; and

> ... that to reduce peak hour road congestion, alternatives to the private car, such as buses and trains, should be maintained and enhanced.

4.7 The Council applies these principles by "assisting with the funding of public transport." Because this is costly to ratepayers:

> The Council ... wants to stimulate the public transport market by funding infrastructure and implementing traffic restraint policies. This will enable public transport operators to provide quality services at market rates without significant funding from regional ratepayers.

The Council also "hopes" that its "strategy of not planning for extra peak hour roading capacity will encourage commuters to leave their cars at home and use public transport" (see page 51 of the Strategy).

4.8 The principles and the rationale cited by the Council appear to be illogical, *ad hoc* and anti-motorist. In respect of the first principle, there are no sound reasons for imposing the full costs of the road network on people who commute by car during peak traffic times. For efficiency and equity reasons, peak charges should, in principle, apply to all users of the road during the congested period. These would include bus operators. Further, optimal road pricing, from a cost recovery viewpoint at least, is currently a central government - not a regional government - responsibility.

4.9 In the absence of price controls, the magnitude of peak charges would reflect opportunity cost considerations, that is, what road users are prepared to pay to deter others from using the road during the relevant period. The revenue from peak-time charges typically belongs to the service provider. After all, a commercial operator needs to earn sufficient revenue to meet fixed costs and may not be able to do this from non-peak users who are only charged short-run marginal cost. In a business enterprise the service provider typically receives all revenue from charges paid by peak and non-peak users.

4.10 Subsidies for peak-time use of buses and trains will generally be inefficient where direct pricing for road usage, including congestion costs, is feasible. They could lead to over-crowding on buses and trains during peak periods, or to the over-provision of vehicle capacity. Alternatively, the diversion of peak demand could see the imposition of opportunity-cost-based peak-time prices on buses and trains. The public would complain that this was self-defeating in terms of the Council's objective of reducing road use by motorists and there might be a public outcry about the contribution of the subsidy and peak-load pricing to the profits of rail and bus providers.

4.11 Subsidies for bus and train passengers that are funded by motorists are also likely to be less efficient than direct congestion pricing if they penalise people who do not use their cars during peak periods. Moreover, it appears that the bus passenger transport subsidies are not directed solely to peak-time travellers who use buses rather than cars. Instead they are funding bus services for less well-patronised routes at off-peak hours. Such subsidies have nothing material to do with easing peak-time congestion problems on major routes.

4.12 The second principle - that it is more important to meet the needs of commercial, recreational, rural and off-peak users rather than those of rush-hour car commuters - ignores consumer needs and the responsibility of the Council to meet them 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 new capacity should never be built to accommodate peak demand from a key segment of the market. The implication would be that, with rising demand, users should have to put up with brown-outs, persistent 'busy-signals' or loss of water pressure. The principle is inconsistent with the objective of maximising the welfare of ratepayers and citizens of the region.

4.13 When road congestion is a problem - and those who have spent time in the world's more congested cities will know that Wellington's congestion problems are minor by comparison - 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.

4.14 The third principle - that transport modes that are alternatives to the private car should be subsidised - also requires justification. 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. The imposition of charges on people who use services at peak times is usually efficient because of the high cost of identifying such people. 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. Moreover, international research suggests that a sceptical view should be taken of the contribution that bus and light rail services can make to reduced congestion. The Council needs to make a sound case for subsidising a subset, or any, of these alternatives to the use of a private car before this principle could be accepted as a sound basis for regional policies.

4.15 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.

4.16 The Council is to be commended for investigating people's apparent willingness to pay for investment in transport as reported in *Transport Future*s, April 1997. However, little weight can be put upon responses unless the participants are aware of the relative costs of options, if they expect other ratepayers to bear the cost of satisfying their preferences, or if the Council has not communicated effectively the efficiency advantages of peak-period pricing. The survey suggests, for example, that 90 percent of respondents support improvements to passenger transport. The reality is that only a minority use it to commute to work and this is unlikely to change.

4.17 We submit that the Council has not adequately defined a proper role for itself in the transport area. It needs to 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, and should seek to identify which, if any, issues in relation to the road network 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.

4.18 The Council's claimed "funding deficit problem" is self-generated. A solution would be to reduce future spending on bus and train subsidies. Given that no sound rationale for the current level of these subsidies has been provided in the Strategy, this is an obvious avenue to explore.

4.19 A related issue is the cost of the decision not to allow buses to compete with rail for passenger subsidies. We understand that rail receives a higher subsidy from the Council for fewer but longer commuter trips than bus operators. All operators should face full competitive pressures when bidding for subsidies to encourage them to find ways of improving the cost-effectiveness of their services.

4.20 The only argument for not allowing bus and rail operators to compete for subsidises appears to be that buses use the roads but trains do not. This is a congestion argument. There are four points to be made here. First, the Council does not appear to have provided data to indicate that congestion is a serious problem in the relevant parts of the Wellington region, or that it will become one before electronic road tolling is feasible. Second, it is odd to use a congestion argument to allow cars to compete with trains but not buses. Although buses use the road, if more people travel on them, fewer cars may be on the roads and congestion may reduce. Third, if congestion is an issue, congestion tolls should be considered in the first instance as a more efficient solution. Fourth, congestion should be remedied by building more capacity when it is economic to do so. It does not provide a non-level playing field case for permanent subsidies to rail transport. In short, this policy should be overturned. Conceivably, that single action could do much to address the Council's perceived funding problem.

4.21 An issue that arises 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 is an optimal taxation issue which would require careful analysis.

4.22 However, the issue discussed in the previous paragraph essentially relates to the funding of local government expenditures on the provision of road infrastructure for the benefit of motorists and heavy vehicles. As such it is applicable to territorial local authorities rather than to the Council. Different grounds must be found by the Council to support its case for charging motorists in order to top up government subsidies for bus and rail operators. The congestion pricing argument is not convincing for the reasons discussed above.

4.23 To conclude, we submit that if the Council is unable to provide a sounder reason for ratepayer subsidies for passenger transport than it has produced to date, it should phase them out as contractual obligations expire. Second, congestion pricing issues should be addressed directly by those responsible for pricing road network services. Arguably, the revenue from such charges should go to the road network operator which is responsible for funding additions to capacity. They should not go directly to the providers of passenger transport services.

4.24 The Strategy states that the Council has been unable to include light rail services at a capital cost of $40 - 110 million. Although the Council claims that studies have shown that it would be economical and viable to construct and operate a comprehensive light rail network in the region, we doubt whether such a proposal could be shown to be economic for a city of Wellington's size and geography. If the project were viable without subsidies, the private sector would undertake it. There would be no role for the Council beyond its regulatory one. On the other hand, the Council's subsidisation of passenger services may add significant uncertainty. Moreover, it is inappropriate for the Council to contemplate funding new passenger services for the reasons cited above.

4.25 If, contrary to these arguments, the Council intends to continue to subsidise passenger services, it should seek competitive tenders for their provision and should not generally be funding the purchase of capital equipment such as rolling stock and other inputs. This approach is endorsed in the Council's *Proposed Funding Policy*.

5 INVESTMENT ACTIVITIES

5.1 In responding to our submission on last year's plan, the Council advised that it was "currently reviewing options for future ownership and management structures for the Plantation Forestry Business Unit." The Strategy makes no mention of the review. However, it indicates that the Council plans to consider the rationale for holding its forestry investments in 1997/98. It also states that at an appropriate time the Council believes it should "reduce" its investments in the Port of Wellington and forestry and use the proceeds to repay debt. However, the 10-year plan has been prepared on the basis that the Council's investment in both are to be retained, and the statement of intent suggests that the Council envisages the retention of an interest, albeit at a lower level, in both. The Council says that it intends to divest its investment properties (apparently excluding its interest in its head office premises) in the longer term, which appears to be beyond 10 years as the divestment is not included in the financial forecasts that are contained in the Strategy.

5.2 The plan provides no sound rationale for ongoing investments by the Council in commercial activities. Its statement of investment philosophy and its actual investment practice are inconsistent. It is impossible to hold relatively risky and undiversified investments, such as interests in the Port of Wellington, plantation forests and a handful of commercial offices in Wellington city, without deviating from the Council's stated policy of only holding low risk investments in the longer term. The holding of an investment for 10 years must be viewed as a long-term commitment. Cash assets and bonds issued by sovereign states (or equivalent) with strong credit ratings would normally be regarded as low risk investments. The comment (on page 108) that income from investments has reduced rates by 8 percent in 1997/98 is misleading because it overlooks the opportunity cost of the Council's investments. The expected net income of $2.4 million appears to constitute a poor return (3.2 percent) on investments stated at $76 million.

5.3 In a revealing observation in the introduction to the Strategy, the chairman confirms that in the past the Council adopted a very short-term (one year) focus in respect of all of its activities. For major businesses, a longer-run strategy is required. The Council cannot hope to achieve the same level of expertise in property, forestry and port activities as privately run businesses since it has no core reason to develop or sustain such expertise and it faces weaker incentives. These investments expose ratepayers to undiversified and probably unwanted risks.

5.4 In our 1995 submission we noted that the Council's investment in Pringle House Finance Limited was projected to be worth $16 million at 30 June 1995 and was shown as $23 million below cost in the 1994 annual report. We commented that the write-down illustrated the risk to ratepayers of unwise Council investments. The Council's 1996 annual report states that the market value of the head office building and remaining investment property assets is $11 million, apparently indicating a further reduction on the 1995 estimate.

5.5 The Council's interests in the Port of Wellington, forests and commercial property arise from historical circumstances. The Council exists to fulfil regional regulatory and related public good functions, not to gamble that it can add more value to non-public good activities than a private sector owner. This conclusion applies equally to full, majority and partial ownership of such investments.

5.6 A competitive sale process would ensure that the Council obtained today the benefit from expert market assessments of the value to be added in the future by the port company and the forestry plantation. Indeed, the likelihood is that private owners would ensure that more value is added than could be added by the Council, thus increasing the benefits from immediate sale. There is no reason to believe that the Council is better placed to judge the future market value of assets, for instance because prices for wood are cyclical, than other investors.

5.7 In the case of the Council's forests there may be a need to examine the extent to which forestry operations should be constrained to be consistent with the efficient management of its water catchments. We do not believe that this would prevent the sale of most, if not all, forests owned by the Council, although it may affect the conditions attaching to such a sale. Nor are we aware of any reason why this issue could not be resolved during 1997.

5.8 We are confident that the Council's independent advisers would not basically differ from our key conclusions: that the Council should not expose ratepayers to risks by engaging in commercial businesses and should sell its commercial investments.

6 OTHER ACTIVITIES

6.1 Sports Stadium

6.1.1 The Council proposes to contribute $25 million to the Wellington Regional Stadium Trust subject to it being satisfied that the risks involved are acceptable. The Council is to raise a 20-year loan to fund its contribution which is to be made with limited rights of recourse. The loan is to be repaid by way of a differential rate which will apply from 1997/98. The proposal will reduce the wealth of ratepayers by $25 million or an average of $60 a person in present value terms.

6.1.2 The services provided by the sports stadium are a private good. There is no public good argument for Council involvement since it is easy to exclude those who do not pay. The primary function of regional councils is to undertake core regulatory and related public good activities. The argument that the stadium might generate external benefits for the community does not establish a case for Council funding. Many other community facilities generate wider benefits and do not attract such funding. Moreover, any valid intervention on external benefit grounds should impose the costs directly on those who will benefit from the stadium where it is economic to do so.

6.1.3 Those in the community who believe that they will derive external benefits from events staged at the stadium can readily contribute directly to its cost. The Council is not likely to be an efficient intermediary for this purpose since it has less information about such benefits than that dispersed amongst the community. The Council may not even be able to readily judge who will benefit and who will not, let alone know the amount that individuals would be willing to pay.

6.1.4 Worse, the Council will be exposed to opportunistic pressure from those who do benefit to force all ratepayers to contribute, even when many would prefer not to. Community welfare would be reduced since money would be spent on a low return activity in the eyes of these ratepayers, and would be reduced further because of the deadweight losses imposed by rates.

6.1.5 During the discussion on our 1996 submission, some members of the Council defended the Council's decision to fund the stadium on the grounds that it had consulted widely and the public supported its decision. Such responses are affected by the questions that are asked, whether people think someone else will pay, and the alternatives that are put to participants. The Council's argument overlooks the need for the Council to base its role on accepted public policy criteria. The Council has also argued that without a subsidy the stadium would not proceed. If true, the argument indicates that the project is uneconomic. Many projects do not proceed in the private sector because they are found to be insufficiently attractive to investors, but that fact alone does not justify a ratepayer or taxpayer subsidy.

6.1.6 We have no objection to the stadium project proceeding on the basis of financing from those who will benefit from it. However, the Council is not an appropriate source of finance and its proposed funding should be stopped.

6.2 Environmental Management

6.2.1 The Council's role is stated to be "To promote the sustainable management of the Region's natural and physical resources." A key Council activity is to administer the provisions of the Resource Management Act 1991 that fall within the responsibilities of regional councils. The overall purpose of that Act 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 sustaining resources for future use, safeguarding the life supporting capacity of air, water and soil and ecosystems, and avoiding or mitigating adverse effects on the environment - to be taken into account. The emphasis in the Act is on enabling people and communities to provide for their social, economic and cultural well being rather than on the sustainable management of natural and physical resources *per se*. In our view, this emphasis should be reflected in the Council's role.

6.2.2 Although environmental management is a key function of the Council, it is impossible to tell from the Strategy whether it is doing a good job. The information provided on the Council's environmental activities is limited and the performance indicators do not adequately show whether the community's welfare is being advanced. Substantial work is needed to provide information which meets the requirements of the Local Government Act.

6.2.3 There is no valid role for the Council (or other government agency) in collecting agricultural chemicals, undertaking hazardous waste disposal or promoting regional tourism. These are private activities and are well beyond the Council's core regulatory role. The fact that the Council is prepared to list them as activities that could not be afforded illustrates our concern that the Council has no clear view on its proper role. They should not be included in the Strategy and valid reasons for this stance should be presented to ratepayers.

6.3 Rural Fire Services

6.3.1 Territorial local authorities are responsible for rural fire services except for commercial forests, the Crown conservation estate and defence land. The Council appears to be willing to provide fire services for a large part of its region. These services could be provided privately. They are not generally an appropriate activity for regional councils.

7 FUNDING POLICY

7.1 The Council's Policy

7.1.1 The summary of the Council's funding policy is confusing. It states that "In theory, the funding policy would have all public benefit components being funded by rates and all private benefit components funded by the beneficiaries." The Council then comments that it is not always practical or possible to apply the theory and cites as an example the view that it is not efficient to charge for the use of regional parks.

7.1.2 The Council's first statement appears to reflect the view that, by definition, users cannot be charged directly for pure public goods. Pure public goods arise where it is infeasible to exclude individuals who do not contribute to the cost of their production from enjoying their benefits (the non-excludability property) or where it is undesirable to exclude individuals from enjoying benefits from the goods, as the enjoyment of them by one person does not detract from that of other people (the non-rivalrous property). The regional park example, which is claimed to contradict the theory, could well be consistent with it because it is infeasible to exclude people who do not contribute to the cost of open-access parks.

7.1.3 After wrongly dismissing the theory that it initially endorsed, the Council states that its funding policy is based on "fair and equitable funding solutions - and ones that can be implemented." There is no information in the summary on how this broad policy has been applied. Moreover, efficiency considerations (aside from the question of feasibility) which are central to the theory cited by the Council, and which should be at the heart of the funding policy, are omitted from the summary policy statement. Economic efficiency is included in section 122F of the Local Government Act 1974 which sets out the principles that will apply to the funding of government spending from July 1998.[2]

7.1.4 The Council's *Proposed Funding Policy* focuses on statutory requirements and processes, and provides no general discussion of the analytical approach that has been adopted in applying the proposed policy. An examination of the discussion on each significant activity suggests that considerable weight has been placed on the benefit principle and feasibility issues.

7.2 Efficient Recovery of the Cost of Council Activities

7.2.1 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 in the Act. Such charges help to balance the cost of providing the service against the benefit

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2 The relevant section of the Act was inserted by the Local Government Amendment (No 3) Act 1996.

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

7.2.2 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.

7.2.3 The Council's funding policy suggests that user pays principles should be modified on equity and fairness grounds. 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.

7.2.4 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 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 costs and make some contribution to fixed costs. Many services provided by the private sector are priced on this basis.

7.2.5 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. Where goods or services are funded by rates, there are large incentives to lobby politicians and administrators for favourable treatment. The administration and compliance costs incurred in collecting rates may also be substantial.

7.2.6 User-pays arguments apply in respect of both public and private goods. The Council apparently takes the view 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. For example, although it may not be possible to directly charge for road use, the tax on petrol may be a relatively efficient alternative. 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.

7.2.7 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.

7.2.8 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. An illustration of this risk is the use of models by some consultancy firms which appear to generate implausibly large external benefits. 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.

7.2.9 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.

7.2.10 Once the Council has reduced its activities to 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 different ratepayers.

7.2.11 The ability of businesses to claim an income tax deduction for rates and an input credit for GST paid in respect of rates does not advantage them relative to residential ratepayers. These factors are therefore irrelevant in allocating rates between the two sectors.

7.3 The Benefit Principle

7.3.1 Section 122F of the Local Government Act 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 the 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 the property to the current owner at a price which reflected the net benefits of Council-provided services.

7.3.2 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.

7.3.3 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 the Council's reliance on rates as a funding mechanism. The Council should divest those 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 revenue from user charges and/or lower subsidies and to reduce its reliance on rates. We believe that there is sufficient flexibility within sections 122F to 122I of the Local Government Act 1974 to accommodate this approach.

7.4 Application of the Council's Funding Policy

7.4.1 The approach outlined above differs from that which the Council appears to have adopted. First, we envisage a much smaller role for the Council. This would require the Council to withdraw from activities other than its core regulatory and public good functions. Secondly, the funding principles outlined above should be applied. The funding arrangements proposed by the Council in the following areas are, in our view, clearly inappropriate:

- environmental management, managing consents. The *Proposed Funding Policy* states that economically efficient funding of the activity comprises 80 percent from user charges and 20 percent from rates. It then notes that charges already set under the Resource Management Act imply that only 22 percent of related costs will be recovered by user charges in 1997/98. The funding recommendation, which is stated to reflect 'feasible' funding, is 20 percent user charges and 80 percent from rates which includes a lower percentage of user charges than currently (27 percent). While a possible timing issue is acknowledged, the Council should aim to get as close as possible to the economically efficient outcome. This generally implies higher user charges than those recommended unless the Council's costs are excessive, in which case they should be reduced. It suggests, as a minimum, that user charges should be increased beyond 1997/98;

- general passenger transport services. In section 4 we argued that all road users should bear the marginal cost of their use of the roads. The proposed 30 percent subsidy to passenger services, largely funded by other road users, is inconsistent with this approach. Moreover, the imposition of the cost on all motorists appears to be a mistaken application of the benefit principle. The ratepayer subsidy should be phased out as contractual commitments expire. In the meantime, the subsidy should be funded from the general rate which spreads the cost broadly and thereby minimises distortions; and

- total mobility access. The Council proposes a 50 percent subsidy, 40 percent of which is to be funded by road users. There are no efficiency grounds for such subsidies. It is also doubtful whether the Council has a role in redistributing income. As it correctly argues in respect of any increase in funding of this activity, this is a function of central government. If the subsidy is to continue, it should be funded from the general rate because the only plausible rationale is to redistribute income. The imposition of the cost on motorists is inconsistent with the benefit principle.

8 DISCLOSURE OF INFORMATION

8.1 The chairman correctly observes in the introduction to the Strategy that better information on local government is available to the public as a consequence of the changes adopted in recent years. There are, however, some deficiencies which we believe the Council should address. They are noted below:

- Section 223D of the Local Government Act 1974 requires every council to include in its proposed annual plan the intended significant policies and objectives of the local authority, local authority trading enterprise, company or other organisation. The plan is required to outline the nature and scope of significant activities to be undertaken, and present the performance targets and other measures by which its performance is to be judged. The Strategy does not do this in some areas. First, it is arguable that the scope of significant activities to be undertaken in respect of the port and plantation forests has been omitted. Secondly, the discussion on the nature and scope of significant environmental management activities that are to be undertaken is, at best, limited. Thirdly, no performance measures have been provided for plantation forests. Fourthly, although investments will amount to about $76 million or almost 25 percent of the Council's net assets it is not possible to obtain a breakdown of the value of the main investments such as plantation forests, Port of Wellington and properties;

- the cost of activities to be undertaken should include an allowance for the cost of capital (section 223D). No information is presented in the Strategy on whether the cost of capital has been included and, if so, the basis on which it has been included. We understand that the Council has not applied a cost of capital on the grounds that the Audit Office is prepared to accept a zero cost of capital. This is inappropriate as it implies that ratepayers' funds have a zero opportunity cost; and

- the long-term budgeted financial statement contained in the Strategy is of limited value because it has been prepared on a very restrictive basis. It essentially reflects a projection of existing activities given no change in policy. Its main contribution is as a check on whether existing policies are sustainable. It is of limited use as a forward-looking planning document. For example, no information is given on how it might change if the Council were to sell down its investments. Moreover, the forecast has been presented without any analysis or commentary on how it differs from that prepared in 1995 or last year's plan.

8.2 The chairman expresses his satisfaction that the Council is one of the few to apply the provisions of the Local Government Amendment Act (No 3) 1996 a year ahead of the obligation to do so. While this initiative is welcome, we note that the Strategy is not substantially different from *Facing the Future* which was prepared in 1995. The main differences are the summary of the Council's proposed funding policy and the presentation of a forecast balance sheet for a 10-year period. Several important provisions of the Act have not yet been applied or have been covered lightly. They include the following:

- section 122L(b) of the Local Government Act 1974 requires a local authority's long-term financial strategy to state the reasons why activities that give rise to estimated expenses are engaged in. The Strategy does not do this. For example, it does not explain why the Council believes it should engage in the supply of bulk water or hold investments. This is a major omission; and

- section 122C(1)(c) of the Act requires the benefits and costs of different options to be assessed in determining any long-term financial strategy, funding policy, investment policy or borrowing management policy. There is little evidence from the Strategy that this provision has been implemented. It identifies some possible marginal activities that have not been included in the Strategy but large policy issues like whether investments should be sold have not been examined in terms of costs and benefits.

8.3 Last year we commented that the level and quality of disclosure in the 1996/97 plan appeared to be inferior to that provided in the previous year. We argued that the Council's objectives should be clarified, discrepancies between performance indicators and outcomes identified, corrective action noted and major changes from the previous year's plan explained. We noted that the level of disclosure generally compares unfavourably with that of central government. These points are still largely true. While the funding policy is a helpful step forward, there are few other improvements. A number of other local authorities are providing better quality information for ratepayers than the Council.

9 CONCLUDING COMMENTS

9.1 The key weakness in the Strategy is the absence of a valid analysis of the proper role of the government and, in particular, that of regional government. We believe that the Council should be working more actively to reduce or shed non-core activities and focus on its core regulatory and public good activities. This would enable debt and rates to be reduced and would advance the welfare of ratepayers.

9.2 On public interest grounds the Council should privatise its bulk water supply business. If the Council is not willing to do so for political or ideological reasons, it should adopt a more commercial approach. Its performance indicators do not inspire confidence that these operations are accountable in any material way for adding value or minimising costs. There is a dramatic and unfavourable contrast between the apparent unwillingness of the Council to contemplate meaningful change in this area and the advances which have been made by the Papakura District Council, the Auckland Regional Services Trust, and governments in many other parts of the world including Australia and the United Kingdom. We suggest the Council should commission independent consultants to review its water supply operations and recommend options for reform along the lines of studies undertaken by Watercare Services Limited and the Auckland Regional Services Trust.

9.3 The Council has not adequately defined its proper role in transport. Passenger transport subsidies are a major departure from a level playing field approach to inter-modal competition. The case for the subsidisation of bus and rail services to ease road congestion seems particularly weak. Ratepayer subsidies for passenger services should be phased out as contractual obligations expire.

9.4 The Council's transport strategy needs to recognise that roading operators should respond to consumer demand where it is economic to do so. The Council should encourage the adoption of economically efficient pricing of road usage.

9.5 The Council should sell all its shares in the Port of Wellington and concentrate on its regulatory responsibilities in respect of the harbour. It should cease its involvement in plantation forestry, sell its investment property and review its decision to own the premises occupied by its head office.

9.6 The Council is not an appropriate source of finance for the stadium project. Its proposed funding should be stopped.

9.7 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 local government legislation. 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.

9.8 The Council apparently takes the view that the provision of public goods should be funded by rates. Although this is reasonable in some situations, in general there should be no such presumption. The existence of external benefits does not, by itself, create a case for rate-based funding. 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.

9.9 The level and quality of disclosure should be improved. 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. We noted that the level of disclosure generally compares unfavourably with that of central government. While the funding policy is a helpful step forward, there are few other improvements in *Facing the Future 1997-2007*. A number of other local authorities are providing better quality information for ratepayers than the Council.

9.10 The Council can make the best possible contribution to the welfare of citizens of the Wellington region by focusing on its core activities, exiting those that are inappropriate, and keeping its rate and regulatory burdens as low as possible.