

# A path to subsidiarity

**Eric Crampton**

Local government does not have to be terrible.

Nothing innate to local government condemns it to failure.

If anything, local government should generally work better than central government. Local governments can learn from each other's examples, taking up successful innovations and avoiding others' mistakes. More than half a century ago, Charles Tiebout's classic work showed that competition among local councils for residents could provide the same desirable outcomes as competition among restaurants for customers. Central government, like a giant monopolist, does not have those advantages.

It has not worked that way in practice.

New Zealand seems stuck in a vicious cycle. Perceived and real local council failures lead central government to remove council responsibilities. Public servants who want to make a real difference in improving their neighbours' lives see little scope for doing so with local councils and take up roles with central government. Diminished council capabilities result in further problems, setting the stage for further centralisation.

Worse, councils face perverse incentives. A council that does the right thing for its community, laying out ample infrastructure to facilitate urban growth and to ensure affordable housing, is left with a substantial infrastructure bill. Central government enjoys the resulting income tax, company tax, and GST. Conflicting incentives facing central and local government provide a recipe for ongoing discord.

Breaking the cycle matters. The basic principle of subsidiarity tells us that policy should be left with the lowest level of government able to manage each policy area. When local government is considered to have a power of general incompetence, local government is trusted with little. Local government needs to be able to be trusted with more.

But breaking the cycle is difficult. Councils vary considerably in their characteristics, competence, and the desires of their residents.

No single prescriptive local government policy will fit all local councils. Local government reform should look instead to frameworks that enable councils to grow into the roles that best suit their communities' needs, in consultation with their communities.

In 2015, the New Zealand Initiative suggested an approach based on the Manchester City Accord. At the highest level, the Accord enabled local councils in the Greater Manchester region to band together to request devolved authority and funding in areas where the Manchester councils believed they had an advantage.

A Manchester-style framework could break the current vicious cycle in local government competence and capabilities. It would enable communities to set policy to suit local circumstances. And it would encourage councils to learn from each other's successes and failures.

The Initiative proposed policy trial areas.

Local councils would be encouraged to consult with their communities to discover the spending or regulatory areas where central government policy was poorly suited to local needs. Councils would, with assistance from Treasury, develop bespoke devolution proposals along with accountability frameworks monitoring whether the trial was working.

Accountability frameworks help build central government confidence in devolving responsibilities and funding to local councils. They also help evaluate whether trials have proven successful and whether they have had pernicious unintended consequences.

If a policy trial proves successful, local communities would benefit. Central government's coffers would often benefit as well. When policy is better suited to local circumstances, communities can achieve greater flourishing. Longer-term need reduces and central government's longer-term fiscal outlook improves. A large proportion of central government's fiscal gains would be shared with the innovating council, ensuring that central and local government incentives are aligned with one another.

And other councils would be able to take up successful trials as well.

If a trial proved unsuccessful, local policy could revert to the national-level default.

The framework would enable a more virtuous cycle to emerge and sustain itself. Councils would attract capable staff encouraged by the prospect of being able to make a real difference. Growing council capabilities would encourage taking on more challenging projects, which would attract ambitious public servants to take on roles with councils. And residents would benefit.

The Initiative's report provided a few examples of potential policy trials, but only as examples. Proposals should originate with local communities and be developed through local councils, through iwi and hapū, or through both in partnership. They should not come from Wellington-based economists and policy analysts. Wellington officials would be needed in their areas of competence: helping to design the monitoring frameworks for policy trials and ensuring that councils shared financially in resulting benefits.

Central government reforms to water infrastructure risk being but the latest round in the cycle of local government failure, further diminishing local government responsibilities, eroding competence, and setting the stage for future rounds of failure.

The Review into the Future for Local Government provides an opportunity to break that cycle, building a framework enabling local governments to succeed.

Doing so matters.

The Government's Urban Growth Agenda requires urban councils to allow a lot more building. But if growth continues to present councils with an unmanageable cost, councils will seek new ways to protect their balance sheets by hindering development.

New Zealand's housing crisis stems from a set of incentives facing councils that lead them to treat urban growth as a cost to be mitigated rather than as an opportunity to be embraced. Councils need better ways of financing the infrastructure necessary for growth. They also need to share in the benefits that central government enjoys when councils facilitate growth. Changing the incentives will fundamentally change the game.

When councils welcome growth, rather than seek to stymie it, the pathologies that follow directly from chronic undersupply of housing will finally have a chance of easing.

At the same time, a framework for bespoke devolution to ambitious councils would let councils tailor policy to local needs. Dozens of local policy laboratories could experiment and find new ways of solving old problems. Failures would happen at a small scale, while successes could be emulated by other councils facing similar circumstances.

Better local government is eminently possible. Enabling it would benefit us all.

Dr Eric Crampton is Chief Economist with The New Zealand Initiative. All opinions and comments in this paper are written in his personal capacity