Time to go local

Two things are an anathema to free-market economists: government intervention and monopolies. And one thing is even worse: When public services are provided by a central government monopolist.

This is why a strong economic case can be made for devolution and competitive localism. It's a pity New Zealand has never properly tried either.

Economic theory has long argued that wherever public services can be provided at a subnational level, they should be devolved to the states in a federalist system or indeed to local government. Such arrangements make it possible to have competition in public services and experiment with different sets of public goods at taxation levels.

Friedrich Hayek, one of the 20th century's greatest economists, was certainly critical of any kind of government intervention. But he also had great sympathies for local government. In his seminal *Constitution of Liberty*, Hayek explains why: "While it has always been characteristic of those favouring an increase in governmental powers to support maximum concentration of these powers, those mainly concerned with individual liberty have generally advocated decentralisation. There are strong reasons why action by local authorities generally offers the next-best solution where private initiative cannot be relied upon to provide certain services and where some sort of collective action is therefore needed."

As an economic liberal, Hayek was suspicious of government as a service provider. But if there was to be a public service provider, then he clearly preferred local government to central government. Unfortunately, in many countries around the world, local government has been relegated to a subordinate role in politics. New Zealand sets a sad benchmark for centralisation. Where other countries still trust their local and state governments to fulfil a wider range of government functions, New Zealand local government only ends up with the crumbs falling from the Beehive's table.

The reasons are historic. New Zealand was a colonial enterprise and not a matter of local people organising their own affairs. A great tradition of localism was never developed because the settlement and development was essentially run out of the colonial offices and by organisations such as the New Zealand Company. There was nothing organically local; everyone was settled and transplanted, and the tasks local government were assigned reflect that reality to this day.

The major difference between local government in New Zealand and in other developed economies is its size. When the OECD analysed government spending patterns in its member countries, it found remarkable differences. In Greece, sub-central government only accounted for 6% of all government spending (if you can trust their statistics, that is) whereas in Denmark it was more than 60%.

Altogether, sub-central spending is about 30% of all government spending in the OECD. And what is the figure for New Zealand? As it turns out, not even half this international average: 11%. Or conversely, Wellington controls 89% of all public spending. Across the industrialised world, only Greece and Ireland have less local government spending – though one probably would not regard either of these two countries as ideal benchmarks.

Astonishingly, even supposedly super-centralised countries like France have a greater devolution of government spending than New Zealand. French local government is responsible for about 21% of France's government spending.

So New Zealand's local government is small by international standards. Unsurprisingly, New Zealand also lags behind for local government's share in public investment. Across the OECD, more than 60% of public investment is driven by sub-central governments. In New Zealand, it is only 44%.

Whereas in most other OECD countries local government fulfils a large variety of roles in public services, in New Zealand there are large areas of government in which local government is completely absent:

- Across the OECD, sub-central government accounts for more than half of all government spending on education. In New Zealand, it is zero.
- Across the OECD, sub-central government accounts for about a third of all government spending on health. In New Zealand, it is zero.
- Across the OECD, sub-central government accounts for about a quarter of all government spending on public order and safety. In New Zealand, it is zero.
- In those other areas in which New Zealand local government contributes more than nothing to overall government expenditure – economic affairs, recreation, culture and religion, environmental protection, housing and community amenities – it still accounts for a share below the OECD average.

New Zealand is also unusual in the composition of local government revenue. In hardly any other OECD member do we find such a dominant role of property taxation as in New Zealand. In fact, two thirds of OECD countries have elements of personal income taxation at the local government level.

Across the OECD, sub-central governments receive about 29% of all personal income tax revenue. In New Zealand, on the other hand, all personal income tax ends up at the national level. The same is true for corporate income tax revenue.

Looking at the headline figures for local government spending and revenue, and comparing these figures internationally, New Zealand looks like an outlier in the developed world. It is hard to find another country in which local government is as limited and marginalised as it is in New Zealand.

From an economic point of view, this state of affairs is deplorable. By keeping government centralised, we are missing out on potential efficiency gains resulting from increased competition in the delivery of public services.

To make government more efficient and to bring it closer to the people it is meant to service, New Zealand should have a debate about a new localism.

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