

LOOKING DEEPER AT THE REFORM OF NEW ZEALAND'S ROADING SYSTEM: DRIVEN BY ECONOMIC RATIONALISM OR AN EXAMPLE OF PUBLIC CHOICE THEORY IN ACTION?

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Successive New Zealand governments have investigated reforming New Zealand's road network since 1994. The draft Roads Bill 1998 creates a system of road provision operated according to commercial principles. Roads remain publicly owned, but operational management passes from Transit and 74 territorial authorities to newly incorporated "public road companies". The reforms are examined from "a law and economics" perspective, which finds that while efficiency gains may be generated, the proposed institutional design may prevent these gains from being realised to the proposed extent. The reform proposal is then analysed using public choice theory. This analysis finds that while some elements of the proposal are consistent with legislator and bureaucrat self interest, it contains too many politically sensitive variables to displace the Government's stated "efficiency gains" premise as the overriding motivation for reform.

I INTRODUCTION

A *The Origins of Reform*

Roads are vital to New Zealand's social and economic wellbeing. The road network's value is estimated at \$23 billion,¹ apportioned at 27 per cent to 10,464 kilometres of state highways,

* This paper was submitted in fulfilment of the LLB(Hons) requirements at Victoria University in 1999. This paper was awarded the Quentin-Baxter Prize for Public and International Law for 1999.

and 73 per cent to 81,400 kilometres of local roads.² The need to manage this resource effectively warrants no further justification. Since 1993, National-led governments have been investigating strategies to improve the management of New Zealand's roads.

The Roothing Advisory Group presented five options for reform (RAG report), ranging from maintaining the present system to adopting a commercial model.³ The Ministry of Transport released its latest reform proposal, "Better Transport Better Roads",⁴ and a draft Roads Bill (the proposal) in December 1998. The proposal establishes publicly owned "road companies" to manage and control all roads according to commercial principles.

B Outline of the Paper

This paper analyses the proposal through both "law and economics" and public choice perspectives. It looks behind the proposal to determine the true motivation for reform. The law and economics perspective places the proposal in New Zealand's wider economic context, demonstrating how it continues contemporary political and economic ideology favouring corporatisation. Examining the proposed reform structure identifies whether this market approach to road provision is consistent with delivering efficiency gains. Efficiency gains are the Government's stated rationale for reform.⁵

The paper then examines whether the reforms are consistent with public choice theory. It questions whether any interest groups benefit sufficiently from the proposal to conclude they have captured the legislative process. The paper then analyses the proposal's consistency with public choice conceptions of legislator self-interest. This offers insights into why particular features of institutional design were selected.

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- 1 Roothing Advisory Group *Road Reform: The Way Forward - Final Report* (Ministry of Transport, Wellington, 1997) 17 [RAG report].
 - 2 Local Government New Zealand *Streets Ahead: Local Government New Zealand's Response to Central Government's Proposals for Road Reform* (Wellington, April 1999) 1 [Streets Ahead].
 - 3 RAG report above n 1.
 - 4 Ministry of Transport *Better Transport Better Roads* (Ministry of Transport, Wellington, 1998), 26 [BTBR].
 - 5 In this paper, "Government" refers to the National minority government in power until November 1999. References to "Cabinet" have a corresponding meaning. In November 1999, a Labour-Alliance minority coalition government was formed. The approach of this government to roading reforms is not considered in this article.

II THE HISTORY OF ROADING IN NEW ZEALAND

Any reform is best judged through pre-existing structures. New Zealand's road management history can be separated conceptually into stages, of which this proposal is the third. The first stage, up until 1924, represents the beginnings of road provision.

In the 1870s both roads and railways were highly sought after as links to other towns. Their provision was highly political. Government borrowing enabled most construction. Consequently, the ability to secure rail or road links for their electorate "was the principal criterion that most [voters] used to judge whether or not their local MP deserved a further term in Parliament".⁶ The relationship between politics and road provision began.

The second stage, up until the late 1990s featured increased legislative involvement in roading. During the mid-1900s road ownership was not prescribed, and without formal structures to evaluate road construction, electoral and political influence over roading decisions must have remained. The Counties Act 1956 formally gave councils management control of county roads in their county,⁷ but did not address road ownership. By 1972, all state highways were vested in the Crown,⁸ although this seemed to conflict with the Local Government Act 1974, which vested the fee simple in all roads in district councils for the first time.⁹ This was clarified by the Public Works Act 1981,¹⁰ which vested in the Crown, subject to section 316 of the Local Government Act 1974, all state highways that are outside urban areas. Both the National Roads Act 1953 and later the Transit Act 1989 required state highways to be managed in an "efficient" manner.¹¹ Transit New Zealand (Transit) currently carries this responsibility.

The current proposal maintains the distinction between central and local government road ownership, but removes the distinction regarding road management. This stage is unique for

6 Keith Sinclair (ed) *The Oxford Illustrated History of New Zealand* (Oxford University Press, Auckland, 1996) 148.

7 Counties Act 1956 s 191(1).

8 Public Works Amendment Act 1972 s 28.

9 Local Government Act 1974 s 316.

10 Public Works Act 1981 s 122.

11 Transit Act 1989 s 5; National Roads Act s 5(k).

emphasising commercial management structures, making road use more responsive to market forces.

III THE CURRENT ROAD PROVISION MODEL

A Structure

Roads are classified as either state highways or local roads. Both are publicly owned and managed. All road funding is administered through Transfund New Zealand (Transfund). Transfund distributes revenue collected from excise taxes, road user charges, licensing and registration to Transit and territorial authorities. Transfund split from Transit in July 1996, separating the state highway "provider" from the funding source, or "purchaser". Territorial authorities also fund local roads through property rates. No central government funding from the general tax base is allocated to roads.

Transit and all 74 territorial authorities are independent entities from central government. Transit is a Crown entity. Territorial authorities are accountable through the local body electoral process, and financial reporting requirements under the Local Government Act 1974.

B Design Defects

The current road provision model is criticised for its lack of commercial sensitivity, and potential for political interference. The latter criticism lacks substance regarding state highways as Transfund and Transit's infrastructure construction criteria are now largely technical. The former criticism is valid; for example, any proposed infrastructural development must meet Transfund's stringent "4:1 benefit: cost ratio" before construction commences. This rationing mechanism is inadequate. It cannot gauge consumer's willingness to pay for new infrastructure. Transfund's "PAYGO" policy prohibits borrowing to finance new infrastructure.

Current funding mechanisms are not economically optimal. Users' contributions to road funding do not correlate with actual road use. This distortion arises through funding local roads using property rates. Rates currently fund about 50 per cent of local roads' cost, irrespective of property owners' road use.¹² Second, a poor relationship exists between the costs a road user pays and the costs they impose on the road network, such as peak-hour travel. No incentive mechanisms exist allowing consumers to express their road use preferences.

¹² Warren Head "Road Reform" (1998) 27 *The Transportant* 6, 8.

Labelling these criticisms as "market failure" in central and local government's direct involvement in road provision overstates the argument. However, the reform proposal eliminates these distortions and implements transparent incentives for road users through the pricing mechanism.

IV THE DRAFT ROADS BILL 1998 AND BETTER TRANSPORT BETTER ROADS - THE PROPOSED MODEL

A Introduction

Better Transport Better Roads is a consultation document explaining the changes proposed in the draft Roads Bill 1998 (the Bill). Between four and eight regionally based "local road companies" will be incorporated to manage roads currently managed by territorial authorities. Transit New Zealand Limited (Transit Limited) supercedes Transit, operating state highways in each roading region. All companies have the principal objective of operating as successful businesses,¹³ focusing solely on managing roads. Similar to the State-Owned Enterprises Act 1986, the Bill imposes a superficial statutory duty of social responsibility upon the companies to have "regard to" community interests.

B Ownership and Governance

Land under all roads remains publicly owned. State highways remain vested in the Crown.¹⁴ Transit Limited obtains a long-term lease over this land. Local roads remain vested in territorial authorities.¹⁵ Local road companies obtain a statutory right to occupy that land.¹⁶ All "road improvements" will be owned and managed by the companies. These include road signs and footpaths.

Shareholding in Transit Limited is restricted to and apportioned equally between the Ministers of Finance and Transit, who are responsible to the House of Representatives.¹⁷ Transit Limited is a Crown entity. The Bill imposes similar accountability requirements upon Transit Limited as apply to state-owned enterprises.

13 Roads Bill cls 7, 24.

14 Roads Bill cl 234(1).

15 Roads Bill cl 208.

16 Roads Bill cl 211.

17 Roads Bill cls 10, 11,13.

Shareholding in local road companies is restricted to territorial authorities. Transit Limited cannot own shares in local road companies.¹⁸ Each territorial authority's share in the local road company will be apportioned according to the value of roads they contribute to the company. Accountability requirements imposed upon local road companies are again similar to requirements of state-owned enterprises. All road companies, including Transit Limited will be subject to an extensive information disclosure regime.¹⁹

C Funding and Commercial Management

Restructuring road funding is the principal mechanism for remedying defects of the existing system. Transfund becomes "Transfund New Zealand Limited", (Transfund Limited) structured identically to Transit Limited. It will purchase roading services from road companies on behalf of road users, a conceptual shift from benefit: cost ratio analysis and fund allocation. It remains funded through excise tax, road user charges, motor vehicle registration and licensing.

Property rates will cease to fund local roads. Local roads currently account for between seven and 60 percent of rates depending on the area.²⁰ To compensate for this revenue reduction the excise tax is expected to rise by approximately 11 cents per litre.²¹ Transfund Limited will be responsible for recommending excise tax rates to the Minister of Transport. 18.7 cents of the current 32.2 cents per litre excise tax will remain diverted into non-roading purposes.

Road companies may establish tolls on new or existing roads.²² The Bill further provides for "congestion pricing" on heavily used routes,²³ where motorists may opt to travel in a lane designated for fee-paying vehicles only. The Bill permits road users to opt out of Transfund Limited's purchasing system and contract directly with public road companies, or use "intermediaries" who will establish themselves for this purpose. Users under such contracts would not pay excise or other heavy vehicle taxes. Major commercial road users are expected

18 Roads Bill cls 26, 27.

19 Roads Bill cl 80(1); draft Road (Information Disclosure) Regulations 1999.

20 Hon Maurice Williamson's Office, Press Release, 8 December 1998, 4.

21 *RAG report* above n 1, 74.

22 Roads Bill cls 62-64.

23 Roads Bill cl 78(2)(b)(iii).

to prefer this option. Road companies may charge differential prices to road users under these road contracts on the basis of off-peak travel times or routes, different classes of road users, and the type of road.²⁴ These funding changes are ultimately intended to remove fuel taxes as the "user pays" mechanism. Users would all pay for road use according to the "competitive" prices determined by road companies through contracting processes and tolls. Ultimately this road pricing payment mechanism is anticipated to operate in conjunction with direct electronic charging of vehicles, although the full model will not operate for a "period of five to ten years".²⁵ Under the proposal, consistent with commercial management practices, road companies will be permitted to borrow to fund new infrastructure. Investment decisions would therefore be based upon road users' willingness to pay, not benefit:cost criteria.

V THE LAW AND ECONOMICS AND PUBLIC CHOICE MODELS

A *The Law and Economics Approach*

Law and economics is a methodology used to analyse legal institutions, determining whether changes to legal structures are consistent with core economic assumptions. Critiquing the proposed roading structures using economic concepts identifies the distinctive characteristics of roading as an economic good. This helps evaluate the proposal's consistency with those characteristics. The methodology assumes that individuals and entities act rationally and select options that maximise their utility. Therefore, the market is assumed to operate predictably according to the institutional design imposed upon it.

B *Public Choice Theory*

Public choice theory applies economic theory to political decisions. All political decision-makers, either elected representatives or bureaucrats, are assumed to be economically rational and self-interested and are assumed to formulate and implement policies consistent with this assumption. The theory posits that elected representatives are primarily motivated by re-election, the prospects of which are determined by a law's impact on voters. Voters are assumed to vote according to their economic self-interest. The bureaucrat's primary motivation is to maximise their budget. Niskanen argues that bureaucrats derive utility from maximising

24 Roads Bill cls 59, 61.

25 *BTBR* above n 4, 26.

their budget through the increased power and influence this brings.²⁶ Subsidiary factors may enter their utility function including salary, perquisites, reputation and power.

Public choice theory therefore suggests that officials and legislators are rent-seekers, attempting to extract "profits" at the expense of taxpayers, consumers or voters, to maximise their own preferences. Public choice theory views this as rational behaviour. This approach is consistent with Farber and Frickey's "pluralist" description of public choice theory.²⁷ Pluralism regards legislation as a product of legislators' responses to interest group influence. To secure maximum votes, legislators respond to those interest groups that have significant influence at the ballot box. This approach suggests that road reform, as proposed or amended by legislators, is a response to interest group pressure.

Public choice theory is criticised for assuming that both legislators and voters are motivated only by economic self-interest. The reasons why individuals or politicians vote in particular ways cannot be conclusively determined and subjected to such a unitary assumption.²⁸ The same applies to legislators. Fenno has identified that other alternative motivations, such as the desire to make good public policy, must be influential.²⁹ However for the purpose of continuing the analysis, this paper adopts the "re-election" motivation as the legislator's principal motivation.

VI THE PROPOSAL: DRIVEN BY ECONOMIC RATIONALISM?

A Objectives Underlying the Commercial Rooding Model

A law and economics analysis dictates that the institutions responsible for road provision are structured to achieve desired policy objectives. The proposal's stated objectives are to create a roading system that: is responsive to user demands; ensures that all users face the actual costs of their decisions; maximises national efficiency; does not distort road user decisions; permits choice and gives the correct incentives to manage and optimise risk.³⁰ These are subsets of the

26 William Niskanen *Bureaucracy and Representative Government* (Aldine, Chicago, 1971).

27 Daniel Farber and Philip Frickey "The Jurisprudence of Public Choice" (1987) 65 Tex L Rev 873 in Maxwell Stearns *Public Choice and Public Law* (Anderson Publishing Co, Cincinnati, 1997) 5 ["Jurisprudence of Public Choice"].

28 For further explanation, see Michael DeBow and Dwight Lee "Understanding (and Misunderstanding) Public Choice: A Response to Farber and Frickey" (1988) 66 Tex L Rev 993.

29 Richard Fenno "Congressmen in Committees" in "Jurisprudence of Public Choice" above n 27, 15.

30 Ministry of Transport "Road Reform - From the Minister's Desk" February 1998, 1.

overarching objective of establishing efficient road management governed by commercial structures.

1 Consistency with state sector reform

The fourth Labour Government's state sector reforms essentially comprised of the State-Owned Enterprises Act 1986, the State Sector Act 1988 and the Public Finance Act 1989. These embody the ideology that previously government-managed sectors or enterprises should be subject to market forces and must operate profitably and efficiently without protective state regulation. The proposal's objectives are clearly consistent with this model. The following explanation outlines how the proposal is designed to achieve "efficiency gains" in the context of road reform. The proposal focuses on the true costs of road use, who creates them, and whether they are imposed on the correct groups. The current system of road funding is only partially user pays. The anomaly is funding sourced through property rates. The proposal entails a transparent fully user pays system, removing the misconception that road use is currently "free". The current roading model promotes this misconception because no relationship exists between first, road users and road providers and second, between road charges and road use. Consistent with an efficiency rationale, the proposed model identifies users who impose the greatest costs upon the road network, for example peak-hour commuters or heavy vehicles, and alters funding relationships (charging) to reflect those costs. A closer relationship between the cost of road use and the payment for that use results. This identifies property rates as an inefficient and inequitable basis to fund roads. Infrequent road users derive little utility from the property rates imposed upon them. Removing rates from road funding ceases the cross-subsidisation of "high-cost" or heavy road users by infrequent road users. Altering these funding relationships is the primary mechanism for inducing efficiency gains through the commercial model.

Matching costs of use more closely with actual use, embodies law and economics theories that road users are utility maximising individuals, who will consume only those roading services that satisfy their utility function. This ability to maximise utility from road use relative to contributions towards road funding is available under the current model only to the lesser extent of the marginal cost of petrol consumption. This does not reflect the full cost of road use. The proposal creates a system where users face the true costs of their decisions and do not face funding mechanisms that distort those decisions.

Imposing a commercial objective is designed to ensure that road companies generate equivalent operating efficiency gains to those achieved by other state enterprises upon their commercialisation, such as Telecom, Post Bank and Electricorp.³¹ Requiring road companies to operate under commercial conditions is designed to generate investment efficiency gains. For example, the capacity to fund new infrastructure through borrowing removes the obstacle currently inhibiting roading construction projects, such as Wellington's proposed second motorway, through Transmission Gully. New infrastructure development will become responsive to road users' demands expressed through willingness to pay, rather than bureaucratic and political haggling. However, this enhanced investment efficiency is balanced against the proposal's objective of using the existing road network more efficiently, rather than constructing new roads.

2 Introducing efficiency into local government

Politics heavily influenced infrastructural decision-making at the turn of the century, and played a decreasing role in roading decisions until the National Road Act's requirement for "efficient" state highway management in 1953. Similarly, Transit's establishment in 1989 prevented politicians from producing "pork-barrel" benefits for their electorate. Transit "was required to make funding and other management decisions on the merits of particular cases, without direct political intervention".³²

Current local government legislation imposes no corresponding efficiency requirement upon territorial authorities by which to make local roading decisions. As territorial authorities are elected by their constituents, political incentives exist to procure certain roading projects within a district. Requiring local road decisions to be made according to commercial criteria precludes any such incentives. Therefore the proposal is a mechanism to introduce equivalent decision-making criteria between local road and state highway provision. Proving that politics still influences local roading decisions is difficult, but this argument is consistent with imposing a commercial structure upon local roads as well as state highways.

3 Scepticism surrounding efficiency gains

These efficiency gains sound simplistic. However many concepts discussed above represent long-term strategies, for example differential pricing is difficult to implement without

³¹ See New Zealand Business Roundtable *The Public Benefit of Private Ownership: The Case For Privatisation* (Wellington, June 1992) 5-7.

³² RAG report above n 1, 18.

electronic charging. Electronic charging is untested over roads other than motorways, and certainly not over an entire network. Therefore the anticipated improvements in responsiveness may not eventuate immediately. The short-term instrument choice simply reduces rates and increases fuel taxes. Fuel taxes are a poor proxy to regulate road use consumption, as vehicle use is inelastic to fuel prices.

Better Transport Better Roads quantifies the total anticipated efficiency gains between \$115 million and \$295 million.³³ To the writer's knowledge, no detailed financial breakdown of these gains has been released by the Ministry of Transport. Maintenance costs are the second largest efficiency saving, estimated between \$50 million and \$100 million. The origin of these gains is unclear, given that road maintenance is already outsourced to private contractors. Rural communities fear these savings are derived through reducing maintenance of rural roads. Further, efficiency gains have been stated to justify reform previously, for example in both health and telecommunications. Only the latter example was successful. The nature of the industry determines whether the gains will eventuate. This is explored in the roading context below.

B Roading as an Economic Good

The proposal assumes that market models can be applied to road provision. The following discussion evaluates this assumption. Government must ensure that it is not imposing a commercial model upon road provision "without having due regard as to whether this is appropriate given the underlying economics".³⁴

The road network exhibits both key characteristics of a public good: non-excludability and non-rivalry. Excluding motorways, which have limited access and exit points, it is currently technologically impractical to prevent licensed road users from using the road network as a whole. Further, one motorist's use does not preclude any other user, as all public goods experience congestion at high levels of use. Consequently, due to "the nature of production and supply, it is difficult or impossible to use the pricing mechanism to regulate supply and demand".³⁵ However where a private benefit exists which is separable from the public benefit, economics dictates that it be charged for. If not, these publicly provided private benefits are

33 *BTBR* above n 4, 56.

34 Grant Andrews and Paul Frater *Report to the New Zealand Automobile Association (Inc): Analysis of Proposed Roading Reforms* BERL, February 1998, 37 [*NZAA Analysis*].

35 *NZAA Analysis* above n 34, 7.

over-consumed. Hence the government is forced to ration their supply. This "rationing" already occurs through user charges and fuel taxes. This suggests that road use has a significant private benefit. However the non-excludable nature of a roading network makes measuring any identifiable private benefit difficult. Consequently, overseas jurisdictions have limited road commercialisation to motorways, rather than the entire network. Motorways exhibit the characteristics of public goods more weakly than rural and non-motorway urban roads.³⁶ Cabinet statements are unhelpful on this point. Cabinet "agreed in principle that there is a public benefit to society in retaining a comprehensive high quality road network" but then stated "and that, to the extent necessary, the cost of this public benefit should be met by all road users".³⁷ This merely merges the concepts of private and public benefit.

Tolls, congestion pricing, direct charging and road pricing through contractual arrangements with road companies, signal that the proposal treats roads as private goods, and that motorists can accurately be charged for their private benefits. This approach views roads individually and ignores their essential characteristic as a network. This network feature characterises roads as public goods. Significant conceptual uncertainty exists regarding the compatibility between road provision and market forces. This creates uncertainty for realising the efficiency gains discussed earlier. The proposal may be more about a particular economic philosophy than a practical response.

C Economic Rationalism and Institutional Design Features: Funding

1 The excise tax

The proposal establishes a more direct funding relationship between the amounts road users are charged and the quality and quantity of road services they receive. However the continued diversion of approximately \$660 million³⁸ of excise tax revenue annually into non-roading purposes, undermines this objective. Allocating excise revenue to non-road purposes means road users are not receiving services they are paying for, or alternatively are being forced to pay more than is economically necessary for the same service level. This represents a \$660 million distortion to the goal of achieving an efficient mechanism of road cost allocation. This distortion contradicts the Government's commitment to establishing a commercially

³⁶ Ministry of Transport Discussion Document *National Roading Account: Roading as an Economic Good* (Ministry of Transport, Wellington, 1995) (i) [*Roading as an Economic Good*].

³⁷ CAB (98) M 23/3, 2.

³⁸ Brian Gibbons "But How About a Fairer Price?" (March 1999) *Directions*, 4.

neutral model. Road users would cease to effectively subsidise non-road users if the Government found an equivalent revenue source elsewhere, such as general taxation. Politically, however, finding a sufficiently large alternative revenue source that is as easily collected may be difficult. Therefore although the continued "siphoning" distorts funding relationships, it is consistent with behaviour posited by public choice theory.

2 The funding structure

The proposed funding structure is conceptually similar to the contractually driven provider/purchaser splits adopted in other public sector reforms. The purchaser theoretically obtains the optimal value for money for services provided through a contracting system. This was supposedly possible in healthcare provision as alternative providers existed. However because only one local road company will exist in each roading region (Transit Limited cannot contract to provide local road services), Transfund Limited cannot obtain similar efficiency gains through a competitive contracting process. This potentially undermines any competitive efficiency gains arising from separating funding and providing bodies.

As a Crown entity, Transfund Limited would not be directly accountable to road users or territorial authorities. These criticisms result from introducing competitive mechanisms into a sector with which they may be incompatible.

D Road Delivery Structures

A law and economics approach suggests that further gains must be achievable through changing the governance structures or road providers, otherwise establishing company structures would be an irrational waste of resources and changes to funding relationships could occur within existing road provision structures.

The structural choices made regarding the delivery of roading services impact on how the system behaves for road users. Requiring road companies to operate as successful businesses is the obvious example. Unusually for commercial enterprises, the shareholding Ministers of Transit Limited or Transfund Limited can require payment of dividends and determine their amount.³⁹ Never before has New Zealand's road network been legally required to return a profit or declare dividends, although the current system operates at a surplus which is reinvested into capital works. The proposal is criticised on this basis, as profits - the current surplus - may be distributed to central or local government rather than being reinvested in

³⁹ Roads Bill cl 12.

roading. This further distorts the efficiency rationale of road users receiving the level of services they fund.

A rational utility maximising road company would extract the maximum profit possible from the institutional design within which it operates. The Bill requires that road companies operate as profitably and efficiently as comparable businesses that are not publicly owned. It is unclear what "comparable" means in a non-existent market. A road's rate of return should theoretically reflect the nature of the industry – low risk with predictable returns and costs. However the proposal creates entities which possess considerable market power, and which have incentives to generate returns higher than the industry's risk characteristics suggest.

E Monopoly Providers or Competitive Marketplace?

The proposal creates regional roading monopolies. Transit Limited and local road companies both operate in each roading region but provide essentially different products, meaning they compete against each other only to a limited extent. The Roothing Advisory Group report recognised roads' characteristic as natural monopolies means that competing roading networks are not a viable proposition.⁴⁰ Further, alternatives to road transport are limited, especially in rural areas. A small element of competition is possible through comparing local road companies' prices between regions.

Due to this natural monopoly characteristic, the proposal attempts to produce a competitive market at the purchasing level instead of the usual providing level. Road users have the ability to opt out of Transfund Limited's funding system and contract with road companies directly or through intermediaries. This is intended to ensure that Transfund Limited obtains the optimal level of services for road users. Theoretically this structure will keep road companies' charges "competitive". However, as Transfund Limited is ultimately forced to contract with the local road company, its bargaining position is undermined. The proposed competition is therefore artificial. The provider enjoys a dominant market position. This differs from other reforms such as healthcare, where more of a national market for services exists. Roothing is distinctly regional.

The economically rational outcome of monopoly supply is more restricted output and higher prices than in a truly competitive market. Rent-seeking is an inevitable consequence of managing a natural monopoly under a free market model. These effects may counterbalance any efficiency gains described earlier, unless these monopoly rents can be controlled.

⁴⁰ RAG report above n 1, 52.

The Bill contains several mechanisms to control these potential monopoly rents. The Bill provides for regulations which if promulgated, may specify principles that all road companies must "take into account" when setting prices.⁴¹ Secondly, pricing methodologies are subject to a disclosure regime to promote transparency.⁴² Thirdly, the High Court may resolve disputes over "...whether or not a specified road company could reasonably have set or agreed to any road price".⁴³ However, the Bill contains no explicit requirement that prices be "reasonable" and draft Road Price Regulations contain only indirect reference.⁴⁴ Lastly, *Better Transport Better Roads* states that "a public road company's returns should only increase through its undertaking new investments"⁴⁵ and that road price regulations would specify this. This would be a conclusive measure for controlling excessive prices at least in the short term, but unfortunately the draft Road Price Regulations do not contain such a restriction.

Heavy-handed regulation is possible. The Bill provides for periodic mandatory reviews to assess any abuse of market power, and to consider whether any road prices should be controlled under the Commerce Act 1986.⁴⁶ However reviewing competitive behaviour in this "market" against what would occur in a hypothetical "competitive" roading market is difficult. Further, price control is politically difficult, as recent experience in the electricity industry demonstrates. Ironically the more effective these regulatory mechanisms are, the more they undermine the premise of the commercial model. The light-handed regulation seems weak. Cabinet backed down over the Bill's requirement to "take into account" the pricing principles. The Cabinet Strategy Committee Memorandum stated that road companies "must comply"⁴⁷ with the pricing principles. The weaker phrase Cabinet adopted was "will have to be consistent with".⁴⁸ The Bill's "take into account" seems weaker still. No explanation for the difference is

41 Roads Bill cls 78(1), 79(1)(a).

42 Roads Bill cl 80(1)(d).

43 Roads Bill cl 83(2).

44 Draft Road Price Regulations 1999 reg 4(a): "A road price should not exceed the amount that present and future road users would be prepared to pay for obtaining the benefit of the relevant road service".

45 *BTBR* above n 4, 41.

46 Roads Bill cls 95, 96.

47 Office of the Minister of Transport "Memorandum to Cabinet Strategy Committee: Road Reform 6: Commercial Regulation" undated, para 2.4(d).

48 CAB (98) M 30/11, para e(iv).

given in publicly released documents. The Bill's approach relies on the "competitive" market, although the need for regulation itself acknowledges the market's artificiality. Adopting primarily light-handed regulation was a deliberate Cabinet policy.⁴⁹ Price control seems unlikely in reality, and this means that road companies may pursue profit maximising practises more aggressively.

A potential conflict exists between a profit motive and the socially desirable standard of road provision. A rational profit maximising road company will be unwilling to invest in either new routes or maintenance for economically unviable areas. Rural residents therefore oppose the profit objective. Both Cabinet decisions and the Bill require that the existing network be retained.⁵⁰ From a law and economics perspective, this is economically inefficient, but socially and politically essential. This necessitates substantial cross-subsidisation of non-economic roads within each local road company. Therefore rural residents should advocate fewer, larger road regions as larger companies will be financially better able to cross-subsidise uneconomic roads through economies of scale.

F Structural Distortions Within the Proposal

1 Potential conflicts of interest

Three distinct potential conflicts of interest may prevent the new road provision structure from achieving its potential efficiency gains. Further, they may potentially create political controversy due to road companies' public ownership.

Retaining public ownership of road companies and simultaneously extracting profits from road users is not inherently inconsistent, but does create a policy with dual objectives. Although territorial authorities must maximise investment returns as shareholders in the local road company, they have also repeatedly expressed their role as representing their communities to ensure roading standards are maintained in their constituency.⁵¹ While the reform proposes to derive managerial efficiencies through introducing private sector management, these may not be optimised where territorial authorities have electorally driven responsibilities to their constituents. The same arguments apply to central government but are

49 CAB (98) M 30/11, para a.

50 Roads Bill cl 179, sch 2,3; Cabinet Paper CAB (98) M 23/4 para d(vi).

51 *Streets Ahead* above n 2, 4.

likely to be more intense for territorial authorities because roading is such a major focus of territorial authorities' operations.

Transfund Limited's profit directive is questionable. Transfund Limited's ability to return profits and dividends while simultaneously negotiating and purchasing services for road users at "optimal" prices seems anomalous. Further still, Transfund Limited is responsible for recommending excise tax rates to the Minister of Transport, thereby acquiring the ability to determine its own revenue base.

The proposal is premised partly on reducing congestion on state highways. Ironically Transit Limited, as a rational profit maximiser has the incentive to increase traffic volumes at peak times to generate higher revenue through tolls or congestion pricing. This incentive is inconsistent with reducing congestion, even though *Better Transport Better Roads* anticipates significant efficiency gains through reducing congestion costs.

2 *Agency costs*

From a law and economics perspective, the reform proposal is only economically rational if it increases the net efficiency of road provision. The analysis so far has identified variables each way. Analysing agency and transaction costs under the proposed structure relative to the existing framework further assists this purpose. The smaller these costs the more efficient the provision structure.

Theoretically an agent will always act to maximise their self-interest if the entity's structure allows it. High agency costs reduce an entity's ability to realise its optimal economic performance. The establishment of road companies separates the management and ownership roles of road provision. State highway management and ownership is already separate, through Transit's Crown entity status. The creation of Transit Limited is unlikely to dramatically increase agency costs from their current levels. However, separate management and ownership will be new to local road provision. Therefore agency costs of local roads are currently minimal. Separating these roles will introduce agency costs for territorial authorities, because the proposed structure creates the diverging incentives of shareholder and community representatives discussed above. Consequently, territorial authorities may have to invest resources in monitoring any incidences or effects of these diverging incentives. The Bill addresses these costs through similar methods to the State-Owned Enterprises Act by requiring for example, public disclosure of statements of intent and by imposing reporting requirements upon local road companies. The effectiveness of these reporting requirements for accountability purposes remains uncertain, as they are prepared by the local road company.

Agency costs are typically controlled "by a series of market and organisational constraints which arise because of the transferability of ownership in private sector companies".⁵² This mechanism will not be possible in the case of public road companies, because their shares are not transferable. Other techniques to align the incentives of agents and principals, such as performance-based remuneration, will be available under the proposal's commercial management structures. Just how extensive these new agency costs will be depends upon how significantly the local road companies' incentives diverge from the territorial authorities' objectives in practice.

3 *Transaction and administrative costs*

Transaction costs are "obstacles to market exchange that make the process of transacting more difficult".⁵³ These will increase relative to the current system. New management and funding mechanisms such as the negotiation of Corridor Management Agreements and contracts between road companies and groups opting to contract directly, are expected to cost \$10 million to \$15 million to develop, and \$1 million to \$2 million to maintain annually.⁵⁴ These costs have few equivalents under the current model. Compliance costs from electronic or direct charging could potentially be large if bureaucracies are required to process nationwide billing and payment systems. Transaction costs are currently relatively low as fuel taxes are easily collected. This point has been acknowledged by the Government, with Cabinet recommending that "to minimise the transaction costs of change, the initial model should be based on the continued reliance on conventional charging mechanisms".⁵⁵

Ongoing administrative costs of the current model are high because 75 separate entities administer roading. The proposal reduces this to between five and nine. Centralising management decisions should therefore significantly reduce administration costs over the long term. The Bill accounts for these costs given that "the minimisation of administration and compliance costs of local road companies"⁵⁶ is a factor in determining the final number of

52 R S Deane "Reflections on Privatisation" in *United Kingdom/New Zealand Committee Conference on Economic and Social Reform* (United Kingdom, September 1989) 10.

53 *Roading as an Economic Good* above n 36, 6.

54 Office of the Minister of Transport Memorandum to Cabinet Strategy Committee "Road Reform 14: Impacts" undated, para 6.8.5 ["Impacts"].

55 CAB (98) M 23/4, para c(ii).

56 Roads Bill cl 295(2)(e).

companies. Administrative costs of initiating the reforms are essentially one-off. Restructuring Transit Limited and Transfund Limited for example is expected to cost between \$12 million and \$15 million.⁵⁷

VII AN INTEREST GROUP ACCOUNT OF THE REFORM PROPOSAL USING PUBLIC CHOICE THEORY

The law and economics analysis identified that establishing commercial management criteria and deriving efficiency gains are core motivations for reform, although significant concerns exist regarding whether the proposal can actually deliver them. The following section investigates whether the reforms are motivated by efficiency gains alone. Public choice theory suggests that motivations other than purely efficiency gains are driving the reforms. Actors are still assumed to be rational utility maximisers, but the underlying rationale is personal self-interest rather than systemic economic gains.

A Interest Group Analysis: Disaffected Groups or Rent-Seekers?

Viewing legislation as an economic model, interest groups form the "demand function", and legislators comprise the "supply function". Identifying whether the proposal's design specifically advantages particular interest groups helps analyse whether any interest groups or rent-seekers have successfully captured the legislative process.

Many rent-seeking groups have an interest in road reform. The most significant interest groups are territorial authorities, rural communities, commercial transport operators and road users as represented by collective action groups, such as the Automobile Association. *Better Transport Better Roads* received 189 submissions specifically from interest groups. While submissions are by nature reactive to a consultation document and may not constitute the lobbying by interest groups as anticipated by public choice theory, they still attempt to influence policy content.

1 How the RAG report differs from *Better Transport Better Roads* and the *Roads Bill 1998*

Comparing the RAG report to *Better Transport Better Roads* highlights changes in policy. Although both documents adopt a commercial model, Schlozman and Tierney have demonstrated that an interest group's most significant influence lies in the details of

57 "Impacts" above n 54, para 6.8.7.

legislation.⁵⁸ The Roothing Advisory Group recommended that only one entity jointly owned by the Crown and territorial authorities manage both state highways and local roads within a region. The Bill, however, creates separate companies for local road and state highway management. *Better Transport Better Roads* does not explain the difference. Territorial authorities favour the former option of including the more profitable state highways in their companies.⁵⁹ Local government has not successfully influenced the Crown here. The change favours the Crown's financial self-interest.

The Roothing Advisory Group recommended that road companies have separate governance and equity shares.⁶⁰ It is unclear whether the proposal adopts this. *Better Transport Better Roads* states that "[t]he Crown would be the *only* permitted shareholder in Transit".⁶¹ However, under the Bill the requirement that Ministers hold all the shares does not apply to shares without voting rights,⁶² implying that privately owned equity-only shares are permissible. Either view is significant. The former view prohibiting non-public ownership indicates potential interest group capture. The public sensitivity of non-public ownership renders the Crown susceptible to lobbying. Lobby groups such as "Public Access New Zealand" who oppose the commercialisation agenda may have influenced any reversal from the Roothing Advisory Group position. Alternatively, favouring the Roads Bill interpretation discounts interest group capture theories, but is significant from a public choice perspective. The inconsistency between the consultation document and the Bill demonstrates the Government's awareness of community sensitivity to non-public ownership. The Government is communicating inconsistent information to the public, few of whom will ever see the Bill to note the inconsistency. Public awareness of the difference may be electorally damaging.

Other divergences between the documents do not indicate interest group capture, because they all favour the Crown. The requirement to consult appropriate road users before setting or changing prices has been dropped since the *RAG report*,⁶³ and introducing specific tolls is no

58 Kay Schlozman, John Tierney "Organised Interests and American Democracy" (1986) in "Jurisprudence of Public Choice" above n 27, 13 ["Organised Interests"].

59 *Streets Ahead* above n 2, 38.

60 *RAG report* above n 1, 7.

61 *BTBR* above n 4, 17 (emphasis added).

62 Roads Bill cl 11(2)(b).

63 *RAG report* above n 1, 8.

longer explicitly subject to a statutory consultation process.⁶⁴ These reversals are inconsistent with interest group capture. Logically, interest groups would want the Roading Advisory Group's propositions retained.

2 *Road users*

Cabinet papers identify relative "winners" and "losers" from the proposal. There is no attempt to gloss over those adversely affected. Cabinet papers state that road users "will pay more for their road use", but benefit through "the opportunity to gain greater control over the roading costs they incur and, particularly, the way they pay".⁶⁵ This is inaccurate if property rates do not fall correspondingly. The Roads Bill does not compel this reduction. Territorial authorities have wide discretion to set rating levels under the Rating Powers Act 1988 and the Local Government Act 1974. The Court of Appeal has held that elected representatives decide rating matters, provided they follow the required statutory processes.⁶⁶

If territorial authorities can find a legitimate alternative justification for the status quo level, no legal requirement to reduce rates exists. Theoretically, electoral sanctions exist if voters consider that their elected local representatives have not passed the benefits of road management changes on to them. Ministry of Transport representatives have stated that "the Auditor-General will audit each local authority to see what happens. If rates are not reduced but should have been, questions would be asked".⁶⁷ Further, Maurice Williamson, the Minister of Transport, has expressed willingness to require reductions in rates through legislation if necessary. This would be politically difficult. It would fundamentally alter the relationship between central and local government.

The Roads Bill's failure to definitively act on behalf of road users to both instigate mandatory reductions in property rates and to reallocate the non-roading component of excise tax to roading purposes, suggests that road user interest groups have not successfully captured the legislative process.

64 *RAG report* above n 1, 10; Roads Bill cls 61 - 65.

65 "Impacts" above n 54, para 9.1.

66 *Wellington City Council v Woolworths New Zealand Limited* (No 2) [1996] 2 NZLR 537, 546 (CA).

67 *Te Puni Kokiri Summary of Issues Raised Verbally: Better Transport Better Roads Hui* February/March 1999, 5.

3 *Territorial authorities*

The proposal affects territorial authorities on two core grounds. First, assuming that roading-related rates are reduced following intense community pressure, territorial authorities' income will fall nationally by an estimated \$288 million.⁶⁸ Although their expenditure will fall correspondingly, making net fiscal impacts minor, rates comprise a substantial part of many territorial authorities' revenue. This potentially "compromise[s] the viability of some rural councils, some of which are dependant on roading for 65-70 per cent of their work. Rural amalgamations would result".⁶⁹ Such amalgamations may threaten the adequate representation of constituents. The Ministry of Transport's reform proposal effectively restructures local government from a "service provider" to a role centred on governance. Central government is imposing its economic ideology upon local government.

Secondly, territorial authorities would suffer an externally imposed loss of managerial control of their largest asset. Road companies are to manage local roads "without interference" from the local territorial authority.⁷⁰ Territorial authorities retain management control only to the extent of their shareholding in the local road company.⁷¹ As shares in road companies will be allocated according to the value of the roads comprising that company, smaller territorial authorities have smaller voting influence and therefore reduced control over roads in their constituency. Smaller territorial authorities effectively lose control over an asset, which in practice, if not in theory, will significantly impact their own re-election prospects. Any community dissatisfaction with roading outcomes is likely to remain directed at territorial authorities, in the short term at least. The scenario is more serious where fewer road companies are established, as greater numbers of shareholders proportionally reduce the voting power of individual territorial authorities. Consequently, having a lesser number of road companies reduces the accountability of each road company to the communities which comprise that company.

As the proposal transfers significant power away from territorial authorities, it is difficult to conclude that local government has captured the reform process. Territorial authorities are most likely to succeed in arguing for more but smaller local road companies. The

68 "Road Reform" above n 12, 6.

69 "Road Reform" above n 12, 7.

70 Roads Bill cl 213.

71 For example, by appointing directors, or by modifying the company's statement of intent.

Establishment Commission, an independent body set up for the purpose of determining the number of road companies, makes this decision according to prescribed criteria. The criteria are primarily economic, but the "interests of the community" are included.⁷²

4 *Rural communities*

Rural communities have specific interests in road reform. Rural residents fear formal road closure or in-substance closure through reduced maintenance of economically unviable roads. Cabinet has acknowledged that isolated area residents will pay relatively more and/or experience a reduction in services,⁷³ but has stated that "the geographic extent and physical standards of the current New Zealand road network are to be retained at the expense of road users unless there is user and community support for modification..."⁷⁴ The Bill contains specific protection against rural road closures, and road safety provisions prevent excessive reductions in road quality. However, the statement "...at the expense of road users..." is potentially ambiguous. Exactly which road users will bear the expense is left open. This may refer to Cabinet's statement that rural residents will "pay relatively more".

Cabinet's position highlights the tension between economic rationalism and public choice theory. Establishing road companies to act rationally as profit driven entities would result in them closing unprofitable rural roads, however politicians acting in a rationally self-interested manner would suffer electorally if this were permitted. Whether rural residents have captured the legislative process in the public choice sense is unclear. Their views have clearly influenced Cabinet policy, although the negative effects upon rural groups are still potentially significant.

The proposal creates diverging incentives for rural communities and territorial authorities. Rural communities will favour having fewer, bigger road companies in order to cross-subsidise their road network more effectively and as seen above, territorial authorities favour the opposite. Rural territorial authorities therefore face conflicting incentives. The Establishment Commission will face competing submissions in determining this issue. Examining whether the reasons for the final decision clearly favour the interests of either group may prove illustrative.

72 Roads Bill cl 295(2)(f).

73 "Impacts" above n 54, para 9.2.

74 Cabinet Paper CAB (98) M 23/4 para d(vi).

5 *Commercial transport operators and other manufacturing groups*

Road reform directly impacts upon commercial transport operators. These groups benefit little through rating reductions and are faced with increased fuel taxes or direct charging in the future. Therefore they have an active interest in influencing the proposed structures away from an explicit commercial model. Their self-interest lies in maintaining the subsidy they currently receive from ratepayers.

Submissions responding to *Better Transport Better Roads* do not support contentions of rent-seeking behaviour by such groups. The Manufacturers Federation is "supportive of the broad concepts of reform"⁷⁵ stating that reforming road funding and administration will "provide significant gains for road users and the wider economy, and would bring an improvement in the efficiency of the commercial transport sector".⁷⁶ The Bus & Coach Association and Stagecoach New Zealand express similar views.⁷⁷

B *Does Evidence of Capture Exist?*

Whether particular groups have successfully captured the reform process is a difficult assessment. To an extent it depends upon decisions yet to be made, such as the number of road companies. Some influence must have occurred, and still will occur, otherwise public consultation is illusory. The conclusion probably depends upon whether public choice theory distinguishes between influence and capture. No interest group appears to have successfully captured the reform process in the more pessimistic public choice sense, as all groups face potentially substantial negative effects. Schlozman and Tierney concluded that interest groups are most effective when they are small in size, have narrowly defined goals and focus on low-visibility issues.⁷⁸ This may explain the apparent ineffectiveness of the groups above. None of the groups analysed above fit well with these criteria, especially where they seek to alter fundamental features of the commercial structure.

75 New Zealand Manufacturers Federation *Better Transport Better Roads* (submission to Ministry of Transport, April 1999) s 8.2 ["Manufacturers Federation submission"].

76 "Manufacturers Federation submission" above n 75, s 8.2.

77 Bus & Coach Association (NZ) Inc *Better Transport Better Roads: A Response from the Bus & Coach Association (NZ) Inc* (submission to Ministry of Transport, April 1999) 2; Stagecoach New Zealand *Submission From Stagecoach New Zealand* (submission to Ministry of Transport, April 1999) 2.

78 "Organised Interests" above n 54, 14.

Examining changes to the Bill following submissions made under *Better Transport Better Roads* will better illustrate whether either capture or influence has occurred. Any changes may highlight sensitive areas over which the groups above or the submitters treated as a whole have exerted influence. Some changes in detail may even indicate influence by smaller interest groups not considered above.

VIII A POLITICAL ACCOUNT OF THE REFORM PROPOSAL USING PUBLIC CHOICE THEORY

The inability to isolate any definite interest group capture indicates that the proposal is driven either by bureaucrat or legislator self-interest or less cynically, by the efficiency rationale analysed previously. This section examines the former alternatives.

A Bureaucratic Self-interest

Before asserting that the proposal is driven by central government self-interest, the main proponents of reform must be identified. Assessing this is complicated because reform began almost five years ago, accompanied by changes in Ministry of Transport personnel, politicians and three (National) Ministers of Transport. While it is impossible to ascertain this definitively without inside information, senior officials and policy analysts at the Ministry of Transport do have sufficient self-interested incentives to drive such reform. These include departmental budget increases and increased job security by making themselves an indispensable part of a lengthy reform process. The Ministry of Transport has received \$1,181,000 and \$485,000 of additional funding from Vote: Transport in the 1998/1999 and 1999/2000 financial years respectively.⁷⁹ With this funding the Ministry has established the additional output class of "Road Management Policy" to explore policy and implementation issues specifically dedicated to the proposal. This is consistent with Niskanen's predictions of bureaucrat's behaviour under public choice theory, and illustrates how agency capture may occur.

B Governmental Self-interest

The Government's official rationale driving the proposal of increased road management efficiency, represents indirect self-interest only. Electoral benefits occur only indirectly through improvements to the economy and the road network as a whole. All government policies theoretically share this objective. Part VI of this article analysed the proposal with the

⁷⁹ Letter from Ministry of Transport dated 7 September 1999, responding to Official Information Act request.

assumption that legislators select institutional designs to maximise the wealth and efficiency of state assets. This section casts doubt upon that assumption.

1 Accountability and ministerial responsibility

This section addresses constitutional accountability. The proposal dislocates road provision from central and local government. Whether this distancing reduces the responsibility and accountability of "the state" or elected representatives for road provision, can be evaluated by comparing the proposed structure against current ones.

(a) State highways

As Transit Limited and Transit are both Crown entities, they are subject to identical reporting requirements under the Public Finance Act 1989. Road companies are subject to accountability requirements that are similar to those imposed upon state-owned enterprises, as well as additional company law obligations. These latter mechanisms are not imposed upon Transit. *Better Transport Better Roads* states that "much more detailed information on the financial and other aspects of the performance of these entities, and of their plans, would be available for public scrutiny and comment than currently exists".⁸⁰ Therefore the proposal does not diminish formal accountability requirements.

These accountabilities may be distinguished from ministerial responsibility. Transit's Crown entity status means that no direct ministerial responsibility currently exists regarding state highway provision. However, Transit reports to and has a performance agreement with the Minister of Transport.⁸¹ The shareholding Ministers of Transit Limited will be responsible to the House of Representatives, and the explicit profit objective replaces the performance agreement. Transit's Crown entity status means that Ministers, although not responsible for direct provision, are responsible for policy. Imposing a commercial structure similar to the state-owned enterprise model does not alter this as "[m]inisters continue to be responsible, but in a different way. They will be responsible for policy".⁸²

80 *BTBR* above n 4, 40.

81 Transit Act 1989 s 4(5).

82 (30 September 1986) 476 NZPD 4723.

(b) Local roads

Constitutional accountability regarding local roads provision will change. Territorial authorities, being elected bodies under the Local Government Act 1974, are currently not directly responsible to a Minister nor consequently to Parliament. Their constitutional accountability lies in local body elections. The Roads Bill theoretically eliminates this mechanism. Territorial authorities should be judged by their electorate over roading matters to a much lesser extent. The Bill replaces this constitutional accountability mechanism with the weaker requirement that local road companies' statements of intent must be made public.⁸³ The rationale appears to be to introduce consistency with Transit Limited, whose statement of intent is an important element of its constitutional accountability. This change introduces consistent accountability structures governing all roads.

(c) Roads generally

Subjecting all public road companies to both the Ombudsmen Act 1975 and the Official Information Act 1982 reinforces the conclusions above.⁸⁴ Roads currently managed by Transit and local authorities are also subject to these statutes.⁸⁵ These two statutes are important constitutional accountability mechanisms and their continued application indicates that state sector principles of transparency are being maintained. Further, as road companies remain publicly owned their actions will, like Transit and territorial authorities, be subject to judicial review even though they are private law bodies.⁸⁶

Therefore it is inaccurate to argue that central government is reducing accountability mechanisms for road provision.

2 Financial self-interest

Intuitively, financial benefits to central government could explain the Government's desire for reform. However, Cabinet agreed that "the overall package of decisions on roading reform [will] be designed to ensure that it has a broadly neutral net fiscal impact".⁸⁷ This part of the

83 Roads Bill cl 28(1).

84 Roads Bill sch 7.

85 Ombudsmen Act 1975 sch 1, parts II and III.

86 Judicature Amendment Act 1972 ss 3, 4; *Mercury Energy Ltd v Electricity Corporation of New Zealand Ltd* [1994] 2 NZLR 285 (PC).

87 CAB (98) M 23/4 para p.

article questions the Government's commitment to fiscal neutrality and demonstrates how the Crown benefits financially from the proposal's current structure.

Central government does not fund roading through general taxation, so corporatisation does not generate expenditure savings. Road companies will be tax-paying entities to maintain commercial discipline. The Roading Advisory Group recognised that this delivers an automatic and non-transparent benefit to the Crown, and to offset the additional revenue, the Government should make a fiscally neutral reduction in other tax revenue such as excise tax.⁸⁸ Despite Cabinet's statement, neither *Better Transport Better Roads* nor the Bill contains assurances of reduced excise tax or of fiscal neutrality generally. Failure by central government to ensure fiscal neutrality would emphasise its use of road reform as a revenue generating exercise. Public choice theory suggests that fiscal neutrality will only occur if central government cannot avoid public criticism for retaining the additional income. Politicians' incentives are to retain the additional revenue for use in election years in vote-sensitive portfolios.

The proposal represents a backdoor for the Crown to acquire additional assets. The Crown Law Office has advised that the Crown owns all motorways and state highways in rural areas but territorial authorities own state highways in urban areas, although the issue is "extremely complex".⁸⁹ This advice did not prevent Cabinet from agreeing that all state highways be vested in the Crown.⁹⁰ Cabinet explicitly noted that this was likely to be opposed by local government.⁹¹ The Bill explicitly effects this "seizure",⁹² vesting these assets in Transit Limited.

3 *Re-election implications*

As 1999 was an election year, public choice theory suggests that the (then National) Government should be promoting this policy as being in voter's economic self-interest, or at least not sheltering it from public debate. This part examines the proposal's likely impact on the Government's electoral success and therefore analyses the proposal's consistency with public choice theory.

88 *RAG report* above n 1, 36.

89 CAB (98) M 43/12, paras 3e, 3f.

90 CAB (98) M 28/13, para r.

91 CAB (98) M 43/12, para 3g.

92 Roads Bill cls 279, 280.

(a) Is roading a "vote-winner"?

Major infrastructural reforms are rarely vote-winners. Further, Vote: Transport and road provision have not been electorally sensitive recently in the same way as health or social welfare. Public choice theory suggests that the utility maximising politician is unlikely to invest effort in portfolios that are ineffective vote generators, especially as road provision is now a less political area than it has been historically.

No previous New Zealand Government has attempted to generate a profit from its entire roading network. If road companies are profitable, claims of monopoly abuse seem inevitable. Including the "social responsibility" clause serves the Government's self-interest, as otherwise criticism of profit as the principal objective would be more severe. However, if the companies are unprofitable the reforms will be criticised for failing to deliver efficiency gains, like the health reforms of 1991 which were promoted upon the same basis. Including a profit motive creates a political "no-win" scenario for central government.

The proposal's implications for continued public rights of access to roads are socially controversial. Cabinet agreed "that the common law rights [of passage] in respect of public highways not be extinguished".⁹³ *Better Transport Better Roads* states that "existing rights of public use will remain unchanged". The Bill casts doubt on this position. Clause 151 provides that "a road service provider...may exercise any powers...in relation to any road controlled by it despite any rights in relation to roads applicable under any rule of common law". "Any powers" includes restricting the use of roads.⁹⁴ The prospect of reduced public access was "the principal concern" of the Christchurch City Council who initiated litigation to halt the reforms.⁹⁵ Although unsuccessful, this litigation highlights that even the prospect of reduced public access would be electorally unpopular.

The media will portray the proposal's more controversial aspects to the electorate. If central government wants these reforms to constitute "vote-winners" as public choice theory suggests, major adjustments are required. These include allowing tolls only for the construction of specific infrastructure, ceasing to divert excise tax into non-road purposes, removing or tempering the profit and dividend requirements, ensuring that a high proportion of profits are

93 CAB (98) M 30/10, para e.

94 Roads Bill cl 153(2).

95 *Christchurch City Council v Attorney-General* (4 September 1998) unreported, High Court, Wellington Registry, CP76/98, 5.

reinvested in roads and not distributed as dividends, and possibly entrenching the public ownership provisions. Without such changes it is unlikely that the electorate will view the proposal positively, and certainly will not see that it is in their economic self-interest. However, effecting even some of these changes undermines the proposal's commercial management thrust.

(b) The Government's election stance over road reform

The National Government of the time stated that it would not proceed with road reform until after the November 1999 election.⁹⁶ The reason given was that insufficient time remained to pass the necessary legislation. Arguably, the Government was attempting to deflect public attention away from the proposal. The Government stated that it was not shielding the proposal from electoral scrutiny, but was simply unwilling to campaign on incomplete policy and that further consultation was required. Although this seems accurate, the alternative argument is equally compelling. The Government, by necessity, included the proposal in its election manifesto. The proposal's controversial aspects outlined previously, made it an easy target in election year. Therefore, from an electioneering perspective the proposal seems inconsistent with public choice theory. However, little political capital was made from road reform over the election campaign. This may simply illustrate the theory's limited application.

IX CONCLUSIONS

Public law can no longer ignore the constitutional implications of economic policy. The institutional design of proposed reform structures determine an industry's characteristics and the incentives facing decision-makers at a practical level. Roading has traditionally been influenced by politics, especially state highway provision. This influence has declined gradually as "efficiency" has become the decision-making criteria for state highway provision. The proposal introduces "efficiency" criteria into local road provision thereby making it consistent with state highway provision. This is consistent with the proposal's explicit goal of increasing the efficiency of road provision.

From a law and economics perspective the design structure carries the necessary incentives to deliver efficiency gains by realigning road funding structures to establish improved relationships between road use and the costs of that use. This removes the current distortions in road use decisions. However, the proposed structure of the providing institutions raises

⁹⁶ Prime Minister Jenny Shipley, Newstalk ZB Paul Holmes Show, 5 July 1999.

serious concerns. Some aspects of the proposal's design may detract significantly from the efficiency gains anticipated, assuming that road companies behave economically rationally.

Any efficiency gains may be diluted by potential increases in agency and transaction costs. In the long-term, agency costs, transaction costs and compliance costs will rise relative to the current roading model. Administrative costs should fall. Quantitatively, the net effects are difficult to measure given the inherent uncertainty in such costs. Whether the proposal will ultimately deliver net efficiency gains overall is unclear. Some matters will not be evident until the model is actually implemented, for instance the final number of local road companies and whether local authorities reduce property rates.

Analysing the proposal through public choice theory determined that it is primarily driven purely by efficiency motivations. No single interest group has conclusively captured the reform process. The proposal's likely effects do not overtly favour any single interest group. Amendments to the Bill following the *Better Transport Better Roads* consultation process may enlighten this analysis, although comparing the consultation documents to date does not suggest interest group capture.

Bureaucrats have sufficient incentives to drive the proposal, but without inside information the only firm conclusion possible is that their incentives are consistent with public choice theory. Central government potentially derives significant financial gains under the proposal. However, in general the proposal does not indicate significant self-interested behaviour by legislators. There seems no obvious attempt to reduce political accountability for road provision over the current model. The probable controversy over the proposal's delivery structures and profit orientation is inconsistent with a pure re-election motivation. Overall the proposal is driven by the ideology of market efficiency, although the analysis shows these efficiencies may be overstated. The proposal is not a convincing example of public choice theory.

