

LOCAL GOVERNMENT BUSINESS FORUM

27 March 2015

Local Government Funding Review
Local Government New Zealand
PO Box 1214
WELLINGTON 6140
By email: fundingreview@lgnz.co.nz

SUBMISSION ON LOCAL GOVERNMENT FUNDING REVIEW

1. INTRODUCTION

- 1.1 The Local Government Business Forum ('the Forum') welcomes the opportunity to provide this submission to Local Government New Zealand's Local Government Funding Review.
- 1.2 The Forum comprises organisations that have a vital interest in the activities of local government. Its members include BusinessNZ, the Electricity Networks Association, Federated Farmers of NZ, NZ Initiative, NZ Chambers of Commerce, the NZ Property Council, and Retail NZ. The Forum was established in 1994 to promote greater efficiency in local government and to contribute to the debate on policy issues affecting it.
- 1.3 Some individual members of the Forum will be making their own submissions on the discussion paper and we acknowledge their submissions.

2. SUMMARY OF RECOMMENDATIONS

- 2.1 The Forum recommends that the LGNZ Funding Review should:
 - (a) Consider how the role of local government impacts upon councils' expenditure and revenue requirements.
 - (b) Consider funding options that would cater for the diversity of the local government sector.
 - (c) Consider how to advance the two partnership principles set out in Chapter 4 of the discussion paper.
 - (d) Encourage greater use of prices to fund local government activities.
 - (e) Encourage the use of effective financing options.
 - (f) Encourage the use of regional funding and management and/or corporatised public utility models.

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- (g) Promote the following improvements to the rating system:
 - Targeted rates should be used to raise revenue earmarked for a specific function and benefiting subsets of ratepayers.
 - Business differential rates should be phased out and their use restricted to the application of a lower rate to ratepayers in a defined area where clearly specified services available to ratepayers in general are not available to those in the affected area.
 - The 30 percent legislative cap on uniform annual charges should be abolished.
 - Ratepayers should be provided with itemised rates assessments, which show how much they are paying for council activities.
 - Statutory rating exemptions should be abolished.
- (h) Carefully consider any proposals for new tax bases for local government, with particular attention to the incentives they would provide and the costs of administration and compliance.
- (i) Reject the idea of taking GST off rates.
- (j) Carefully consider ideas to assist vulnerable councils and communities with particular attention to criteria for assistance.

3. GENERAL COMMENTS

- 3.1 The Forum agrees that the funding of local government needs to be improved to put it on a more sustainable footing and to improve the efficiency and effectiveness of local government, as well as its affordability to residents and businesses.
- 3.2 Improved funding arrangements are particularly important for providing the right incentives to communities, councils, and central government.
 - Communities: If people are paying appropriately for the services they get from councils then they are more likely to consume the right amount of those services and hold their council to account for the costs and as a result for the desired level of service.
 - Councils: Rates are simply a mechanism to allocate a funding burden which is determined by a council's spending plans. Rates are not a buoyant revenue source and although this provides councils with revenue stability, rates do not give councils much incentive to control their spending during downturns or to be more encouraging of economic growth or development.
 - Central government: There is currently little incentive for central government to take any consideration of the costs its policy and regulation impose on councils in the national interest.
- 3.3 The discussion paper has identified four key themes, with which the Forum generally agrees:
 1. *A need to develop an effective partnership between local and central government around shared goals and strategies for the activities pursued by local government, and how those activities can be prudently funded over time.* The Forum agrees that it is very important for local and central government to work more effectively together, and we note that the Productivity Commission's Inquiry

into Local Government Regulation identified major shortcomings in this respect and made a similar recommendation.

2. *Before pursuing fundamental changes to the funding regime, the local government sector needs to assure communities that it is open to innovation in service delivery so as to build confidence over time in the quality of the spending decision it makes.* The Forum considers that councils definitely need to improve the quality of their decisions and demonstrate commitment to efficiency. Without this commitment, communities and central government are unlikely to be receptive to changes in funding arrangements.
3. *The diverse nature of New Zealand's communities raises different challenges.* The Forum agrees that different councils face different challenges that require different of solutions rather than a 'one-size-fits-all' approach. However, 'diversity' and associated challenges should not be used as an excuse for poor practice or performance.
4. *An appropriate funding mix that includes greater use of tools available to local government, in particular the use of prices (user charges) where appropriate and a prudent use of debt, especially for assets that have an inter-generational benefit.* The Forum agrees that funding solutions should include making better use of existing tools, especially pricing, and prudent use of debt, before new tools are made available.

4. LOCAL GOVERNMENT FUNCTIONS, REVENUE AND EXPENDITURE

- 4.1 The Forum notes the information contained in Chapter 2 on local government functions, revenue and expenditure. In the context of funding, function (or role) is very important, because what councils choose to do (and not to do) will have a big influence on their spending and revenue. With regard to role, the Forum's longstanding position is that councils should focus on core activities, such as provision of local infrastructure (especially roading and transport and the 'three waters'), local public services, and local regulation, and doing them well. There is, as the paper notes, wide variation among councils as to the breadth of activities, with rural councils generally more focused on the 'basics' while large urban councils are generally spending much higher proportions on activities like culture, recreation and sport, community development and economic development, without in our view sufficient regard for the efficiency of these expenditures or even whether the council is best placed to deliver these outcomes.
- 4.2 The discussion paper does not make any suggestions on what should be the appropriate roles and functions of local government. This omission is not surprising but the Forum submits that the sector as a whole needs to think about the best roles for local government and individual councils need to carefully assess their activities and services to ensure that they are efficient and effective, with existing funding tools appropriately used. Otherwise we consider it unlikely that ratepayers, communities, or central government would buy-in to changes to funding arrangements. A 2007 publication by the Forum provides a discussion on the roles and responsibilities of local government¹.

¹ *Democracy and Performance, a Manifesto for Local Government*, Local Government Forum, February 2007, see <http://www.localgovtforum.org.nz/Documents/Documents-and-Reports/Democracy-and-Performance--A-MANIFESTO-FOR-LOCAL-.aspx>

- 4.3 **Recommendation: the Forum recommends that the LGNZ Funding Review should consider how the role of local government impacts upon councils' expenditure and revenue requirements.**

5. DIVERSITY OF LOCAL GOVERNMENT

- 5.1 The Forum agrees that there is great diversity among New Zealand's 78 councils, which results in councils facing a wide range of issues and challenges, including for funding. This diversity requires different sets of solutions rather than a 'one-size-fits-all' approach.
- 5.2 In the past 'diversity' and its associated challenges have been used by the local government sector to resist benchmarking or comparisons of councils and sometimes to excuse variable practice or performance. In more recent times, the Forum has detected a change in attitude, which is welcomed, but resistance and excuses still arise on occasion.
- 5.3 Targeted assistance may well be required in some cases, but as stated above councils will first need to carefully assess their activities and services to ensure that they are efficient and effective, with existing funding tools appropriately used. Otherwise we consider it unlikely that communities or central government would buy-in to changes to funding arrangements.
- 5.4 **Recommendation: the Forum recommends that the LGNZ Funding Review should consider funding options that would cater for the diversity of the local government sector**

6. A PARTNERSHIP APPROACH

- 6.1 The Forum agrees that there has been an increasing cost burden placed on local government by central government. This was confirmed by the Productivity Commission's findings from its 2012-13 Inquiry into Local Government Regulatory Performance, which also observed that there is a lack of understanding about local government among central government policy-makers. This is disappointing but not surprising given the lack of incentives – political as well as financial – that central government policy-makers have when considering the effects of policy and legislation on local government.
- 6.2 The Productivity Commission recommended more of a partnership approach between central and local government, but the Government did not take this on board in any meaningful manner when it announced its response to the Inquiry. The Forum agrees that a partnership approach is needed and we agree with the two principles suggested by the discussion paper:
- *Local government will be consulted on all proposals with cost implications for local government, and the cost benefit analysis for these proposals will include costs and benefits for local government.*
 - *Where a policy is intended to generate national as well as local benefits (or generates only national benefits and no local benefits) central government will provide a proportionate amount of co-funding to councils to meet the implementation costs.*

- 6.3 Recommendation: the Forum recommends that the LGNZ Funding Review should consider how to advance the two partnership principles set out in Chapter 4 of the discussion paper.**

7. FUNDING AS A SYSTEM

- 7.1 The Forum agrees that in the first instance prices should be used as a funding mechanism to recover the costs associated with local government activities. The exception would be for those activities that are public goods (i.e., those that are non-excludable and non-rivalrous), where a taxation mechanism (such as rates) is more appropriate. A 2008 publication by the Forum provides a discussion on private and public goods².
- 7.2 Currently, many local government activities are private goods or a mixture of public and private goods but are funded to a greater or lesser extent from rates. It is appropriate in these cases to use rates funding up to the degree of public good, but beyond that ratepayers are in effect subsidising users, often in the name of 'public benefit', which is not the same thing as 'public good'. While there might (on a case-by-case basis) be some valid reasons to apply ratepayer funding to recognise 'public benefit' (for example, in the context of regulation), there is a risk that it becomes an implicit but somewhat crude form of income redistribution. The Forum believes that councils should not be in the business of income redistribution as unlike central government they do not have any information on incomes, beyond the value of rateable property which is not a robust indication of income. A 2009 publication by the Forum provides a discussion on income redistribution³.
- 7.3 Recommendation: the Forum recommends that the LGNZ Funding Review should encourage greater use of prices to fund local government activities.**
- 7.4 The Forum also agrees that effective financing options can reduce pressure on funding. For example, prudent use of debt or proceeds of asset sales for large and lumpy investments can take pressure off today's rates.
- 7.5 Recommendation: the Forum recommends that the LGNZ funding review should encourage the use of effective financing options.**
- 7.6 Infrastructure renewals and upgrades will clearly be a major issue for councils over the coming years. 30 year infrastructure plans should help improve the quality of information but it is concerning that according to the Office of the Auditor General the local government sector appears to have under-provided for renewal expenditure compared to depreciation expenditure, with a gap of \$6-7 billion likely by 2022. The concern is that if this is correct, council asset bases are declining and that there is a steady build-up in unplanned renewal work that will eventually have to be made to maintain existing levels of service, which will put funding pressure on councils.
- 7.7 The Forum considers that councils need to better manage their network infrastructure. This includes the options set out in Chapter 5.5, such as regional

² *Local Government and the Provision of Public Goods*, Local Government Forum, November 2008, see: <http://www.localgovtforum.org.nz/Documents/Documents-and-Reports/Local-Government-and-the-Provision-of-Public-Goods.aspx> .

³ *Income and Wealth Redistribution, Should it be a Role of Local Government*, Local Government Forum, March 2009, see <http://www.localgovtforum.org.nz/Documents/Documents-and-Reports/Income-and-Wealth-Redistribution.aspx>

funding and management or corporatised 'public utility' models or a combination of the two. The Forum agrees that these options will need to be utilised more and should be encouraged by sector leaders and the Government.

7.8 Recommendation: the Forum recommends that the LGNZ funding review should encourage the use of regional funding and management and/or corporatised public utility models.

7.9 Chapter 5 also discusses the use of development contributions. The Forum is cautious about development contributions and we generally supported the recent changes made to narrow their scope. A 2010 paper by the Forum and the Property Council discusses development contributions⁴.

8. IMPROVING THE CURRENT RATING SYSTEM

8.1 As well as councils being more efficient and effective in their spending and making greater use of pricing mechanisms, the Forum considers that the current rating system can be improved in a number of ways:

- Targeted rates should be used to raise revenue earmarked for a specific function and benefiting subsets of ratepayers.
- Business differential rates should be phased out and their use restricted to the application of a lower rate to ratepayers in a defined area where clearly specified services available to ratepayers in general are not available to those in the affected area.
- The arbitrary 30 percent legislative cap on uniform annual charges should be abolished.
- Ratepayers should be provided with itemised rates assessments, which show how much they are paying for council activities.
- Statutory rating exemptions should be abolished.

8.2 Many of these improvements were proposed by the 2007 Independent Inquiry into Local Authority Rates (the 'Shand Inquiry'). Councils can already choose to make most of them – and some make good use of them – but changes to the Local Government (Rating) Act would be required to abolish the 30 percent cap and the rating exemptions.

8.3 Recommendation: the Forum recommends that the LGNZ funding review should recommend the following improvements to the rating system:

- **Targeted rates should be used to raise revenue earmarked for a specific function and benefiting subsets of ratepayers.**
- **Business differential rates should be phased out and their use restricted to the application of a lower rate to ratepayers in a defined area where clearly specified services available to ratepayers in general are not available to those in the affected area.**
- **The 30 percent legislative cap on uniform annual charges should be abolished.**
- **Ratepayers should be provided with itemised rates assessments, which show how much they are paying for council activities.**

⁴ *Taxing Growth and Development, a Critical Review of the Role of Development and Financial Contributions*, Local Government Forum and Property Council NZ, March 2010, see: <http://www.localgovtforum.org.nz/Documents/Documents-and-Reports/Taxing-Growth-and-Development.aspx>

- **Statutory rating exemptions should be abolished.**

9. OPTIONS FOR CHANGE: AVAILABLE TAX BASES

- 9.1 As well as administrative efficiency and economic costs, incentives are crucial when designing taxes. The current rating system was appropriate when councils were expected to do little more than provide basic services (such as roads, the three waters, and regulation) to properties, but modern local government is expected by communities and by central government to do much more than that. While not wishing to relitigate the 2002 and 2012 changes to the purpose statement of local government, the funding of local government has not kept pace with the evolution of local government to advance broader community well-being. As a result, rates are over-relied upon to fund this broader role and, as discussed previously in this submission, do not provide the right incentives either to communities, councils or central government.
- 9.2 Even if councils put their own houses in order, such as by being more efficient and effective in their spending and by making better use of existing funding tools (pricing mechanisms, improved rating systems, etc.), there may be a need for further changes, especially for councils facing demographic and infrastructure challenges. However, while the Forum is open-minded about new funding tools, councils will have to demonstrate that it is as efficient and effective as possible. Otherwise there will not be buy-in from communities or central government.
- 9.3 The Forum agrees with the descriptions in Chapter 7 of the different tax bases available. In terms of options, we have the following comments:
- Local income tax: There are a number of hurdles to enable councils to levy their own income taxes. These are well discussed in the paper and we do not believe this option should be considered further.
 - Local expenditure tax: As above.
 - Revenue sharing: In practice, income taxes or expenditure taxes would have to be implemented as revenue shares with central government. Some have suggested that local government should keep the GST it collects off rates. This would cost central government around \$610 million, which is unlikely to be acceptable to central government. Targeted proposals might have more merit. For example, it has been suggested that councils could receive the GST revenue on the value of houses built within their boundaries as a way to encourage them to be friendlier towards housing development. Similarly, councils could receive a share of royalty revenue from minerals exploitation within their boundaries, again to make them more receptive of mining. While these ideas have some attraction, they would need to be designed carefully, including a robust formula to allocate the revenue to councils and strong accountability mechanisms to ensure that revenue received is spent appropriately.
 - Selective taxes: Again, this option has more potential, and we support the principle of road pricing, especially if used to fund projects to alleviate congestion (not just to manage it). We agree that caution is needed to ensure that such taxes do not shift problems when the issue is of national importance.
 - Regional fuel taxes: There are a number of hurdles to regional fuel taxes, some of which are noted in the paper. A particular problem, not noted in the paper, occurs if such a tax was to apply to diesel which is used heavily off-road (for example, in farming, forestry, rail and maritime sectors) and does not currently attract any excise tax (instead diesel powered vehicles pay Road User Charges).

A regional tax on diesel would require a cumbersome and complex refund system for off-road use.

- **Transaction taxes:** As the paper notes, high economic costs have resulted in a number transaction taxes being removed (rightly) from the New Zealand tax system.

9.4 Recommendation: The Forum recommends that the LGNZ Funding Review should carefully consider any proposals for new tax bases for local government, with particular attention to the incentives they would provide and the costs of administration and compliance.

9.5 Some people have suggested that GST should be removed from rates on the grounds that it is a 'tax on a tax'. This is usually put as a way to make rates more affordable.

9.6 The Forum does not agree that GST should be removed from rates. Firstly, having GST on rates is consistent with New Zealand's very broad base approach to GST which is widely regarded to be one of the best in the world. Secondly, having GST on rates is consistent with the concept of rates being a charge for a basket of specific services provided by councils. Thirdly the argument that GST on rates is a 'tax on a tax' is spurious. GST is applied to the prices of alcohol, petrol, and tobacco, all of which have significant excise tax components, as well as to any product subject to an import tariff (such as clothing and footwear). No one seriously suggests that GST should not apply to these products.

9.7 Recommendation: The Forum recommends that the LGNZ Funding Review should reject the idea of taking GST off rates.

9.8 With regard to vulnerable communities and councils, the Forum is open-minded about targeted central government funding to assist them. However, to be eligible for funding, councils should have first endeavoured to be as efficient and effective as possible using existing tools. Such funding would also need a robust formula for allocating the revenue to councils and strong accountability mechanisms to ensure that revenue is spent appropriately.

9.8 The Forum would not be supportive of 'equalisation payments' where 'well-off' councils would be levied to prop up those that are 'vulnerable'. It is inappropriate as it would send the wrong signals to councils, providing a disincentive for councils to perform well. In fact it would unfairly penalise well-performing councils (and their ratepayers).

9.9 Recommendation: The Forum recommends that the LGNZ Funding Review should carefully consider ideas to assist vulnerable councils and communities with particular attention to criteria for assistance.

10. SUMMARY

10.1 The Forum generally agrees with the points made in the Summary chapter and we welcome LGNZ's initiative to review local government. We look forward to further engagement on this review.