

FUTURE SOURCES OF FUNDING FOR COMMUNITY NEEDS

4TH ANNUAL LOCAL GOVERNMENT FINANCE FORUM

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INTRODUCTION

The immediate context for this paper is the substantial review programme the present government has set in train for the legislative framework for local government. This includes:

- ▶ The replacement of the Rating Powers Act by a new Local Government (Rating) Act, the Bill for which is currently in the house.
- ▶ A substantial re-write of the Local Government Act, including the introduction of a power of general competence.
- ▶ A new Local Electoral Act which came into force on 1 July 2001.

Accompanying this major legislative work programme is a change in the way in which central government deals with local government. Traditionally, local government has been almost an after thought except in certain specialist areas such as environmental law and transport policy. The present government, when it came into office, moved quite quickly to start changing this relationship with the establishment of the central government/local government forum. Although very much welcomed by local government, it was one of a number of signals suggesting at least the possibility of a larger role for local government and therefore a greater requirement for funding the activities which it is required to or, through its democratic processes, decides to undertake.

This paper:

- ▶ First provides some background to funding issues.
- ▶ Next considers the question of who should pay, looking particularly at issues of national versus regional versus local public goods and private versus public benefit.
- ▶ Considers ability to pay at the level of both the community and the individual.
- ▶ Looks at possible alternative sources and ways of addressing funding issues and the concerns they raise.

BACKGROUND

Local government has traditionally felt itself to be something of a poor relation, all too often put upon by “big brother” from Wellington to undertake activity without equivalent funding. A review of central/local government relationships suggests that, in fact, there has been relatively little in the way of deliberate transfer of functions from the centre to a local level without equivalent funding. Instead, pressure has come on local government from three principal sources:

- ▶ The creation of new functions under statute, requiring quite significant input from local government to discharge its new responsibilities. Good examples are the Resource Management Act and the Biosecurity Act.
- ▶ A gradual increase in standards, especially in the environmental area. A number of councils currently face the need to spend substantially in areas such as wastewater disposal and waste management as the temporary consents put in place when the Resource Management Act was passed expire and new longer-term consents are required. Another example is the current initiative through the Ministry of Health to make drinking water standards mandatory (the estimated cost to local government is in the order of \$200 million).
- ▶ The impact on local communities of the withdrawal of government services or representation, something which has seen most councils in recent years feel compelled to build up their capacity to undertake research and advocacy in areas such as health, education, and employment.

Other pressures operate as well. Observers of the local government scene will have noticed that the enthusiasm of some of our larger cities, such as Auckland and Wellington, for transferring much of the cost of their activities onto the business community through differential rates has diminished. Inevitably, this is bringing additional pressure back onto residential ratepayers and ultimately through the electoral process.

At the time of the reorganisation of local government in 1989 and again with further changes in 1992, the question of local government funding came under quite close scrutiny. From the local government sector the argument was for a new source of funding to increase the capability of local government to meet ever increasing demands. Amongst the options which were canvassed at that time were a local GST or a local income tax. Neither of those options, nor any other ideas which were put forward at the time, found favour with the government.

The question of further funding sources has arisen again with the current legislative changes and, in particular, the replacement of the Rating Powers Act. My firm, McKinlay Douglas Limited, in partnership with the New Zealand Institute of Economic Research, were commissioned by Local Government New Zealand to report on future funding of local government activities. This paper draws, quite substantially, on that work.

WHO SHOULD PAY?

Perhaps the most important question, in thinking about who should pay for local government services, is the question of what those services should be. The business of local government is often described as delivering local regulation and local public goods. That is easily said. Defining the scope is rather more difficult.

The Local Government Forum, in association with the New Zealand Business Round Table, made a substantial submission in response to the discussion document on the review of the Local Government Act. Its view of the scope of local government activity was stated in that submission as:

The core function of local government, however, relates to the funding or provision of local public goods. These comprise activities related to democratic, governance and representative processes, civil defence, street lighting and footpaths, open-access parks and reserves, and public health.

On this criterion, the range of council activities is already excessive. The vast majority relate to the provision of private goods and services. Private goods are the polar opposite of public goods. They include the supply of water; refuse, sewerage and waste water collection, treatment and disposal from private properties; libraries; art galleries; museums; recreational facilities where access can be restricted such as swimming pools and halls; and car parking facilities.

That view is significantly narrower than the scope of activity of any New Zealand local authority. It is a polar opposite from the scope of activity undertaken by what is probably New Zealand's best known local authority, internationally, Christchurch City Council. That council undertakes a very wide range of activity including multi-million dollar investments in economic and community development, the country's largest public housing programme outside central government, substantial investment in artistic and cultural activity, and the ownership of very substantial commercial business enterprises. The October 2001 issue of *Governing*, a US based magazine specialising in governance issues, in a detailed article on Christchurch described it as "*the best run city in the world*". This was not the first time that Christchurch had received an international accolade. In 1993 it was joint recipient of the Carl Bertelsmann prize for "*democracy and efficiency in local government*".

These two different examples illustrate the wide range of views about the scope of local government activity. That debate is unlikely ever to be resolved in a sense of arriving at one common view which will be consistently applied across New Zealand. At the practical level, though, resolving this issue is something which every local authority confronts. It does so through applying the principles and processes now incorporated in Part 7A Financial Management of the Local Government Act. That Act requires local authorities to explain the rationale for the activities they propose carrying out and, when considering how to fund them, to apply a set of principles now often referred to as the "benefit" principles.

Effectively what these imply, with exceptions justified by considerations such as council policy and views on equity and fairness, is that the burden of funding activity should be borne by those who benefit from it. What this suggests is that, to the extent council activity includes private benefit, the recipients of that private benefit should pay (the so-called "user pays" approach) and that, to the extent that the services are public goods, the cost should be borne by that section of the public which receives the benefit.

I am going to assume that this audience understands the difference between public and private goods and, within the category of public goods, subsets such as merit and club goods, and that the audience is also familiar with transaction cost theory and agent/principal theory.

In considering questions of who should pay, there are two main areas of concern, at least looked at from a local government perspective. These are:

- How to pay for infrastructure.
- Payment for national, regional and local public goods.

- ▶ At the local level, public cost versus private benefit.

Infrastructure

There is absolutely no doubt but that New Zealand faces the reality of needing to spend very considerable sums on public infrastructure, especially for water, wastewater and stormwater, and for transport.

With water, wastewater and stormwater, there seems a clear consensus that ownership of the infrastructure should remain in public hands. The difficult question is the appropriate means of paying for that infrastructure.

There has been a gradual shift, in recent years, towards metering for water so that users pay, usually per cubic metre. This has generally been seen as reasonable for commercial and industrial users (although the quantum of charge has sometimes been queried), but it has been quite controversial for residential users. Witness the continuing protests in Auckland and the Letters to the Editor column of the Bay of Plenty Times as examples.

Several points arise:

- ▶ How should the payment be fixed and what should it cover? The Parliamentary Commissioner for the Environment, in his recent report *Beyond Ageing Pipes. Urban Water Systems for the 21st Century*, argues for a whole of system approach, which would see payment not just for water but for wastewater and stormwater as well, and for the associated impacts on the environment. Amongst other things, this raises the question of how to levy charges for wastewater disposal and for stormwater.
- ▶ How should pricing systems be established? One common objection to charging for water and wastewater services is the impact on low income households. This could be dealt with by establishing a two-tier system – a basic universal entitlement at a relatively low rate and a higher price on the balance, established so that total revenue received met a revenue target derived from the application of charging principles.
- ▶ How should the revenue itself be treated? Simply as an offset to rates? As a business income, with water, wastewater and stormwater utilities treated as the equivalent of other utilities? Would this raise public concerns about future privatisation?
- ▶ As local authorities start charging for water and wastewater, how should we deal with questions of regulating monopoly – and what kinds of structures, incentives etc should be in place to ensure least cost operation to agreed performance requirements?

It is difficult to forecast exactly what will happen, as decisions will be driven at least as much by politics and public opinion as by any kind of rational analysis. That said, my best assessment is that we are moving, slowly but surely, to full pricing of water, wastewater and stormwater services simply because of the strength of the environmental arguments for doing so. However, I would hesitate to put a timeline on this process.

Roading raises similarly complex issues. Current problems include the claimed underfunding of Transfund, roading pressures in areas such as Auckland, the Bay of Plenty and Wellington, and different means of charging. For example should we make greater use of toll roads? Is it time (or practical) to move to electronic charging for road use? What privacy issues might this involve? How are regions such as the East Coast, Northland or Marlborough to finance the costs of the roading needed to transport the “wall of wood”?

National vs Regional vs Local Public Goods

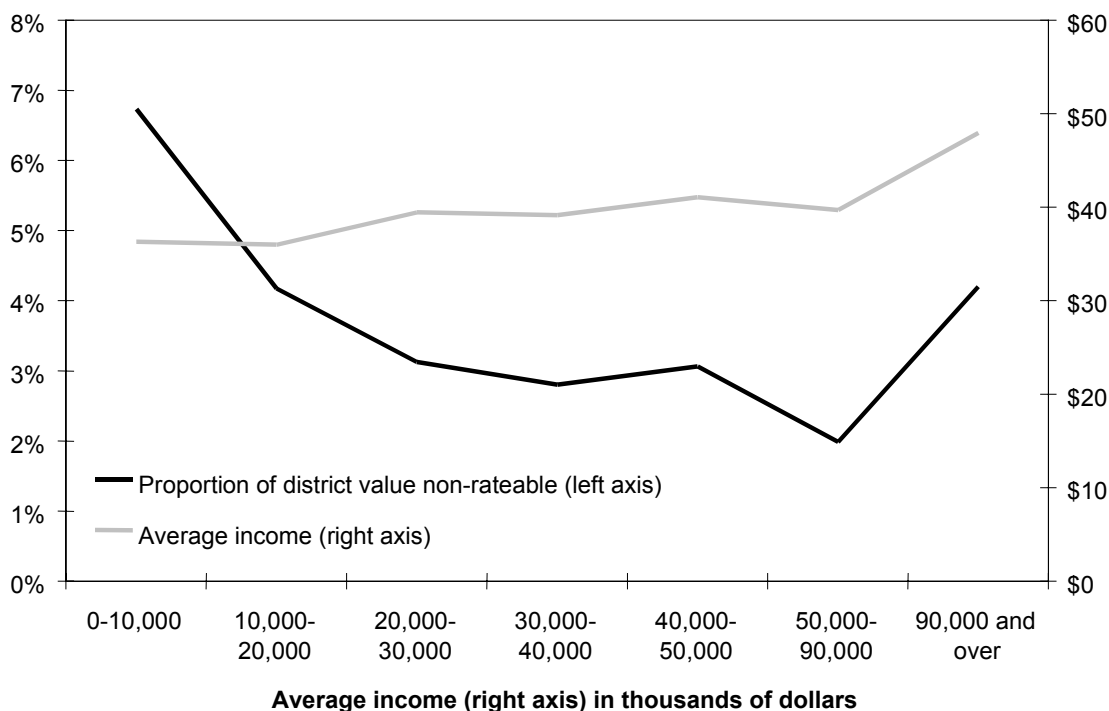
Logically, the cost of providing public goods should, as far as possible, be shared across all of those persons who benefit¹ from their provision. Within local government there is increasing concern that this is not the case, largely because of the impact of central government policy.

Rates Exemption

A first example is the exemption of certain categories of land from rates. This includes protection of natural, historical, cultural and heritage values (eg Department of Conservation land; National Parks), land used for education or health purposes, and Defence land. The local government view is that these uses are either national public goods (Defence, heritage land) or are for uses whose public funding is properly provided in full by the taxpayer (education and health). The local government view is that, by maintaining in place exemptions which have grown up very much like topsy over the years, the Crown is taking improper advantage of historic accident and that it should, instead, apply a principled public policy approach to the review of these exemptions. That argument has been put on a number of occasions and, on each occasion, rejected.

There is reason to believe that this contributes to quite significant inequities as between different parts of the country. The following table shows the proportion of district value which is non-rateable and average incomes, in each case by size of local authority. It seems clear that smaller, low income local authorities bear the heaviest burden from the exemption policy.

INDICATIVE PROPORTION OF NON-RATEABLE VALUE AND AVERAGE INCOMES



Source: Department of Internal Affairs

¹ Benefit in this sense covers both actual use and the option to use.

The above table includes the impact on local authorities of exemption from rating for Maori customary land. The exemption is a function of the Crown's Treaty obligations to Maori. Local government makes the point that the Treaty is between the Crown and Maori and not between Maori and the ratepayers of local authorities within whose districts Maori customary land is located. From a local government perspective, this is a national obligation which should be funded nationally.

Environmental Costs

As already noted, a number of local authorities face very considerable costs in the area of water, wastewater and stormwater, in part because of the need to comply with higher environmental standards. Meeting the cultural concerns of Maori is also an issue which local authorities are now required to address, again by the requirements of the Resource Management Act.

The question which a number of local authorities are asking is who should carry the financial responsibility for meeting new and higher standards, or satisfying Maori concerns? The starting point is what decision would local people make if they were not bound by the consequences of centrally imposed legislation? There is a strong sense that, if choice of appropriate means of provision, treatment and/or disposal were a matter of local democratic choice, there would be a tendency, often, to choose less costly options even although these might be seen as less satisfactory environmentally or from a Maori perspective.

What this line of reasoning highlights is the nature of the requirement to meet a higher standard. From a local perspective, the benefit of complying with the higher standard looks like a regional or a national public good – satisfying the environmental sensitivities of people, many of whom may not live in the area – a sense that sometimes urban dwellers tend to impose their values on others – or of obligations which are inherently those of the Crown under the Treaty of Waitangi. The issue is a very real one when the impact on local communities of the cost of putting in place systems which are fully compliant is considered.

The point this example makes is that there is a very real but scarcely debated question of who should meet the cost of local provision to meet what are essentially national considerations – in other words delivering what are really national public goods. The question is more than just a quirk of analysis. In the context of the way in which we now think about public policy and resource allocation, it has very real implications. Specifically, would central government be so enthusiastic about mandating (or in effect requiring the mandating of) quite rigorous standards for local performance in order to meet national objectives, if the taxpayer rather than the local ratepayer were required to meet the cost.

Public vs Private Benefit

The same issue arises in a somewhat different way within local authorities which have significant fluctuations in population as the result of internal tourism. Here, obvious examples are coastal areas such as the Coromandel Peninsula, parts of Northland, the Bay of Plenty, Nelson/Golden Bay, and the South Island Lakes District.

The issue which local authorities in these areas face is the need to provide public infrastructure – especially water and wastewater facilities – able to cope with a peak demand situation in which the holiday population may be three or four times the normally resident population.

Councils see themselves as being required to impose costs on locally resident ratepayers to meet the needs of people who are non-resident and may spend only two or three weeks a year in the district. Some regard this as an unfair imposition and argue that they should have a means of redressing the perceived imbalance, perhaps by some sort of dedicated tourism tax, perhaps by a subvention from central government treating the need to provide facilities for peak capacity as a form of national public good.

That argument seems a little less than robust. Its main attraction is its apparent similarity with the genuine burdens such communities face through the rates exemption on Crown and certain other land and the need to meet higher environmental standards, especially in environmentally sensitive areas – which, almost by definition, popular holiday resorts are.

In considering the tourism/holiday maker impact, the following points are worth noting:

- ▶ Absentee owners of holiday properties themselves pay through rates on those properties.
- ▶ There are available mechanisms, for example through the “pan tax” provision under the current Rating Powers Act, to impose rates on facilities such as hotels, motels and camp grounds which have multiple toilets. Admittedly, this may not be sufficient to deal with the fact that these will often be very high use facilities, or to cover the cost of providing and servicing public toilets.
- ▶ Typically, local ratepayers, at least those who have been property owners for some years, have enjoyed very significant capital gains, usually far in excess of the net present value of any additional rates burden. Often, also, they will derive much of their income from servicing tourists and holiday makers.
- ▶ The differential rating provisions of the present Rating Powers Act already provide a mechanism which could be used to impose a differential rate on properties used primarily for tourism or holiday related activity. The capacity to levy rates designed specifically to offset costs generated by defined activities will be increased by the targeted rates provision in the Local Government (Rating) Bill once that is enacted.

On analysis, my view is that the main difficulty in this area is a lack of clarity in two respects:

- ▶ Identifying the benefits as well as the burdens which flow from the additional activity generated by tourism and holiday makers.
- ▶ The failure to distinguish between the costs resulting from additional activity and the costs resulting from higher environmental standards (which can, I believe, be more properly seen as a national public good issue).

ABILITY TO PAY

Community

There is considerable anecdotal, and some research-based, evidence that ability to pay is a very real factor within a number of local authority districts. It seems that typically there is less variation in the cost of providing basic services – water and wastewater, stormwater disposal and roading etc – than there is in the capacity of a number of local authorities to generate sufficient rates income to cover costs without imposing a quite heavy burden on at least the lower income members of their communities.

Several factors appear to affect affordability. They include:

- ▶ The presence or absence of a substantial business (commercial, industrial) component in the rating base.
- ▶ Relative incomes within the community – some districts are significantly wealthier than others (the best information base to illustrate this is the Deprivation Index developed by the Health Services Research Centre)
- ▶ Economies of scope and scale. Smaller local authorities, or ones with a relatively low population density, may face higher costs per ratepayer in providing services. As we saw above in discussing rating exemptions, the problem of affordability is also exacerbated by the distribution of exempt land.

The Wanganui Affordability Study² explored the potential impact on Wanganui households of rates increases. It noted the relatively low levels of household income in Wanganui as compared with New Zealand as a whole (from 1996 census data, a median household income in Wanganui of \$27,021 and for the whole of New Zealand, \$34,707). In broad terms, its findings suggested that at least those households in the bottom 20% of the income distribution, if faced with rates increases, would have to make changes in discretionary spending on items such as food and health care which would have an adverse impact on their health status.

That study is the only one so far carried out looking at the relationship between affordability and health status or, indeed, analysing affordability across a community in any great detail. However, a quick look at a selection of Annual Plans of other local authorities will show that Wanganui is not alone in facing pressure:

Gisborne District Council Annual Plan 2000 – 2001

Mayoral Forward: “The net effect of all these influences is a much reduced work program, the reduction or elimination of some Council grants, and a greatly reduced capital works program for the next decade...”

CEO Comment: “...draft Annual Plan has been an extremely demanding exercise, not the selection of what services and improvements to provide, but more particularly a definite desire to minimize any real rate increase and thereby delete or defer projects.”

Significant Issues: “The district once again has experienced financial demands which conspire to push rates up to horrific levels.”

Rangitikei District Council Annual Plan 2000 – 2001

CEO Comment: “Roading maintenance is the most significant activity the Council has consuming approximately half of our overall budget. Even allowing for the subsidy received from Transfund, the overall rates requirement for roading is almost \$3.5 million. This is proving difficult to sustain.”

Far North District Council Annual Plan 2000 – 2001

Message from the Mayor: “Council has approached this year’s plan positively but also realistically given the tight financial position Council faces Roading continues to be a substantial consumer of the rate dollar. Approximately 33% of the total operational costs is spent on roads. This year Council is working within extremely tight constraints and has consequently concentrated its limited resources in maintaining roads.... Council recognises that a number of desirable works have been deferred. These decisions were made so as to minimize the potential impact on services and to avoid imposing a further burden on rate payers.”

² A report commissioned by the Wanganui District Council from the Department of Public Health at the Wellington School of Medicine to consider the potential impact on households’ physical and mental health of rates increases to fund upgrading Wanganui’s wastewater scheme.

Individual

The problem of affordability is not confined to the (probably still) minority of councils who find themselves faced with the genuine dilemma of choosing between deferring what should be seen as essential works or striking rates at levels which put real pressure on a significant proportion of their community. Many local authorities whose residents and ratepayers would generally have little difficulty in paying current or likely future rates, have significant pockets within them of areas where there are genuinely very real problems. This is particularly the case with small coastal or rural settlements facing the need to upgrade wastewater treatment and disposal. Typically these communities will have relied on septic tank systems which, for both public health and environmental reasons, are no longer acceptable. The following table gives a measure of the impact which putting in new systems can have. It is taken from analysis by a district council of rates within the areas of two of its community boards, both of which have recently had new wastewater treatment and disposal systems installed.

Rates in Two Community Board Areas		
<i>Rate demands for community boards A and B were analysed on the basis of:</i>		
<ul style="list-style-type: none"> • <i>district costs including a uniform annual general charge, a district general rate, roading costs and environmental protection;</i> • <i>community costs (including operation of the community board) covering services specific to the area of the board;</i> • <i>water and wastewater.</i> 		
<i>The percentage share of these costs in the total rate demand was as follows:</i>		
	Community Board A (%)	Community Board B (%)
District costs	29.7	30.5
Community costs	10.0	14.5
Water and wastewater	60.3	55.0
<i>As a further demonstration of the impact of infrastructure costs, roading charges made up 41.5% of the district costs for board A and 51.7% in board B.</i>		

To put this properly in context, in each of those two community board areas the average annual rate demand was in the order of \$1,500.

The problem is made worse, or at least more difficult to manage, by the effect of the current financial management provisions of the Local Government Act. The basic principle underpinning that legislation is that the costs of providing services should be met by those who benefit from them³. In many local authorities this is taken to mean that the cost of putting in a community wastewater scheme should be borne by that community and not (say) by the district as a whole. In other words, the Act is seen as discouraging local authorities from any kind of cross subsidy between the richer and poorer parts of their districts.

The other major problem of affordability is what is known as the “asset rich, income poor” ratepayer. Typically this will be a retired person or couple with a debt free property but

³ It is interesting to reflect that if the same approach were applied to central government activity it would be virtually impossible to run any of our major government funded social services.

relatively little income – national superannuation plus perhaps some income from savings. These people have little or no scope to increase their income to offset any additional costs. Their difficulties are seen at their worst when the home they have chosen for retirement happens to be in a high value area. They might have purchased a holiday home 30 or 40 years ago as their intended retirement dwelling and now find that, because of capital growth, they have a very valuable asset but correspondingly a relatively high rate demand and very real difficulty in meeting that unless they sell. Alternatively, they (more often she) may be living in the former family home in a middle or upper income suburb. Remaining there is important in terms of links with friends, known places and associations etc, but again the property now incurs a rating burden which may be getting difficult if not impossible to manage.

Under current provisions, there is little or no means of relief for people in these situations. Briefly:

- ▶ The rates rebate scheme, introduced in 1973, provides maximum relief of \$200 with an income limit of \$7,400 gross plus \$156 for each dependant. As a consequence, very few people are eligible – in 1999/00 4,117 rebates were granted.
- ▶ The accommodation supplement administered through the Ministry of Social Development is available for home owners only when their costs of home ownership exceed 30% of their income – effectively ruling out anyone whose property is debt free.
- ▶ The Local Government Act allows local authorities to postpone rates payment on the grounds of hardship. As the legislation is currently written, this effectively requires the local authority to put any applicant through an assets and income test, a very demeaning process and one which effectively discourages people from applying. A second difficulty is what amounts to a six year limit on the postponement period, thus merely compounding the problem for an elderly person or couple who survived for that period.
- ▶ Home equity conversion, a generic term for a range of means of enabling elderly persons to access the equity in their property without actually selling it, although common overseas, is virtually non existent in New Zealand (there is one provider, but on terms which it would be difficult to recommend that any person actually accept).

POSSIBLE ALTERNATIVE SOURCES AND WAYS OF ADDRESSING FUNDING ISSUES

In this section I review a number of possible alternative sources and ways of addressing funding issues. They are categorised under the following headings:

- ▶ Government Assistance
- ▶ Utilities
- ▶ Communication
- ▶ Restructuring
- ▶ Rates Postponement
- ▶ Coordination.

Government Assistance

There are four separate issues I want to explore:

- ▶ Dedicated taxes
- ▶ Revenue sharing
- ▶ Rates exemptions
- ▶ Petrol excise.

Dedicated Taxes

The conceptually simple answer to providing an additional source of funding for local government is some kind of dedicated tax. What is simple in concept proves to be difficult in practice.

First, analysis of the two most popular candidates, a local income tax or a local GST, in practice collapse into a form of revenue sharing. Compliance costs, including the difficulty of determining the location at which a transaction should be taxed, make establishing a separate local income tax or GST system non-feasible. In practice, either a local income tax or local GST would need to be implemented as a percentage margin on the equivalent central government tax. It thus becomes little different from a decision by central government to allocate a portion of revenue – in effect revenue sharing.

Dedicated taxes with more of a local impact – for example a local payroll tax – both raise significant compliance cost concerns and have significant adverse impacts. As an example the areas which are most in need of additional funding are likely also to be those which have the greatest difficulty in growing employment. A payroll tax would simply compound that difficulty. Similar problems appear to arise with almost any type of local tax.

Revenue Sharing

Again, from a local government perspective, this has some superficial attractions. However, it carries with it the very substantial risk that, if revenue sharing were on any significant scale⁴, it would be likely to pose a very real threat to the autonomy of local government. It is highly unlikely that central government would hand over a significant part of taxpayer revenue without insisting on quite rigorous accountability and the right to have a say in how that funding was spent. Recognising this risk, New Zealand local government appears to have turned away from any support for the concept of revenue sharing.

It also faces one other difficulty, shared by any proposal to introduce a new tax for the benefit of local government alone. This is that central government itself faces very real fiscal pressure. Why should it be prepared to give up part of its revenue, or the opportunity to benefit from a new tax, to provide general revenue support for a different level of government?

Rates Exemptions

This does seem to be an area in which progress ought to be possible. The existing rating exemptions are either relatively ad hoc or amount to imposing on local government the cost

⁴ In practice it can be argued that there are already certain forms of revenue sharing in place, for example the allocation to local authorities on a per capita basis of funding for local arts, culture and recreation grants.

of meeting central government obligations (as under the Treaty of Waitangi). There is some partial recognition on the part of central government that, although practice is on its side, principle is not. There are signs that central government is prepared, reluctantly, to consider making grants in lieu to local authorities to offset the revenue they lose through exemptions which benefit the Crown. It is my view that central government should implement such a measure and do it so that local authorities receive, by way of grant, the revenue they would have received if the land had been rateable. As observed earlier, this is no more than consistency with the standard public policy view that activities should bear their own costs for reasons, amongst others, such as transparency, accountability and ensuring that people responsible for activities face the incentives for efficiency which come from bearing the full costs of those activities.

Petrol Excise

There are times in life, and in public policy, when it is appropriate to be pragmatic. This is one of them. The work which NZIER and we undertook made it clear that there was a case for providing some additional assistance, especially for those local authorities which themselves had a relatively weak rating base. The issue was how to achieve this.

The problem definition made it clear that the answer could not be simply devising a different tool for extracting money from the same population – local government already has a range of tools; the problem we were concerned with was that a number of communities seem simply unable to afford any significant additional burden.

We therefore cast around for a potential source of additional funding which might have about it a modicum of logic as well as the ability to deliver additional funding. As already noted, the idea of an additional stand alone tax, or of some form of central government revenue sharing, did not seem appropriate. After considering quite a wide range of possibilities, the one which seemed to have some attraction is an increase in the petrol excise of an amount sufficient to offset the annual cost to local government of maintaining local roads. This is a little more than \$200 million per annum.

There is some logic to the suggestion:

- ▶ The capital costs of building local roads can be seen as a legitimate charge to land owners (ratepayers) as this provides access to their properties and accordingly adds value.
- ▶ Maintenance, in contrast, is a function of use and therefore reasonably charged to users rather than to land owners.
- ▶ Excluding diesel reduces the risk of adding to intermediate costs.

The measure, if adopted, would need a two step approach if it were to address the needs of those authorities which are least able to meet the demands they are currently facing. It is quite common in the allocation of taxes collected for redistribution to local government to include some form of equalisation measure⁵. To avoid the risk that the greater part of any such additional funding would go to those authorities which were most well off (substantially metropolitans with significant road maintenance expenditure), distribution could be skewed, perhaps through a weighting based on the Deprivation Index, so that those authorities whose ratepayers were least well off received two or perhaps three times the amount of their maintenance expenditure in whatever year was adopted as the base, and better off authorities received only a proportion.

⁵ As for example in England, Australia and a number of US States.

Collecting and distributing this additional tax would involve a very minimal administration cost. The price elasticity of demand for petrol suggests that the impact on consumption would be relatively minimal.

In recommending this approach for further study, we freely admitted that it was an ad hoc proposal. However, like democracy in the political realm, it has the merit that it meets an identified need and appears to do it better than any alternative yet suggested.

Utilities

Under legislation regulating utilities – the Electricity Act, the Gas Act, and the Telecommunications Act – utility operators have the right to put their infrastructure in place on council property, typically road reserves or roads themselves. Councils have some power to impose conditions but cannot refuse the utility operator the right to do this.

It is a right which is problematic, from a local authority's perspective, in several ways:

- ▶ First, it is a statutory override of normal property rights. Why should a local authority, unlike any other land owner, not be able to charge a rental?
- ▶ It distorts decision making, by the utility – free access to local authority land underprices that way of delivering a service as compared to other means.
- ▶ Perhaps most importantly, it creates a situation in which local authorities end up incurring substantial cost because they lack the normal powers of a landlord to require due performance by a tenant or terminate the right to occupy. This is particularly important in roading. One major metropolitan reports very substantial difficulty and added cost in maintaining council roads because of this situation. The fact that utilities have a statutory right means they have no incentive to coordinate with the local authority on when they actually lay their pipes or cables. Too often, a utility will dig up a recently laid road, thus weakening the structure and significantly lessening its useful life. Worse, their record in restoring the surface as adequately as possible is extremely poor. Although conditions can be imposed in this respect, the council concerned finds that in practice it is cheaper to end up doing the work itself – suing the utility is an extremely costly option.

This suggests that the relationship between council and utilities should be more akin to that of landlord and tenant – perhaps with the utilities still having a right as it were to pre-empt a lease, but then holding land under conditions similar to that of a lease so that non-performance – especially in terms of coordination or reinstatement – could see the right to use the land terminated.

It also represents a potential revenue source. The rights of way concerned are valuable so that a commercial rental would be significant. In some overseas jurisdictions utilities rentals are a substantial part of local authority income. There would, of course, be a need to factor in the likely impact when considering such a measure as utilities would be virtually certain to pass this cost on to their consumers. (Note that some local authorities, notably Auckland City, are already rating utilities infrastructure although most do not, largely because of uncertainties over the legal situation.)

Communication

Part of the problem of affordability, at least across councils as a whole, is ratepayer/resident/business perceptions of value. If you think that you are getting really good value for money that you are required to pay, then you are likely to feel much better able to meet the cost than

if you believe that money is being compulsorily extracted from you for purposes which are relatively wasteful or lacking in direct benefit.

It is my personal view that local government could do a much better job of communicating to ratepayers than is currently the case. Let me give three examples:

- ▶ First, how good are local authorities at communicating the value of what they provide? It is interesting to note that, for many households, their annual electricity bill is equal to or greater than their rates. Think of using this as a benchmark. For your electricity bill, all you get is electricity. For your rates, you get a bewilderingly wide range of services including potable water, wastewater treatment and disposal (for most people at least), streets, footpaths, street lighting, a wide range of artistic, cultural and recreational facilities, important regulatory services (although some ratepayers might be happy to do away with the Resource Management Act or dog control) and so it goes on. Perhaps there is a case for local government generally putting some effort into raising people's understanding and appreciation of just what they do get for what they are required to pay.
- ▶ Billing. Under the current law, local authorities send out one demand to cover all of the various services which they provide. This makes it all too easy for ratepayers, especially those who do not read the fine print (and quite often this can be very confusing), to think of high rates or rates increases as reflecting incompetence, over staffing, or some other form of administrative failing within the council rather than (say) the cost of putting in place an upgraded water and wastewater scheme. One suggestion which came out of the work which we did was that local authorities should have the power to send separate bills for discrete parts of their activity. For example, why should a council not be able to send a separate bill for "XYZ District Council Utility Services" covering the cost of water and wastewater? Go back to the table on page 9 of this paper. If the Council in that example could issue a separate bill, it would have been sending out one in the order of \$800-\$900 for utility services and a rate demand for all its other services of somewhere between \$500-\$600, thus making it very clear where the burden of cost really lay. The present Rating Powers Act does not permit the sending of separate bills. There is an opportunity with the new Local Government (Rating) Act to change this although the Bill, as introduced, does not include the necessary power.
- ▶ Income and capital. Every year when local authorities strike their rates, the media is full of stories of how the XYZ Council has yet again increased rates beyond inflation. Typically the story will quote national or local business leaders citing this as evidence of lack of discipline in the local government sector and a need to put further restrictions on councils so that they are required to be efficient.

These reactions assume that rates are raised purely and solely for councils' operating expenditure. The plain fact is that is wrong. As well as funding current operating expenditure, rates also provide needed capital for investment in new facilities. One measure which I believe all local authorities should put in place is a breakdown of their rates increase to demonstrate what portion is due to increased operating expenditure and what portion to the need to provide for investment or to repay borrowings raised for earlier investment.

Restructuring

An obvious question, if a local authority is facing difficulty in funding its activities, is whether that is a function of scale. There is a growing view that a number of New Zealand's smaller local authorities are beneath viable size, if they are to be cost effective deliverers of a full range of services including major infrastructure. Identified problems include:

- ▶ Inability to capture economies of scale or scope.

- Difficulty in attracting and retaining professional staff with the experience, qualifications and capability needed to manage what are complex services.
- A consequent increased level of risk to the viability of services, including the potential for quite significant incidents.

The simplistic answer to this kind of problem is that, where there would be significant efficiency gains (and in practice these are not restricted to New Zealand's smallest local authorities), there should be more local government amalgamation. The logic in terms of cost effectiveness may be correct. However, in terms of the politics of local government, and the nature of community attitudes, the suggestion is not practical. First, it is extremely unlikely that any New Zealand government, in the foreseeable future, will undertake the kind of large scale restructuring of local government which we witnessed in 1989. Secondly, the alternative of voluntary amalgamations, using the provisions of the Local Government Act, is extraordinarily difficult. Amongst other things, any amalgamation proposal must be submitted to a poll of electors in each district affected and will only be carried if there is a majority of more than 50% in **each** poll. Experience is that, almost inevitably, proposals of this kind will be defeated.

A much more promising approach is rationalisation of functions between different local authorities. This can take a variety of forms ranging from joint planning, coordinating purchasing and tendering, through to a full joint venture approach, possibly through a joint committee, possibly through a jointly owned LATE or jointly established trust. Ideally this is an approach which leaves the political side of the organisation undisturbed but allows for economies of scope and scale in the operation of functions.

A good example is the Wairarapa, which contains three local authorities – the Masterton, Carterton and South Wairarapa District Councils. Increasing cooperation between these councils covers planning, coastal strategy, waste management, libraries, tourism and business enterprise. This has evolved out of an awareness that, if each wishes to maintain its independence, but to be cost effective and capable in its operation, working together to achieve economies of scope and scale is a virtual prerequisite.

There is a second form of restructuring which we can expect to see more of as local authorities seek to manage the tension between ever rising demands for service, including increased quality, and limitations on ability to pay. This is ongoing restructuring of their own activities to ensure that they are conducted in ways which:

- Produce the desired level of service at the least cost.
- Maximise possible leverage.

Some of this may come through the continuing development of local authority trading enterprises to handle activities which are of a trading nature. The obvious area here is water and wastewater, although progress may be slow for two reasons:

- Public resistance to the use of business techniques to manage an essential service (including a fear that this may lead to privatisation).
- The relative lack within the local government sector of the skills and understanding needed for good governance of LATE arrangements.

More immediate progress is likely to come through transferring not for profit activities to trust structures. This is increasingly happening in the arts, culture and recreation area. One benefit this does offer is the opportunity for greater leverage through increased community involvement, both at the governance level and in taking “ownership” of the vicinity thus

enhancing the potential for community support outside the rates/user pays regime which the parent local authority may have operated.

Rates Postponement

At page 10 above I outlined the postponement provisions under the current Rating Powers Act and explained why they are, in practice, virtually unworkable.

The new Local Government (Rating) Bill introduces a major change in this area. Local authorities will be able to adopt whatever postponement policy they desire provided they do so through the special consultative procedure (in practice this will mean provided they include it in their Annual Plan). Once that policy is adopted, then ratepayers will be able to use it as of right with no discretion on the part of the local authority so long as the ratepayer meets the conditions of the postponement policy.

In practice, the likeliest targets for the type of postponement the new law will make available will be elderly “asset rich, income poor” ratepayers. The likelihood is that the only requirement they will need to satisfy is that they have sufficient equity left in their property so that it is a reasonable expectation they will either sell or die before that equity is exhausted.

That opens up a very real potential for local authorities to ease the single most serious pressure they face in increasing the burden on ratepayers generally. A word of caution is needed however. Although the new provisions look very straightforward, it is likely that in practice they will have complexities of their own. Anyone familiar with the difficulties in the area of home equity conversion will understand this reference.

I am aware of at least one initiative currently in the course of development which will deal with the potential difficulties. However, for reasons of commercial confidentiality, I am unable to disclose details.

Coordination

Apart from infrastructure, the major source of new pressures on local government funding will be in the social services area broadly defined – community development, health, education, employment etc.

Traditionally, local authorities have had very little funding available for these purposes. One reason is that social services, generally, have been seen as a central government rather than a local government responsibility.

The new purpose for local government with its emphasis on community well being, and the likely scope of the requirement for a council long term plan under the new legislation, suggests a marked shift in emphasis. In most parts of the country, the major sources of locally controlled funding which are available for these types of purposes are held not by local authorities but by trusts of various kinds – community trusts which originated with the restructuring of trustee savings banks, the energy trusts, licensing trusts, etc.

The relationships between these various entities and local government have generally been somewhat uneasy. Trusts, in particular, will often see local government as the equivalent of the big bad wolf, keen to get after their money for its own nefarious purposes.

The practical reality is that the combination of fiscal stress on both central and local government, and the growing emphasis on partnership at a local level, will make closer coordination amongst these entities a necessity – especially as they are all working on behalf of the same group of people. It is to be hoped that both local government and the various trusts will have the maturity and farsightedness to recognise that working together is one very important way in bridging the gap between public demand (need) and available resources.

CONCLUSION

There are no magic bullets for resolving the funding difficulties of local government. In many respects they simply reflect the same situation that central government faces – a mismatch between public expectations (or needs) and fiscal capacity.

Accordingly, rather than any kind of “big bang” solution to the funding needs of local government, progress will come in incremental steps but there are a number of promising areas. As this paper has discussed, they include:

- ▶ A possible extension of the petrol excise.
- ▶ An acceptance by the Crown of its responsibility to pay rates or the equivalent in respect of currently exempt land.
- ▶ Better communication by local authorities of just what they do and the value which people receive – (perhaps an issue for Local Government New Zealand as the sector’s representative).
- ▶ A tightening of the conditions under which utilities are able to access local authority land.
- ▶ A greater focus on restructuring both in terms of closer cooperation amongst local authorities – shared services, joint ventures, etc – and within individual local authorities to ensure that the functions they undertake they do or have done in the least cost way which will deliver the services that their residents and ratepayers require.
- ▶ Greater coordination amongst the various entities currently engaged in funding local activity.