

Claudia Scott

Local Government Funding facing the issues

Introduction

Designing funding policies to serve all the local and regional councils in New Zealand is challenging. This article looks at some of the issues that arise, and some principles for addressing funding arrangements and for considering whether current local government funding arrangements are suited to the requirements of local governments throughout New Zealand. The need for new sources of revenue for local governments in New Zealand is a topic which is raised

in most reviews of local government funding. The larger question is whether the nature, level and mix of current funding sources meets the needs of all the councils, given the diversity of their roles, funding requirements, opportunities and constraints.

Similar issues are raised by councils themselves and the private and community sectors. Funding is often a matter of concern to ratepayers, particularly commercial and industrial ratepayers who feel that their rates are too high in relation to the benefits they receive from the services provided by local and regional councils. Some

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councils are stretched to provide and maintain essential physical and social infrastructure. Councils with low population or economic growth and a declining or ageing population are being challenged, as are those with small populations in places that attract visitors who require services and amenities but do not directly contribute to funding them. Visitors generate costs for small councils and communities. They can generate demand for places to park and to camp, and high levels of service delivery: for example, in respect of water quality.

Local governments must also incur costs arising from central government's expectations and policy decisions. A recent example is a central government

has now obtained an 'in principle' agreement to the council charging motorists driving on the city's most congested streets. The recently published interim report of the Auckland Transport Alignment Project (ATAP) has found that charges of between 3 cents and 40 cents a kilometre would be likely to have a dramatic positive impact on congestion and the use of public transport.

Funding pressures are leading some councils to be less responsive to pressures for development, because their ability to secure adequate funding to meet requirements and expectations is constrained under current funding arrangements. Fast-growing urban communities in New Zealand, especially

resources can expand the revenue base while also reducing the contribution required from existing funding streams.

The predominant source of funding for councils is rates, which make up about 50% of the revenues raised by local governments in New Zealand. A lack of clear linkages between the functions, jurisdictional boundaries and funding of local governments has prevented fruitful discussions of funding approaches and their suitability for each particular council and context. Ministers have shown a preference for creating unitary authorities, which combine regional with territorial councils. This has been done in Auckland, Gisborne, Nelson, Tasman, Marlborough and the Chatham Islands. Auckland Council was formed from eight authorities. A similar proposal developed for the Wellington region by the Local Government Commission was not supported by a popular vote. Arguments as to whether 'bigger is better' or 'small is beautiful' are perennial and unresolved. They are likely to remain so as long as policy for local government is framed with a heavy emphasis on efficiency gains from reorganisation and limited attention to funding arrangements for local governments.

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decision to alter the way regional councils will be reimbursed for the transport subsidies to superannuitants. It will result in councils receiving less revenue for delivering transport services, which was not anticipated and therefore not budgeted for in their long-term plans. Councils are also expected to meet the costs of implementing regulations made by central government, but there is no provision made for cost-sharing.

The 2015 OECD economic survey of New Zealand said that the most problematic factor cited for doing business in New Zealand remains inadequate infrastructure. The survey recommended that New Zealand facilitate the provision of better urban infrastructure by diversifying the revenue streams available to local governments. It also suggested better management of the demand for and use of urban infrastructure, including congestion charging to reduce urban traffic. After some years of seeking support from central government, Auckland Council

Auckland, expend considerable energy and resources to deliver planning and infrastructure services, address congestion and housing affordability issues, and endeavour to placate strong objection to proposed intensification.

While councils have the power to set tax rates for existing sources of revenue, they do not have power to create new revenue sources. Any such changes will require legislation by Parliament, and therefore support from central government. These matters will often also involve community consultation. It is easy for central government to signal that they are not interested in supporting proposals for additional revenue sources. Ratepayers often oppose proposals for new sources of finance because they believe this will necessarily encourage councils to spend more overall. But new sources can in fact spread the costs of local government more widely without increasing them, and target particular population groups and sectors that benefit from services. New funding

The Local Government New Zealand funding review

Most previous funding reviews have been instigated by the government or done internally by the public service, whereas the 2014–15 review was initiated by the local government sector. Local Government New Zealand (LGNZ) created a working group of invited participants, who contributed to a discussion paper on local government funding issues. The review developed some case studies that widened the discussion of funding and made comparisons which brought together issues of function, structure and funding. Members were independent and drawn from many different sectors, recognising the diversity of local governments and their issues, opportunities and challenges. The funding discussion paper was followed by a more specific ten-point plan issued by the LGNZ national council.

The working group provided perspectives on a wide range of issues

regarding current funding arrangements, and suggested options for reform. Members brought extensive knowledge of the issues and challenges facing various councils. Some councils felt financial pressures arising from rapid growth and high demand for infrastructure and development. Others councils had ageing populations and shrinking economies, and some communities that attract tourists were challenged to meet visitors' expectations.

If the function of local government, its jurisdictional structure and its funding arrangements are artificially separated, then it is difficult to say anything of consequence about any of them. This separation has become newly important as a result of the Local Government Act 2002 Amendment Bill, currently before a parliamentary select committee, which sets out a new framework for local government organisation without taking financial considerations into account.

Structure, functions and funding of local governments

The history of the organisation of local government in New Zealand has been one of consolidation. In 1974 there were 991 territorial and ad hoc authorities; there are now 78 local authorities, comprising 11 regional councils and 67 territorial authorities (unitary authorities, city councils and district councils).

Local authorities vary considerably in size. At the last census of population and dwellings (March 2013), the largest regional council was Environment Canterbury (population 539,433); the smallest was West Coast Regional Council (population 32,148). Territorial and unitary authorities' populations ranged from 1,415,550 (Auckland) to 600 (Chatham Islands).

Table 1 sets out the functions of territorial and regional councils.

Local and regional councils create and maintain infrastructure and provide services for districts, cities and regions. They play an important role relating to planning, and build and maintain local roads. Many councils deliver various community services, such as libraries, swimming pools, parks and recreational facilities. Councils must also implement

Table 1: Local government functions

Territorial council functions		
Rural fire protection	Museums	Drainage
Civil defence	Libraries	Cemeteries
Crime prevention	Economic development	Cultural facilities
After-school care	Tourism promotion	Drinking water
Crèches	Airport ownership	Waste water
Voluntary sector grants	Events	Storm water
Public health protection	Sports facilities	Citizens' advisory services
Housing	Parks and open spaces	Citizenship ceremonies
Community centres	Public health regulation	Town planning
Refuse collection and disposal	Local roads	Environmental management
		Local regulations
Regional council functions		
Public transport	Biodiversity	Regional environmental
Port ownership	Bulk water supply	planning (air and water)
Marine regulations	Pest management	Environmental protection

Source: Reid, 2016

regulations established by central government. Many services are taken for granted by those who use or benefit from them, and the general public is often unsure as to the roles of councils and other organisations in financing and delivering services; communities differ in the level and mix of particular services provided by their local councils beyond the core services that are required by legislation.

Relative to councils in other OECD countries, however, all local governments in New Zealand have a narrow mandate, and their range of services excludes the delivery of education, health and social services, which are local government responsibilities in other jurisdictions. Council planning and regulatory functions influence the location of various activities and set standards for the built environment. Councils also play an important role in emergency management, and have a role in building strong communities and resilience in their communities. These activities influence the quality of life and the economic, social, environmental and cultural outcomes in local communities. Councils also vary in the range of services and amenities that they provide to residents and visitors, and this will

affect perceptions of their territories as attractive places to live and to visit.

As already observed, rates are the predominant revenue source, delivering almost 50% of revenues on average. Taxes on property were recognised in the funding review as the cornerstone of funding for local government services, though new revenue sources, such as an accommodation tax and the sharing of sales taxes, were also considered. The imposition of mandatory rating exemptions was also raised. One option proposed was that mandatory rating exemptions be removed, and exemptions made in response to specific local needs, following consultation by councils with their communities. Core Crown land is exempt from rates, though in many overseas jurisdictions it is common for councils to pay grants in lieu of rates.

There are also subsidies from central government, including cost-sharing arrangements with the New Zealand Transport Authority (NZTA), which collects petrol tax and shares a proportion of this revenue with local government to fund local roads.

In 2013 the proportions of local government funding sources were as follows: rates 49%, user fees and charges 15%, current and capital grants (from

Table 2: Average council activity funding sources for services (by percentage), 2013

	Rates	Regulatory Income	User Fees & Charges	interest & Dividends	Grants
Roading	61	4.5	4.5		30
Transportation	16	10	28		46
Water supply	64		36		
Waste water	85		15		
Solid waste/refuse	45	1	51		3
Environmental protection	74	4	19		3
Emergency management	63		17		20
Planning and regulation	38	47	13		2
Culture	65	1	16		18
Recreation & sport	66		32		2
Community development	78		13		9
Economic development	56		16		28
Property	21	1	77		1
Governance	94		6		
Support services	76	3	4	17	
Other	28		14		58

Source: Local Government New Zealand, 2015a, p.15

NZTA contributions) 19%, vested assets 7%, regulatory income and petrol tax 5%, interest and dividends 4%, and development and financial contributions 2%. The percentage of income derived from taxes can vary substantially between councils, as it depends upon the availability of other forms of revenues from investments and user fees and charges. Councils vary in the degree to which they rely on particular revenue sources to fund their activities.

The Local Government Act 2002 replaced legislation that mandated specific services. It included a new purpose clause, giving councils a power of general competence and local choice regarding the services to be delivered to their communities. The act required councils to specify their intended levels of services and to work with their communities to prepare a ten-year long-term plan. Councils are now also required to each provide a 30-year plan for infrastructure.

Expenditures also vary considerably across authorities. In 2013 the six largest operating expenditure categories on average by activity were, from high to low, transport and roading (at 29.1%), council support services (14.9%), water, storm water and waste water (14%), recreation and sport (8.5%), culture (6.5%) and planning and regulation (5.3%). Other categories included property, environmental protection, solid waste/refuse, economic development, community development, governance and emergency management.

Revisions to the legislation in 2010 and 2012 focused on improving the performance of local governments and improving transparency, accountability and financial management. Some modifications allowed more flexibility to make use of targeted rates, with a view to assigning rates more precisely to the benefits received. No provision has been made, however, for introducing new sources of revenue.

Good practice principles for funding arrangements

Local government funding design should be guided by acknowledged good practice principles for taxation and revenue systems. Some criteria for well-designed funding policies and arrangements are allocative and technical efficiency, horizontal and vertical equity, administrative simplicity and transparency. The efficiency criterion is concerned with ensuring that the tax system does not distort economic behaviour and incentives, and maintains relative prices to avoid economic inefficiency. Equity is about fairness. Horizontal equity means treating people who are equal in terms of their income or economic status the same way; vertical equity seeks to compensate for differences in ability to pay, by varying taxes for different income groups. Governments pursuing growth and efficiency have become interested in administrative simplicity, to keep the administrative and compliance costs of taxation relatively low as a proportion of the revenue collected.

In New Zealand, discussion of funding for local government tends to place an extraordinary emphasis on the burden of rates on ratepayers, and on perceived inequities and inefficiencies. Many candidates in local government elections have campaigned on the platform of keeping rates down, unsurprisingly given the reliance on rates as a principal source of funding. Some councils make use of differential rating, which allows councils to impose different rates on property values for residential, commercial and industrial property, and differentials can also be used to impose different rating levels on properties in different value classes. Differentials are sometimes used with a view to considering differences in the benefits received and/or ability to pay of different classes and value classes of property. Councils can also impose a uniform annual general charge which is imposed at the same rate for all ratepayers.

Making decisions on how to fund various council services requires consideration of the purpose of delivering the services and the precise benefits received from them. Public services can confer private benefits to the

users of the service; benefits to those in the community who support councils' delivery of services irrespective of whether they personally benefit from them; and benefits to others, including visitors, who do not contribute to the funding of services. Funding arrangements such as the metering of water are designed to produce efficiencies, as user charges will make individuals more aware of costs and provide incentives to reduce the amount used. Water saving confers benefits to other users, and financial benefits to the council and thus indirectly to all those who help finance council services.

The nature of benefits from a service – such as swimming pools, for example – will vary between communities, and funding policies must have regard to the public and private benefits they confer. The proportion of public and private benefits from swimming pools will differ within and between councils depending on who uses the pools, and the degree to which entry is subsidised for particular user groups. In Auckland a decision to provide free swimming for people under 16 years of age was initially made by a local board, then extended to all parts of the city by the governing body. Public funding of pools and other recreational facilities is often delivered to ensure access for the community which would otherwise be unaffordable to some individuals and groups.

Services provided by central or local government may provide private benefits to users and benefits to those who do not use the services themselves. If the services provided by councils were producing only private benefits to individuals, then, in theory, one could consider mandating that households purchase specific services, such as rubbish collection. The services provided by governments are often those that benefit the community even though they confer private as well as public benefits. Public parks and reserves are an example of amenities from which both public and private benefits are enjoyed.

As observed, councils in New Zealand continue to rely principally on rates for revenue. They can impose differential rates on property zoned for different purposes, and can also differentiate

within a specific category of property by value class or other attributes. Differential rating for commercial property is widely used by large urban councils. Research commissioned in 2016 by the Property Council of New Zealand reported commercial differentials, which are multiples of the general rate applied to residential property by the same council. The commercial rates differential applied by Wellington councils in 2015 were: Wellington City 2.8; Porirua 3.5; Lower Hutt 3.14; and Upper Hutt 2.7. The proportion of general rates collected from commercial property ranged from 22% in Upper Hutt to 45% in Wellington City. Only Porirua had a uniform annual charge.

available to councils, or subsidies linked to income or consumption taxes collected by central government.

These issues raise questions as to whether the revenue base in New Zealand should be diversified, and if central government should share some of the proceeds from GST with local governments, or find ways to reward communities which are growing and thus generating revenues to local governments. In some countries sub-national governments, particularly in large urban areas, have access to a local tax based on income, payroll or sales, which can generate some local revenue from local and international visitors and others who place significant demands on

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The use of differentials makes the rating system less transparent, in that valuation becomes less important in determining the quantum of rates paid by different sectors. These arrangements have the effect of increasing the share of rates paid by commercial ratepayers. Differential rates can make it more difficult for people to predict their liability for rating increases in the future than if a single uniform rate was imposed on all classes of property.

Debate about new sources of revenue is more common in rapidly growing cities such as Auckland, but the issues involved also affect small rural communities and areas with small local populations that are popular with tourists and visitors. There is ongoing discussion about the costs associated with visitors and tourists and the revenue contribution they make to local governments. One option to consider is imposing taxes on visitors and tourists, which should be paid locally. There is no payroll, income or sales tax

council services but do not contribute to local taxes. Such a subsidy, for example, is the sharing by the federal government in Australia of the proceeds of the goods and services tax with the state governments.

The funding review examined several potential new sources of funding for councils. It focused particularly on issues of rapid growth and housing affordability in fast-growing urban areas, but also looked at the financial challenges facing small districts with declining populations and rating bases, which still need to renew infrastructure and maintain services, and the service delivery requirements of places that are under pressure from non-resident populations.

A key theme of the funding review's recommendations was the need to re-examine existing funding arrangements to provide stronger incentives for councils to support economic growth and to strengthen local communities. Oliver Hartwich, executive director of the New Zealand Initiative and a member of

the LGNZ working group, describes the current approach to growth as follows:

In New Zealand, unfortunately, we have separated out the benefits and costs of development. Taxes on economic activity – income profit and sales taxes – typically end up in central government's coffers. Yet costs associated with increasing economic activity – infrastructure spending but also losses of amenity – are borne locally.

economic development. Environment Canterbury, for example, has developed a comprehensive strategy with support from mayors of all the local councils in the region. The local government sector has been through a long period of constant reform and legislative change, and could benefit from more certainty about its functions, structures and funding policies. If councils are to be encouraged to support growth more proactively and are to provide infrastructure efficiently and effectively, there is a case for looking

expanded and strengthened Local Government Commission has a focus on reorganisation and the potential benefits of further consolidation of local governments. But legislation currently before a select committee proposes to reintroduce mandatory community polls on any proposed amalgamation of councils. The bill proposes allowing the commission to amalgamate particular councils' services, as distinct from their identities, where it believes this will lead to efficiencies. The New Zealand Council for Infrastructure Development considers this approach to improving local government to be too narrow. Its report on local government and planning reform proposes 'a fully integrated planning, governance, funding, regulation, delivery, and resource management system that will drive regional social and economic development, improve environmental outcomes and strengthen local democracy and community engagement' (New Zealand Council for Infrastructure Development, 2015).

Designing funding policies should involve consideration of the potential role of new sources of revenue, and of the principles that should guide the design of a robust and suitable funding system.

As a result of this disconnect, central government is a pro-development force while local government is an obstacle to growth by definition. This affects all sorts of development, whether of residential housing, new businesses, or more controversially, oil and gas exploration and mining. (Local Government New Zealand, 2015b, p.8)

There remain many options to consider. The jurisdictional structure of local government might be subject to change, with implications for the roles local governments undertake, as well as for funding. The tendency has been to seek amalgamations, reducing the number of councils and gaining efficiencies in service delivery, without changes in councils' roles. Regional councils were formed in response to environmental concerns, but may yet take on a wider role regarding growth and economic development: this function is sometimes carried out by specific councils, or by separate economic development agencies, but some regions are beginning to work with local councils on regional

at ways to broaden their permissible revenue base.

This should in turn serve to make councils more receptive to accommodating growth and development. Social, environmental and cultural outcomes will need to be considered, and mechanisms devised to help governments make informed judgements about individuals' and communities' well-being, and on the benefits and costs of alternative courses of action.

The local government reform agenda

In many countries arrangements for funding local governments are the subject of lively debate because the range of funding sources is wide. Governments with multiple levels of sub-national government often have arrangements for revenue sharing, with the aim of transferring revenues from higher- to lower-level government units. These transfers are made for various purposes.

Efforts to secure alignment between functions, jurisdictional arrangements and financing arrangements can be undermined by selective focus on any one of these three dimensions at the expense of the other two. The recently

The issues facing Auckland regarding growth, transport, urban planning and housing affordability are challenging and substantial. They are not unique to Auckland. Tourism is growing, and regional development strategies are being developed by local governments in various regions.

Conclusions

Assessing the suitability of funding arrangements requires balanced consideration of the roles and functions to be undertaken; the jurisdictional structure of local government; and the adequacy of the level and mix of revenue sources. These three elements must be able to work well for a diverse range of local and regional councils in New Zealand. The diversity of issues, opportunities and challenges for New Zealand councils necessitates policy settings that recognise and cater for the whole range of communities and regions in New Zealand. Designing funding policies should involve consideration of the potential role of new sources of revenue, and of the principles that should guide the design of a robust and suitable funding system.

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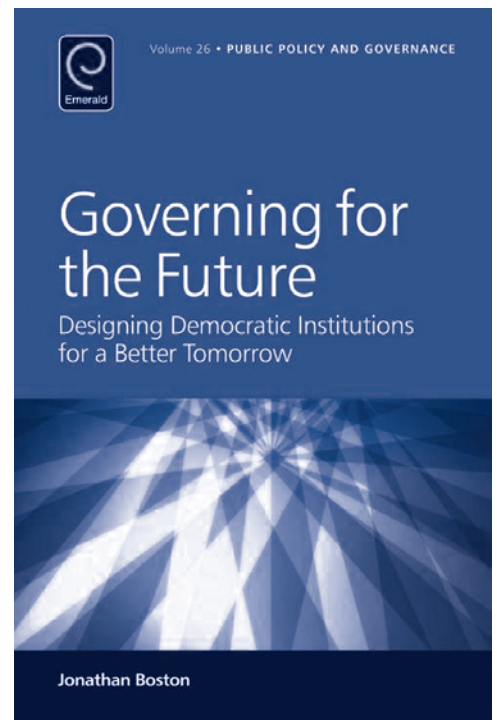
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