Grey Power
NEW ZEALAND FEDERATION INCORPORATED

# Submission to the Productivity Commission on the funding and financing of Local Government

## Introduction

This submission is made on behalf of the New Zealand Grey Power Federation Inc.

The New Zealand Grey Power Federation(GPF) is a non-sectarian and non-party political, advocacy organisation that aims to advance, promote and protect the welfare and well-being of older people. Made up of some 75 individual Associations with an overall membership of approximately 65,000, GPF is the premier organisation representing older New Zealanders.


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## Preamble

Whilst we acknowledge the importance of all the questions posed in the discussion document, there are several where we feel that our level of knowledge and expertise is such that we cannot add anything beyond the factors noted in the discussion document. We have omitted any reference to these questions in our response, except where we wish to emphasise the importance of a point.

The level of rates and the ability to pay them are of major concern to older New Zealanders, an increasing number of whom have limited income. We are also concerned at the projected number of older people who will shortly enter old age with little or no assets. We consider provision of services, including housing to this demographic will become a major point of expenditure for local as well as central government. At the same time we understand that some categories of current expenditure, particularly roading, will become increasingly discretionary as it has overseas, when balanced against potential finance and funding constraints.

## Responses to Questions

### Q1 What other differing circumstances across councils are relevant for understanding local government funding and financing issues?

Whilst not adding to the list of circumstances noted, we would emphasise the importance of the projected changes in demographic profiles of local government areas across the country. We consider that local government has an increasing role to play in the provision of housing and transport services for older people, noting the project increase in the requirement of this age group for rental housing, and especially for rental housing at below market rates[1]. Given other demographic changes and the implications for funding noted in the discussion document, we are concerned that mismatches between services required for older people, and available sources of revenue will be unevenly spread across local government areas.

### Q2 What explains the difference between the amount that councils account for depreciation and the amount spent on renewing assets? Are changes needed to the methods councils use to estimate depreciation? If so, what changes are needed?

We do not feel able to comment on the first part of this question, but we do have concerns that much local authority infrastructure, particularly that associated with the 'three waters' has been insufficiently maintained and that equally insufficient reserves have been allocated for renewal. To that extent we consider that depreciation accounting should be reviewed. We acknowledge that funding depreciation is a major tool in delivering inter-generational equity, and are concerned that under funding as much as over-accounting militates against this. Our main concern is that councils have under-funded depreciation in an attempt to minimise rates increases.

### Q3 In what ways are population growth and decline affecting funding pressures for local government? How significant are these population trends compared to other funding pressures?

We concur with LGNZ that with an increasing number of superannuitants living on a fixed income, whether in rental accommodation or their own home, the opportunity for any increased revenue from rates is severely limited. Unless other revenue sources are available and practical, we consider that this can only be addressed by changes to rating differentials in favour of private dwellings.

### Q4 What are the implications of demographic changes such as population ageing for the costs faced by local government?

As we note in the response to Q1 above, we consider that an ageing population will require a change to both services and service levels provided. We consider that housing and transport are key areas that local government will be expected to provide in the future.

### Q6 Is an expansion of local government responsibilities affecting cost pressures for local government? If so, which additional responsibilities are causing the most significant cost pressures and what is the nature of these increased costs? To what extent do these vary across local authorities?

Although we do not believe that this is causing significant cost pressures currently, we are concerned that the financing and funding implications of climate change and of rising sea levels together with the cost implications for both infrastructure and housing should be at the forefront of council's planning. In the immediate term we are concerned that those councils that are taking pro-active steps are facing costly legal challenges from those whose equity is adversely affected. We concur with Boston and Lawrence that future costs should be minimised by regulatory control to prevent development in high risk areas. We agree that the basic indifference of the public to risk mitigation in favour of disaster relief is a major problem, but can offer no solution beyond continuing education.

Additionally we are particularly concerned at the degree to which responsibilities have for many years been passed to local government by central government without the associated funding.

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[1] Tenure insecurity and exclusion: older people in New Zealand's rental market, 2018, James, Bev, Saville-Smith, Nina, EuropeanNetwork of Housing ResearchersConference, Uppsala Sweden
Give Me Shelter: An Assessment of New Zealand's Housing Assistance Policies, 2013, Johnson, Alan,The Salvation Army Social Policy and Parlimentary Unit
Taking Stock: The Demand for Social Housing in New Zealand, 2017, Johnson, Alan, The Salvation Army Social Policy and Parlimentary Unit

Q7 How is the implementation of Treaty of Waitangi settlements, including the establishment of 'co-governance' and 'co-management' arrangements for natural resources, affecting cost pressures for local government? How widespread is this issue?

Although issues such as co-governance and participatory decision making increase initial costs, we consider there is an overall benefit to the community. We also consider that adherence to the principles of Te Tiriti o Waitangi, the incorporation of Maturanga Maori and acknowledgement and incorporation of Maori spiritual and cultural beliefs in the process of decision making is an essential pillar of New Zealand democracy.

Q8 How are local authorities factoring in response and adaptation to climate change and other natural hazards (such as earthquakes) to their infrastructure and financial strategies? What are the cost and funding implications of these requirements?

We consider it essential to differentiate between 'natural hazards'(sic) that are entirely random in time, place and effect, such as earthquakes; and processes such as climate change where these dimensions can be predicted with increasing certitude as data and the sophistication of models increases. We again emphasise the importance of prevention and reduction of impact, by stopping development in areas that will be affected.

Q11 Is local government expenditure shifting away from traditional core business into activities such as economic development, sport and recreation and community development? If so, what is the rationale for this shift, and could these activities be better provided by other parties?

'Tempora mutanur, nos et mutamur in illis'. To suggest that local government expenditure is 'shifting away from core business' fails to acknowledge that societal change is the driver of what is considered 'core business, and that this is not an immutable concept. To the extent that there is an overarching concept involved, we consider the 'core business' of local government is the delivery of public goods. We also consider that the phrase 'could be better provided by other parties' with its implications of privatisation, also fails to acknowledge the diversity of views attaching to the word 'better' in this context.
We are opposed to any privatisation of services, but note that delivery of services such as potable water, are managed effectively by the private sector overseas, further calling into question the definition of 'core services'. We do not suggest that private organisations do not have a role in the delivery of a public good, but that the success of that service must be validated by community set criteria, not a profit and loss account, and hence must be governed by the community directly.

We also note that although cases may exist where service delivery has improved with privatisation, in the vast majority of cases, 'improvements' and cost savings are achieved by excluding delivery to the costly 'tail', reducing wages and employment conditions or both. We consider that neither of these outcomes are consistent with the concept of delivery of service to the community as a whole.

Q13 What other factors are currently generating local government cost pressures? What will be the most significant factors into the future?

We consider that adaptation to and mitigation of the effects of climate change, together with the associated disruption of current transport and farming sectors when the Zero Carbon Bill takes effect will dominate local government costs for the foreseeable future, no matter how they are expressed or assigned within existing budget structures.

Q16 How effective are councils' Long-term Plan consultation processes in aligning decisions about capital investments and service levels with the preferences, and willingness and ability to pay, of residents, businesses and other local organisations?

The current LTP process is opaque so far as most citizens are concerned. It is also largely a 'mock consultation' since the ability of either public submission or councillor opinion to effect more than minor changes is very limited. Attempts to improve citizen engagement by singling out specific items of expenditure together with costs and rating implications, whilst welcome, often merely diverts attention to projects several orders of magnitude smaller in cost terms than the business as usual expenditure and financing associated with major infrastructure.

### Q18 How much scope is there for local government to manage cost pressures by managing assets and delivering services more efficiently?

Experience has shown that there is scope for both cost savings and improved services through collaboration between adjacent TLAs. We also consider that improved data collection and service monitoring with the emphasis on 'agile' preventative maintenance rather reactive problem fixing will deliver similar benefits. We agree that investment in risk management is an effective and worthwhile strategy, and that greater emphasis on demand side management within the areas of greatest expenditure needs to have much higher profile.

### Q19 What practices and business models do councils use to improve the way they manage their infrastructure assets and the efficiency of their services over time? How effective are these practices and business models in managing cost pressures? Do councils have adequate capacity and skills to use these practices and business models effectively?

See response to Q18

### Q21 What incentives do councils face to improve productivity as a means to deal with cost pressures? How could these incentives be strengthened?

We consider that councils have few incentives to improve productivity. Of the factors listed in the discussion document, we consider the aversion to risk as the most pernicious. We understand that this is a natural outcome of a public culture that is essentially blame seeking in behaviour, and only grudgingly acknowledges success. Nonetheless the degree which complaints are seen to be driving both policy and implementation rather than building on success is a major concern.

### Q27 How do councils manage trade-offs between the ability to pay and beneficiary pays principles? What changes might support a better balance?

We consider the rates rebate scheme as the principle vehicle for maintaining affordability on the finance side, whist noting that this can lead to inequity where a landlord incudes the rate component of their costs within a total rent, thus excluding tenants from the scheme. To rectify this, we suggest that consideration should be given to collection of rates directly from the occupier rather than the owner.
We consider that the regressive nature of uniform annual charges outweighs any cost savings form collection and that these charges should be abolished. Where the use of a service has a high discretionary component we consider that consumption charging is appropriate, but we consider that essential services including public goods where the benefits accrue outside the local government budget structure, should be funded from the general rate.

We note that whilst it is generally accepted that if the 'ability to pay' principle is to be applied equitably, wealth as well as income must be taken into consideration, the ability of many older people on fixed incomes and no easily liquidisable assets is in practice a major concern for our members. For example we note that rate deferment is available from an increasing number of councils but that this process is not well understood and that there is a high level of resistance to asset decummulation amongst many older people.

## Q28 Do councils currently distribute costs fairly across different groups of ratepayers? If not, what changes to funding and financing practices would achieve a fairer distribution of costs across ratepayers?

With the exception of UAGC we consider that cost distribution by tax type across different groups of ratepayers is broadly fair. However we consider that inequity arises when comparing domestic rate payers with businesses. We understand the implications of the cost flow on to the wider community, but consider that the differential for businesses of whatever sort should be increased, agreeing that for businesses "rates are a small proportion of operating revenue".

## Q29 Do councils currently distribute the costs of long-lived infrastructure investments fairly across present and future generations? If not, what changes to funding and financing practices would achieve a fairer distribution of costs across generations?

We do not have the expertise to add to the points made in the discussion document, but wish to emphasise our concern that future generations (our grandchildren) are not disadvantaged in any methodology used to spread cost across generations.

## Q30 What principles should be used to appraise current and potential new approaches to local government funding and financing, and how should these be applied? What are appropriate trade-offs across these principles?

The criteria for a successful and sustainable system of taxation are quoted in the discussion document. It should be:

- Fair,
- Administratively simple
- Convenient to pay and transparent,
- Economically efficient

The additional premises of Benefit received and Ability to pay do however pose problems. With benefit received, a practical problem is that individual's perception of benefits received tend to differ when the benefit delivered lies wholly or principally in the domain of public rather than private good, and this can effectively limit the utility of this approach in those areas. With the ability-to-pay, as noted above, the problem lies in the practical application of a tax on wealth to achieve equity, where a high proportion of the wealth to be taxed is not readily realisable, and there is no associated revenue stream.

## Q32 Is there a case for greater use of certain funding tools such as targeted rates and user charges? If so, what factors are inhibiting the use of these approaches?

We consider that targeted rates are appropriate where the benefit derived can clearly be limited to a defined population. As noted above, we consider user charges when applied as a consumption tax and where discretion of use is high, a valid and useful approach. However we consider UAGC as both regressionary and counter to the principles of good management since there is no price signal limiting usage nor incentive to reduce usage through efficiency.

## Q33 What is the rationale underlying councils' approach to levying rates? What are the costs and benefits of shifting from a capital value system to a land value system?

New Zealand Treasury data indicates that rates based on capital value are regressive, a factor that is exacerbated for Superannuitant rate payers, since their homes were on average of higher value than those of non-superannuitants with similar income[2]. Consequently, superannuitants with incomes in deciles 2-8 need to devote a larger proportion of their income to paying rates than other property owners with a similar income.

Land value based rates on the other hand is considered progressive as the value of the land owned by those with higher income is a greater share of the total land value in a Territorial Local Authority. A view endorsed by the Productivity Commission in its 2015 Draft Report on land supply.

Regardless of whether land or capital value is used, the majority of perceived problems with rates appear to rise from complex application of differentials which undermine their essential simplicity and efficiency.

### Q36 What are the pros and cons of a funding system where property rates are the dominant source of funding? Does the local government funding system rely too heavily on rates?

Rates remain the only major tax on wealth in New Zealand. This has two major implications. First it is perceived as inequitable that one form of wealth is taxed whilst others are not, and secondly the removal of any tax on wealth can only increase the inequity within society[3]. It is difficult to argue against the taxation of wealth in principle, but the close association of this form of tax has led to a unique dislike of rates. It does however firmly ground the tax base within the area of the authority levying the rate, tying it to a high level of transparency and local political control. We are concerned that other forms of taxation run the risk of diluting that connection and the effectiveness of local governance.

### Q37 Under what circumstances (if any) could there be a case for greater central government funding transfers to local government? What are the trade-offs involved?

Although we noted above the problems with the transfer of functionality without funding from central to local government, we are concerned that transfers of funding may be associated with greater central government control, overt or otherwise, on expenditure at local level, contrary to the principle of subsidiarity. In particular, the benefit received basis of taxation relies on the allocation of cost and value to the community at large through the political process. These allocations can and do vary widely between communities based on local preference. Where local costs are met by transfers from a central source, this link is broken and rather than being held to account for failing to manage expenditure efficiently, councillors are as likely to be rewarded for their ability to negotiate a higher transfer.
It is also evident from submissions to the Local Government Commission, that the ability to control expenditure and taxation at a local level is of high importance to New Zealand communities.

In contrast, where a public good is constant across all communities, central government has the most appropriate tools. This is recognised through central government's funding of targeted benefits such as the rates rebate scheme.

### Q39 What funding and financing options would help councils to manage cost pressures associated with population decline? What are the pros and cons of these options?

We agree with the commission that areas with declining populations will be best served through central government assistance conditional on policies to adapt to nil or negative economic growth.

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[2] Policy Advice Division Inland Revenue Department and HM NZ Treasury, *Land Tax: Background paper for session 3 of the Victoria University of Wellington Tax Working Group*, 2009, Victoria University of Wellington: Wellington.

[3] The price of inequality, 2013, Stiglitz, Joseph, WW Norton & Co.
Capital in te Twenty First Century, Pickety, Thomas, Harvard University Press

We consider the reaction of councils in developing ‘growth strategies’ as wasteful and wishful thinking. It seems evident that there will be major disruptions in many areas of industry, including primary industries, as well as service delivery within the short to medium term. We consider that highly adaptable distributed systems will be better placed to serve the community in the future, and that in many cases the effectiveness achieved will outweigh any short term gains from economy of scale under the present regime.

### Q41 What are the pros and cons of local income and expenditure taxes?

We believe that these options and their pros and cons were thoroughly explored in the Shand report. We note that generic consumption taxes, such as a locally set value added tax, have high administrative and compliance costs, and are subject to market distortions when trading takes place between authorities with different rates. Similarly, local income taxes have often been posited as a means of widening the tax base from property owners. However, the underlying assumption that the property tax base is narrow has been found to underestimate the levels of transfer involved. Local income taxes are considered inefficient, creating disincentives for work, and having high cost of administration.
Overall efficiency and equity would be eroded if a relatively non-distorting property tax was replaced by a more distorting income or sales taxes.

### Q42What are the advantages and disadvantages of a local property tax as an alternative to rates?

One of the most justified criticism of rates is the complex manner in which they are applied, with a maze of differentials applied in attempts to further political or social objectives. The alternative approach of a progressive property tax could potentially increase revenue whilst simplifying the system and benefiting those most in need. It is however likely to meet strong opposition and will again have to face the problem of decummulation by many superannuitants if they are to meet the tax required, particularly since their properties tend to be in the upper levels of price distribution. We note and agree however with the comment by Infrastructure New Zealand that the likely pressure a local property (land) tax would have on elected councillors would create an incentive to reduce the cost of houses via increased supply.

### Q47If New Zealand replaces rates on property with a local property tax, should it also adopt tax increment financing as a way to finance growth-related infrastructure investments? What are the advantages and disadvantages of tax increment financing?

We consider that this option should be explored in more detail. We certainly appreciate the ability of TIF to provide equitable distribution of taxation based on benefit received, and that this would also be more efficient than the current methodology. We consider that it also provides an efficient means to manage intergenerational equity, but lack the financial expertise to critique it fully.