



29 August 2019

Chairman and Members
New Zealand Productivity Commission
Wellington

Submission on Local Government Funding and Financing Draft Report

This submission is made by the Local Government Think Tank which is supported by a small group of councils seeking to understand and apply new approaches to the role and function of local government including innovation in how councils work with their communities. Think tank submissions and reports are developed with input from members but represent the views of individuals directly involved with the think tank rather than those of member councils themselves

This submission should be read in conjunction with the Local Government Think Tank's (LGTT) submission on the Commission's issues paper, especially in respect of its discussion on the role of local government, and on a possible approach to revenue sharing between central and local government based on GST.

Reaction to the Draft Report

Generally, the LGTT welcomes the Commission's draft report including its detailed and positive analysis of a number of areas of concern facing local government such as funding tourism infrastructure, the impact of the unfunded mandate, the need to address the respective roles of central and local government in regulation, the often inappropriate and over detailed compliance requirements, managing the response to climate change, the need for improved governance within local government and the importance of improving local government's engagement with its communities.

There are three specific issues which are the focus of this submission. They are the Commission's:

- Understanding of the role of local government;
- Proposal that the benefit principle should be the main guide to allocate costs of services; and
- Stance on allocating a proportion of GST to local government.

Understanding the role of local government

At the beginning of chapter 6 the Commission states "Local government's role is to enhance community wellbeing through regulating land use, choosing and funding a set of local amenities and investing in essential infrastructure for transport, water, wastewater and stormwater."

In essence, this is defining the role of local government as primarily a local infrastructure company. This definition is both inconsistent with the purpose and role of local government as stated in the current version of the Local Government Act 2002 and significantly out of line with current international thinking about the nature of local governance. In practice, it is a description of a role for local government which denies to the communities it serves any governing infrastructure capable of representing the interests of that community unless they are directly concerned with local amenities and infrastructure. If applied, it would mean that there was no ready means available to communities to express concerns over issues ranging from inequality, to the impact of loneliness, to how to address the challenges of multiculturalism, to dealing with the local impacts of observing the principles of Te Tiriti o Waitangi, to how to manage the impacts of educational underperformance, to responding to/anticipating major changes in labour markets affecting a council's communities.

There has been a considerable amount of research internationally in recent years seeking to understand the rise of populism as evidenced, for example, in the election of President Trump in the US, the Brexit referendum in the UK and the rise of new political parties at the extreme of the right and left in many European jurisdictions. This research has been a subset of research seeking to understand how best to ensure that public services, including major social services, are managed to achieve the outcomes desired.

A common theme is the pivotal role of local government in building resilient communities able to play a part in determining how best to address their priorities and concerns.

The importance of this role of local government is well described in the recent submission from the Convention of Scottish Local Authorities to the current review of local governance in Scotland¹. The submission is a good reflection of current thinking about the role and function of local government and how it should work with and support its communities. The submission includes this statement which is a good summary:

*Our key theme is the need for **empowerment** and the huge opportunity that this review presents to empower citizens and communities across Scotland. This has driven this submission to the Review of Local Governance. Indeed, our key critique of local government's position within the current system of Scottish governance is local government's relative disempowerment. Disempowered citizens and communities become dispirited, discontented and angry. These*

¹ the full submission is available at: <https://www.cosla.gov.uk//cosla-submission-review-local-governance>

conditions lead to the rise of populism with the mobilisation of the 'left behinds' elsewhere but Scotland cannot expect to be immune. At an individual level, it has health, including mental health implications. Public health improvements require the empowerment of individuals and communities. Local governance requires empowerment to facilitate citizen and community empowerment. We are calling for the increasing demands on local government services to be matched by greater empowerment so that councils and their partners have all of the capability and capacity to act to protect and strengthen the communities they serve.

That is why we are clear that any reform should empower individuals, communities and local authorities across Scotland. This will require reforms which we discuss below under three headings: community empowerment, functional empowerment, and fiscal empowerment.

Our evidence gathering also suggests that our governance arrangements were designed for a different era and have evolved in a manner that is making it increasingly difficult to achieve the outcomes on which there is a consensus for across Scotland. In many instances the thinking behind reforms such as the establishment and development of Community Planning Partnerships and more recently Integrated Joint Boards (IJBs) suggest a direction of travel and key lessons for reform that conform with thinking within the local government community.

The point is much more than just a subtlety of definition. It has important implications for how to think about local government financing and funding including what this implies for partnership relationships between local and central government.

LGTT invites the Commission to revisit its description of the role of local government and bring it into line with current international understanding and practice.

The benefit principle

In respect of the benefit principle, the Commission states "Central government takes the lead on macroeconomic stabilisation and redistribution across citizens including by providing a social safety net for the least well off. Local government may still consider ability to pay, but it should use the benefit principle as its main guide to allocate the costs of its services in a fair and efficient manner."

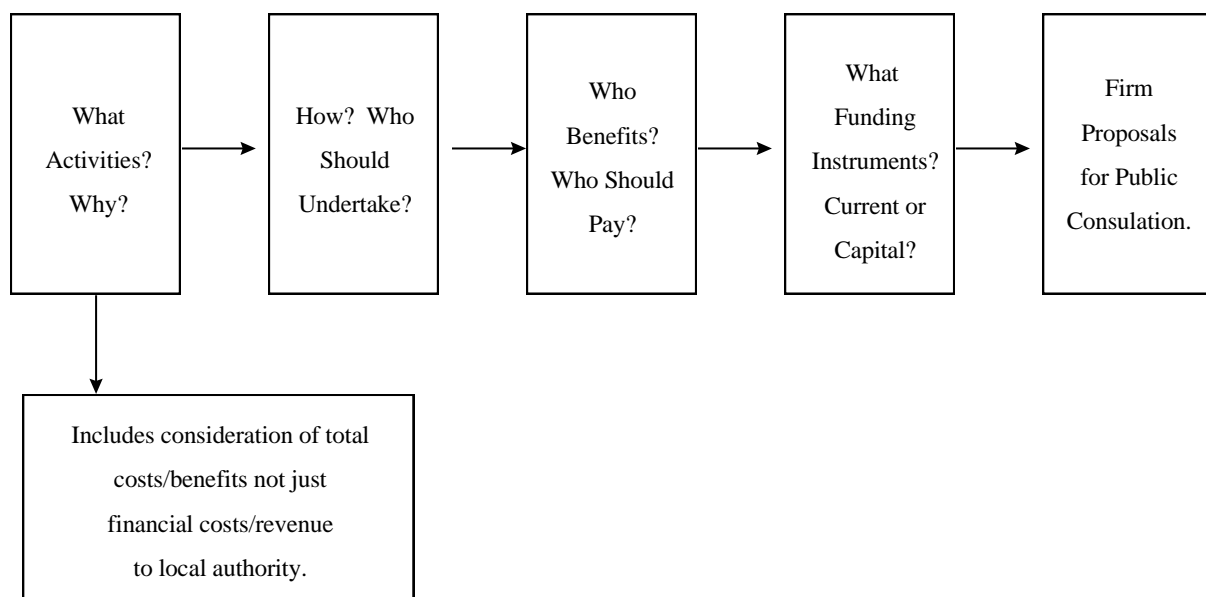
Rates have traditionally been regarded as a tax with the necessary implication that they are based on a measure of ability to pay rather than the value of the services which the individual ratepayer receives. At a local level there are very good reasons for this approach. A literal application of the benefit approach would mean that in a council such as any of our large metropolitan centres poorer communities would receive a significantly lower standard of service including amenities, than wealthier communities simply because of an inability to pay.

The Commission's approach would undermine what has been long-standing practice (albeit occasionally controversial as owners of high-value properties protest in part because of the high visibility of rates as compared with other

forms of tax to which they may be subject). It would further increase the significant inequalities which are already a feature of the districts of most if not all councils.

On a more practical note, it is also an approach which has been previously tried within New Zealand and then abandoned largely because of difficulty in implementation.

What was variously referred to as the Number 3 Act or the New Financial Management Legislation (the local government amendment act number 3 1996) included an attempt to impose a public good framework on local authority decision-making, in essence, a detailed application of the benefit principle. It included not just requirements on how liability for rates should be allocated but a series of other requirements about the activities which should be undertaken, by whom, and what funding instruments should be used. The basic principles are set out in the following diagram:



The expectation was councils would go through a detailed analysis, apply appropriate economic principles, and determine a set of activities, funding instruments and allocation of responsibility which complied with those principles. The reality was very different. First it became very clear that, at least in a local government context, judgements about what constituted private, public and merit goods had a highly subjective element. Next, it was clear that most elected members not only rejected the concept that the benefit principle should be the primary determinant, but were also strongly influenced by what they saw as traditional understandings both of the activities which the Council should be involved with, and how responsibility for meeting costs should be allocated. Library services provided a very good example.

Critics of the way in which local authorities fund libraries argued that books were substantially private goods and that the people who benefited from their use were those who read them or used them as reference tools. Local authorities typically argued (in what was clearly a merit good and/or externality argument, although seldom expressed as such) in terms such as "Dunedin takes pride in its standing as one of the country's oldest cities and being the seat of the original

University of New Zealand. Founded by Council in 1908 the library reflected the importance then of cultural values to the city, and today the Resident's Opinion Survey continues to rate this amenity very highly. Council has always supported equitable access to library facilities for the whole community, regardless of ability to pay."

In theory, central government could seek to develop a set of classifications to apply to each current local government service determining the extent to which the service was a private good, a public good, a merit good, generated externalities which themselves should be taken into account... The reality is such an attempt would both be extraordinarily burdensome and an unwarranted intervention in the local democratic process. It would in essence come close to making local government merely a delegate of central government.

The reality is local government is inevitably in the business of considering ability to pay. In practice that approach is constrained by a number of factors including public accountability (which the Commission's proposals would enhance), the electoral process and the often powerful lobbying of interest groups who prefer to see rates treated as a fee-for-service.

LGTT invites the Commission to revisit its statement and accept that a long-standing and inevitable part of the role of local government is recognising ability to pay as a factor in how rates are determined and liability for payment allocated.

GST

In its submission on the discussion document, the LGTT argued the case for allocating a proportion of GST for the benefit of local government with that proportion to be allocated in much the same way the Australian Financial Assistance Grants Scheme operates. Under that scheme a sum of money is allocated annually to the states and the Northern Territory for distribution to local government. Within each state distribution is handled by a state local government grants commission which is required to apply a set of principles consistent with the provisions of the Federal legislation (details can be found at: <https://regional.gov.au/local/assistance/national-principles-allocation-of-grants.aspx>).

In New Zealand an equivalent would see local government's proportion of GST allocated by a national grants commission required to apply a set of criteria determined in accordance with legislation. It could require the grants commission to set criteria which not only recognised issues such as the strength of an individual Council's rating base, but also the importance of incentivising an emphasis on growth. Potentially this could be far superior to the commission's suggestion of a grant from central government based on new building work put in place.

Before discussing that option, it's worth noting that the objections which the Commission raises to allocating a proportion of GST have not stood in the way of the effective operation of the Australian Financial Assistance Grants Scheme nor has it seemed to be a problem with the practice under which GST in Australia is collected by the federal government but allocated to the states under a formula determined by the Federal Grants commission. The Commission's second objection, that further funding from central government would undermine local government autonomy and accountability is basically a statement that any

significant new revenue source for local government should be in the form of a local tax determined and administered by individual councils. The LGTT cannot see any appetite at either central or local level for such an initiative and notes that the Commission itself has not proposed one.

The proposal to incentivise local government to encourage growth through a grant for new building work put in place has at least two significant problems with it, especially as to have any worthwhile impact on the incentives facing councils the amount involved would need to be significant:

- First, it discriminates against any other council initiative to encourage growth and could significantly distort local government decision-making.
- Secondly, there is already serious concern regarding the extent to which New Zealanders are committed to investment in property especially residential property (note that New Zealand is one of the outliers worldwide in the size of individual newbuild houses). It could not be assumed that the sole impact of such a scheme would be to encourage councils to look more closely at the efficiency with which they manage their regulatory activities in terms of land use, building consents, inspections et cetera. It is at least as likely that councils would start looking at innovative ways of encouraging additional building activity, and not necessarily activity which would improve the country's performance and productivity.

The LGTT invites the Commission to revisit its assessment of the GST option including experience with grants commissions in Australia, and how criteria for allocation of a share of GST could be set so as to encourage desired outcomes.