Submission by

BusinessNZ

GROWING PROSPERITY AND POTENTIAL

to the

New Zealand Fire Service Commission

on the

Public consultation paper on the setting of the rates of levy on contracts of fire insurance for the 2017/18 financial year

November 2016

PUBLIC CONSULTATION PAPER ON THE SETTING OF THE RATES OF LEVY ON CONTRACTS OF FIRE INSURANCE FOR THE 2017/18 FINANCIAL YEAR SUBMISSION BY BUSINESSNZ[1]

1.0 Introduction

1.1 BusinessNZ welcomes the opportunity to submit on the New Zealand Fire Service Commission *"Funding Fire and Emergency Services for all New Zealanders Public Consultation Paper"* (the "Consultation Paper").

1.2 BusinessNZ considers the Government's decision to categorically reject general taxation as a major source of funding for fire services is seriously deficient and ought to be reviewed in light of the fact that much fire service activity comes within the public good category. A number of credible organisations have reviewed the situation and found the current levy on fire insurance seriously deficient. See for example, reports by the New Zealand Institute of Economic Research (NZIER) and Castalia Limited.[2]

1.3 BusinessNZ remains concerned that the paper's proposed funding arrangements fail to comply with its own departments' (notably the Treasury's) best practice funding policy guidelines, as well as to take account of some of the best thinking coming out of the Australian Productivity Commission. BusinessNZ considers the Government needs to revisit its proposed funding policy in respect to fire and emergency services or risk facing a justified public accusation of seriously flawed policy development.

1.4 This submission is in two sections: The first covers the proposals outlined in the Consultation Paper and provides specific comments on them. The second outlines BusinessNZ's concerns regarding the Government's decision to effectively raise costs on fire insurance contracts to fund the transitional fire and emergency services' regime for the 2017/18 year. It also looks at the rationale for particular public service charging regimes and cites a number of reports which provide guidance on appropriate charging regimes and which BusinessNZ recommends that the Government heeds.

[1] Background information on BusinessNZ is included as Appendix 1.
[2] "*The Future of the Fire Service Levy", NZIER report to the Insurance Council of New Zealand"*, 9 May 2014 and *"Review of the Fire Service Funding Model",* Castalia Report to the New Zealand Professional Firefighters Union, March 2012.

Recommendations

BusinessNZ **recommends** that:

As most fire and emergency service activity is of a public good nature, the Government revisits its proposal for a funding system based on insurance levies and instead funds most of the cost of the new fire and emergency services from general taxation, requiring also a relatively low level contribution from fire and rescue service users via user charges.

Without prejudice to the above recommendation:

BusinessNZ **recommends** that:

Before proceeding with its proposed funding approach, the Government carefully considers the Australian Productivity Commission Report *"Cost Recovery by Government Agencies – Inquiry Report No.15, 16 August 2001"* where the principles that should relate to charging for Government provided services are set out.

BusinessNZ **recommends** that:

As the current consultation relates to an increase for levy payers to fund the new FENZ in its first year and with a new broader-based funding regime not in place until 1 July 2018, the Government should (at least) fund the transition cost from general taxation.

2.0 Section 1: Proposals in the Public Consultation Paper

2.1 The Fire Service Commission is proposing a significant increase in levy rates on fire insurance which currently funds the fire service. The increase equates to around 40 per cent for many residential properties, motor vehicles and commercial properties.

2.2 Subject to the coming into force of the Fire and Emergency New Zealand Bill from 1 July 2017, the New Zealand Fire Service, National Rural Fire Authority and 76 Rural Fire Authorities will unify into one organisation, Fire and Emergency New Zealand (FENZ). FENZ is intended to deliver a more flexible fire and emergency service, with resources used more efficiently and effectively to support all firefighters. It also provides a legal mandate to deliver the additional, non-fire services the public expects.

2.3 Fire Services in New Zealand are currently funded in a number of ways. The Fire Service (urban) and the Commission are funded by the Fire Service Levy collected on fire insurance policies; the Rural Fire Authorities are funded by property rates with some cost recovery. The unification of these services and FENZ's widened mandate to include activities outside the 4 R's of fire (reduction, readiness, response and recovery), necessitates a change to the fire services' funding model.

2.4 The change to form the FENZ means that both rural and urban fire services will now be funded using a levy on material damage insurance contracts rather than only fire insurance contracts, together with a small contribution from Government to recognise the fire service's wider public benefit.

2.5 The table below sets out the increased levy rates the Fire Service Commission considers necessary to ensure the current level of service is maintained and to support transition to the new organisation.

Category	Current 2016/17 levy	Proposed 2017/18 levy	Difference
Residential	7.60 cents per $100 insured (insured amounts capped at $100,000 for residential buildings and $20,000 for contents) Maximum levy payable per house is $76 and $15.20 for personal property	**10.60 cents per $100 insured** **(insured amounts capped at $100,000 for residential buildings and $20,000 for contents)** **Maximum levy payable per house is $106 and $21.20 for personal property**	An increase of 3.0 cents per $100 insured (a maximum increase of $30.00 per annum for residential buildings and $6.00 per annum for contents)
Non residential	7.60 cents per $100 insured (uncapped)	**10.60 cents per $100 insured (uncapped)**	An increase of 3.0 cents per $100 insured (e.g. an additional $3,000 per annum for those with insurance of $10 million)
Motor vehicles (less than 3.5 tonne)	$6.08 (flat rate)	**$8.45 (flat rate)**	An increase of $2.37 per vehicle per annum

2.6 BusinessNZ opposes any tax on insurance to fund FENZ. Taxing insurance to fund what is widely regarded as essentially a public good is fundamentally flawed. (See Section 2 for an expansion of these concerns). A tax on insurance is also likely to be costlier to collect than funding through other means, including general taxation.

2.7 The specific impact on particular sectors also needs to be considered, including the impact on insurers who will have to comply with the proposed changes within a limited timeframe.

2.8 Not only is BusinessNZ opposed to the proposed funding change, it has significant concerns about the consequences of the levy increases themselves (in the order of 40% in some cases) and the rationale for them.

2.9 Key concerns include:

(a) The consultation paper states that there has been no increase in the levy rate for eight years. This gives the misleading impression that the New Zealand Fire Service's revenue from the tax has remained static. The reality is that revenue from the levy has increased by $70 million since the last levy adjustment in 2008. This revenue growth far exceeds inflationary growth over that time resulting in a real increase in funding for the service. It is quite fallacious to imply that the absence of a levy increase provides a reason for an increase of the magnitude now proposed.

(b) The consultation now being undertaken is for a levy increase to be applied to current levy payers to fund the new FENZ in its first year. It is worth noting this means current levy payers will bear a disproportionate burden of the up-front costs since the broader-based levy collection system will not apply until 1 July 2018 following the enactment of the FENZ Bill. At minimum, there is a strong case that the Government should fund this "transition" cost out of general taxation until the new funding regime is in place.

(c) The significant levy increase referred to above will apply in an uncapped way to commercial property insurance. BusinessNZ is concerned that such a large increase will result in commercial property owners under-insuring their properties in order to contain the levy increase.

(d) Finally, we are concerned that the new FENZ arrangements will drive up costs and lead to further levy rate increases (see para 3.11.)

3.0 Section 2: Discussion on the appropriate funding arrangements for Fire and Emergency Services

3.1 BusinessNZ remains seriously concerned about the Government's continued decision to fund the new fire and emergency services largely out of fire insurance levies rather than general taxation.

3.2 BusinessNZ raised its concerns in its submission to Internal Affairs on *its "Fire Service Review: Discussion Document (2015)"*. There, BusinessNZ expressed concern Internal Affairs' decision not to consult on the funding via general taxation option suggested political interference, particularly as the rationale for this source of funding is sound, most fire service activity being of a public good nature. BusinessNZ stands by the comments made at that time.

3.3 On page 63, the Internal Affairs Discussion Document outlines the benefits of general taxation (compared with an insurance-based levy). These are worth recapping:

- it ensures all taxpayers are required to contribute;
- it removes the confusing legislation that has given rise to possible levy minimisation;
- it would be highly cost effective, as government would be able to use its existing tax revenue collection systems;
- it would be relatively stable and predictable when compared with an insurance levy on premiums; and
- funding decisions would be subject to Treasury scrutiny, potentially increasing the Commission’s accountability and efficiency.

3.4 The discussion document then went on to state (presumably principally, if not solely, on the basis of the potential cost to government) that ***"Ministers have decided that the Government will not pursue further investigation into this option as part of this review process".*** This decision, however, makes a mockery of the whole consultation process, particularly given the strong economic justification for funding much fire service activity via general taxation in light of its public good nature.

3.5 Given many of the desired outcomes and outputs of the fire and emergency services, it is evident the services are overwhelmingly carried out to protect the wider public interest - of the New Zealand economy, its citizens and the environment. The benefit is to *all* New Zealanders, not just selective (private) groups or particular sectors of the economy but to New Zealand Inc. Therefore clearly, fire and rescue activities are a public good.

3.6 A significant issue cutting across all government services/regulatory enforcement is what is the appropriate charging/levy regime where there is no contestability in service provision. In normal competitive markets, individuals make trade-offs between price and quality of service, along with a host of other factors.

3.7 Where an agency seeks to recover some or all of the costs of service/regulatory provision from service users or direct beneficiaries, the general public, or individuals paying for the service, need to be assured the charges set are not excessive in relation to costs incurred and take proper account of efficiency and equity considerations.

3.8 The danger with fire and emergency services provision, with what are effectively monopoly rights and guaranteed funding, appear to be threefold.

3.9 First is the concern the service price set by the monopoly, the private business or in this case, the fire service, will exceed what it would be had the service’s provision been made contestable.

3.10 Second is the potential for the fire service to provide a sloppy service in the knowledge that there are effectively no other competitors in the market.

3.11 Third (the corollary of the second and more likely) is the potential for the fire service to provide a "gold-plated" service in the knowledge that any increased costs can simply be passed on to private sector businesses and individuals via the insurance levy.

3.12 A number of BusinessNZ members are increasingly raising concerns about government departments and their various agencies using a variety of charging regimes to recoup the costs associated with the provision of goods and services and with specific regulatory interventions in particular sectors. Are such costs justified or are they simply an easy source of revenue for government agencies?

3.13 Various government agencies provide a wide range of goods and services where cost recovery (or some portion of cost) is required from specific groups. Common areas include customs, transport, electricity, fisheries etc. The list goes on.

3.14 Key issues which need to be examined in deciding to charge are:

- Is the good provided largely of a "public" or "private" good nature?[3]
- Are the beneficiaries of the good or service able to be clearly determined?
- Do they have alternative (contestable) choices?
- Are there wider benefits beyond those immediately identified?
- Do users agree to the charges being implemented (i.e. see clear benefits in paying for a particular good or service) or do they oppose simply because they are "free-riders"?
- Have users (payers) been adequately consulted in the design of the charging regime to avoid the potential for "gold-plated" services to be provided?
- Is charging going to increase efficiency?
- What are the transaction costs involved?

3.15 In terms of the appropriateness of cost recovery mechanisms, the fundamental point to be acknowledged up-front is that this will largely depend

[3] A Public Good (of which there are very few in reality) essentially requires two tests to be met. 1. that it is impossible to exclude an individual from utilising (or benefiting from) the good (non-excludability principle) *AND* 2. where one person's consumption of the good does not adversely impact on anyone else's consumption of the good (non-rivalry in consumption principle). Probably the most widely known public good which meets these two tests is National Defence. Lighthouses were often raised in the past as another example of a public good but it is possible to charge for such services (through port charges on ships etc.) so lighthouses don't necessarily meet the strict test of a public good. Public goods are unlikely to be provided to a sufficient extent by the private market, simply because of the inability to recover costs.

A private good in effect means a good which it is physically and economically feasible to identify and charge to users (or beneficiaries) and to exclude non-purchasers. Therefore, if it is profitable to provide a good or service, the market will normally do so. The saying goes "If you can charge for it then it is very likely to be a private good". As an aside, some people are often confused about the difference between publicly provided services and public goods. Most *publicly* provided services (e.g. public transport) are clearly private goods.

on the nature of the good or service provided. Each case has to be determined on its merits. There can well be justification for charging on efficiency grounds but the nature of the charge requires serious consideration to avoid obvious risks such as government simply passing on the costs of inefficiencies (or minimising its own risk through gold-plating).

3.16 A number of publications are available which provide in-depth thinking on the appropriateness of charging by government agencies. Probably the best is a Report undertaken by the Australian Productivity Commission *"Cost Recovery by Government Agencies – Inquiry Report No.15, 16 August 2001".* This report (over 600 pages) provides a very good basis for looking at the principles relating to charging for government-provided services.

3.17 Cost Recovery Principles covered in the report include, amongst others:

- Cost recovery should be implemented for economic efficiency reasons not merely to raise revenue.

- For regulatory agencies, in principle, the prices of regulated products should incorporate all the costs of bringing the products to market, including the administrative costs of regulation.

- In all cases, cost recovery should not be implemented where:
  (a) it is not cost effective;
  (b) it would not be consistent with policy objectives;
  (c) It would unduly stifle competition and industry innovation (for example through "free-rider effects").

- Operational principles for cost recovery include:
  (a) using fees for service where possible;
  (b) applying cost recovery to activities, not agencies;
  (c) not using targets;
  (d) not using cost recovery to finance other unrelated government objectives; and
  (e) not using cost recovery to finance policy development, ministerial or parliamentary services, or to meet certain international obligations.

- Design principles for cost recovery include:
  (a) generally, avoiding cross-subsidies;
  (b) ensuring transparency and accountability; and
  (c) undertaking industry consultation.

3.18 Some other papers worth pursuing on the issue of the appropriateness of Government Charging regimes include:

(a) The Treasury, "*Guidelines for Setting Charges in the Public Sector"* (December 2002).
http://www.treasury.govt.nz/publications/guidance/planning/charges/charges-dec02.pdf

(b) Controller and Auditor General, *"Charging Fees for Public Sector Goods and Services – Good Practice Guide"* (June 2008). http://www.oag.govt.nz/2008/charging-fees/docs/charging-fees.pdf

3.19 As initially stated: BusinessNZ remains seriously concerned the proposed funding arrangements advocated in the public consultation paper fail both to achieve the best practice guidelines proposed by its own departments (notably the Treasury) and to take into account some of the best thinking coming out of the Australian Productivity Commission. The Government needs to revisit its proposed funding policy in respect to fire and emergency services or risk facing a justified public accusation of seriously flawed policy development.

APPENDIX 1

BACKGROUND INFORMATION ON BUSINESSNZ

BusinessNZ is New Zealand's largest business advocacy body, representing:

- Regional business groups EMA, Business Central, Canterbury Employers' Chamber of Commerce, and Employers Otago Southland
- Major Companies Group of New Zealand's largest businesses
- Gold Group of medium sized businesses
- Affiliated Industries Group of national industry associations
- ExportNZ representing New Zealand exporting enterprises
- ManufacturingNZ representing New Zealand manufacturing enterprises
- Sustainable Business Council of enterprises leading sustainable business practice
- BusinessNZ Energy Council of enterprises leading sustainable energy production and use
- Buy NZ Made representing producers, retailers and consumers of New Zealand-made goods

BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy and services for enterprise, BusinessNZ contributes to Government, tripartite working parties and international bodies including the International Labour Organisation (ILO), the International Organisation of Employers (IOE) and the Business and Industry Advisory Council (BIAC) to the Organisation for Economic Cooperation and Development (OECD).

BusinessNZ family