Submission by

BusinessNZ

GROWING PROSPERITY AND POTENTIAL

to the

Review into the Future for Local Government

on the

Draft Report (October 2022)

February 2023

SUBMISSION BY BUSINESSNZ[1] TO THE REVIEW INTO THE FUTURE FOR LOCAL GOVERNMENT DRAFT REPORT – OCTOBER 2022

1.0 EXECUTIVE SUMMARY

1.1 BusinessNZ welcomes the opportunity to submit to the Review into the Future for Local Government Draft Report – October 2022 *("the Draft Report").*

1.2 There are several areas where BusinessNZ strongly endorses proposals outlined in the Draft Report. BusinessNZ agrees with the Draft Report contention that unfunded mandates should cease and that it is important to improve decision-making to ensure the costs and benefits of proposed interventions are much more transparent. Requiring better Regulatory Impact Statements (RIS) on improving the quality of regulation and including central government in the rates-paying base are also issues BusinessNZ has promoted over many years. It is pleasing to see the Draft Report endorsing some of these business community concerns.

1.3 On the other hand, there are several areas which will be of concern to the business community. For example, the lack of recognition that the "beneficiary principle" should largely determine who pays for local government, concern about potential new charges associated with value-capture (unless well-developed with affected ratepayers closely involved) and some muddled thinking over potential new revenue streams.

1.4 Proposals for greater participation by some sectors (e.g., lowering the voting age to 16 and citizen assembly models) and requiring greater participation of iwi/Māori through various decision-making processes, might in fact lead to greater uncertainty and even slower and more contracted decision-making than is currently the case. Uncertainty will likely be exacerbated by some of the Draft Report's proposals specifically said to target increasing democracy and participation in local government affairs.

1.5 In essence the Local Government Draft Report considers there are 5 key shifts local government needs to make. These can be summarised as follows:

[1] Background information on BusinessNZ is included as Appendix 1.

1	Strengthened local democracy	**From** low public trust and participation in local governance **To** citizens participating in local decision-making; councils being trusted and reflecting community diversity
2	Authentic relationship with hapū/iwi and Māori	**From** variable relationships between councils and hapū/iwi/Māori **To** strong, authentic relationships between councils and hapū/iwi/Māori that enable self-determination and shared authority
3	Stronger focus on wellbeing	**From** councils often narrowly focused on delivering services and infrastructure To councils focusing on holistic strategies to improve the wellbeing of their communities
4	Genuine partnership between local and central government	**From** low trust between local and central government **To** genuine partnership to co-invest in and deliver wellbeing outcomes for communities
5	More equitable funding	**From** an over-burdened and constrained funding system **To** an equitably funded system that enables communities to thrive

1.6 While BusinessNZ does not necessarily disagree with any of these points, they need to be put in context and be much more clearly defined than they are in the Draft Report. Dealing with each in turn:

1. Strengthened Local Democracy

1.7 This is an important point, particularly in light of an ongoing, low voter local body election turnout – continuing in the most recent elections of September last year. Greater participation is to be encouraged since, as should be noted, a fundamental principle of taxation (or here, rating policies) is "no taxation without representation" – effectively, that those with skin in the game (ratepayers) should have a say in how their assets are to be utilised and the trade-offs they will accept, understanding the costs and benefits alternative approaches. Without stronger local democracy (and an acknowledgment that those that pay should have the major say), there will be a reduced incentive to develop assets and/or invest.

2. Authentic relationship with hapū/iwi and Māori

1.8 BusinessNZ considers improving relationships across the board is critical for local government, but any "relationships" need to be clearly defined to ensure property rights and democratic principles remain clear and understood. Uncertainty of process and/or of decision-making capability will likely debase the value of assets and make raising capital more difficult if ownership is not clearly defined or clarity in decision-making is undermined in any way.

3. Stronger focus on well-being

1.9 While at both a central and local government level there has been an increased focus on the 4 well-beings (economic, social, environmental, and cultural), these need to be much more clearly defined or there is the potential for local government to involve itself in many activities not necessarily in ratepayers' best interests. It's not a case of trying to be all things to all people; local government's role must be clear, with the primary emphasis on providing local public goods and services.

4. Genuine partnership between local and central government

1.10 This is an important point given central government can use its unfunded mandate (through regulations and the like) to impose all sorts of costs on local government (ratepayers) without any ability for those costs to be scrutinised or feedback provided on what local communities are willing to trade-off. There are numerous examples of costs foisted on local government over the years, including costs relating to water quality standards and earthquake strengthening requirements, to name only two significant costs. Local government has little ability to push back on decisions of this kind, hence the need for more transparency as to the costs central government can impose on local government. And arguably, the reverse is also true. If local government does not have sound governance processes in place, central government (taxpayers) can be left to pick up the mess – a general lack of expenditure on water infrastructure over the years being a good example.

5. More equitable funding

1.11 BusinessNZ strongly agrees with the Draft Report that unfunded mandates should cease and that it is important to improve regulatory decision-making to ensure the costs and benefits of proposed interventions are much more transparent.

1.12 A clear recommendation from the Productivity Commission's work on funding and financing local government was the need to apply the "beneficiaries pay principle" i.e., those that benefit should pay for the costs associated with local government activity.

1.13 From the business community's perspective, councils should arguably receive better guidance on the use of available funding tools to ensure greater consistency across the country, underpinned by an economically principled approach to funding council activities. There should also be greater clarity in distinguishing among the following:

a. ***Appropriate pricing and user charges for local authority services.*** Charging for the use of private goods and services would bring greater efficiencies. Some councils charge for water and waste on a user-pays basis, but many still fund such activities out of general rates, sending strictly limited signals to consumers as to the real costs of their behaviour.

b. ***Taxes imposed on a subset of a local authority's ratepayers to fund local public goods of clear benefit to subset members.*** There may be isolated cases where levying additional rates (taxes) on a particular class of ratepayer is appropriate, for example, where specific local public goods benefit a clearly defined subset of ratepayers such as flood control schemes.

c. ***An appropriate tax to fund local public goods of benefit to all residents.*** The administrative costs of council operations could fall into this category, along with the cost of other public goods such as footpaths and street lighting.

d. ***Charges justified as internalising external costs imposed on people or firms.*** For example, these could include emissions charges (if these were not already covered under other existing legislation e.g., the Emissions Trading Scheme (ETS)).

2. INTRODUCTION

2.1 Local government has a vital role to play in advancing the overall well-being of New Zealanders. However, that role is not all-encompassing but needs to be established on a principled basis and properly circumscribed.

2.2 BusinessNZ considers it desirable for local government to focus on the provision of local public goods since it is likely their provision will otherwise be inadequate.

2.3 While individuals, businesses, business organisations and ratepayer representatives all have different views on local government, one common thread is a concern over the increasing rates burden. The aggregate rates burden is running at close to twice the rate of inflation with, in some cases, significant associated inequities. This is essentially a nation-wide issue, although the problem is greater with some councils than with others.

2.4 The business sector pays around one-third of the country's rates bill and the level of rates paid is often entirely disproportionate to the level of services received. The situation is exacerbated by the widespread use of business/commercial rating differentials despite strong evidence supporting their removal. Where councils have agreed to reduce the differentials, they have often been tardy in doing so, tending to incremental change due to "expenditure pressures".

2.5 Other common concerns expressed by the business community include the role and functions of local government (power of general competence), funding allocation mechanisms and mix (including transparency and caps), size of local councils (including the potential for economies of scale), and issues arising from central government's imposition of further costs via regulation.

2.6 A fundamental principle on which a market economy (such as New Zealand) is based is that property owners (including businesses) should have relative security in their property rights with the right to use their property in the manner they choose (while respecting the rights of other property owners).

2.7 Investors, too, must have confidence that any assets they purchase or improve upon will be safe from confiscation or unreasonable restrictions, or alternatively, that they will be compensated for any erosion of property rights. If this is not the case, there will be limited incentive for anyone to undertake long-term investment.

2.8 The remainder of this submission largely focuses and comments on some of the recommendations and questions raised in the Draft Report where these are of particular importance to the business community at large.

2.9 As might be expected, BusinessNZ membership has mixed views on the merits or otherwise of some of the specific proposals, recommendations and questions contained in the Draft Report. As a result, BusinessNZ has encouraged individual members to make their own submissions raising issues particular to their areas of expertise.

3. DRAFT REPORT RECOMMENDATIONS AND QUESTIONS

Chapter 2: Revitalising citizen-led democracy

Recommendations:

R1: That local government adopts greater use of deliberative and participatory democracy in local decision-making.

R2: That local government, supported by central government, reviews the legislative provisions relating to engagement, consultation, and decision-making to ensure they provide a comprehensive, meaningful, and flexible platform for revitalising community participation and engagement.

R3: That central government leads a comprehensive review of requirements for engaging with Māori across local government-related legislation, considering opportunities to streamline or align those requirements.

R4: That councils develop and invest in their internal systems for managing and promoting good quality engagement with Māori.

R5: That central government provides a statutory obligation for councils to give due consideration to an agreed, local expression of tikanga whakahaere in their standing orders and engagement practices, and for chief executives to be required to promote the incorporation of tikanga in organisational systems.

Questions:

Q1: What might we do more of to increase community understanding about the role of local government, and therefore lead to greater civic participation?

BusinessNZ response:

3.1 BusinessNZ notes that this chapter focuses strongly on deliberative democracy.

3.2 The Draft Report proposes a range of initiatives to enhance input into council processes (and enhancing input can be considered a laudable objective), including citizen assembly models, and an increased obligation to give due consideration to engagement etc, but there is little to suggest the proposed mechanisms will either improve outcomes or be generally acceptable to ratepayers who must fund the process of enhanced engagement.

Chapter 3: A Tiriti-based partnership between Māori and local government

Recommendations

R6: That central government leads an inclusive process to develop a new legislative framework for Tiriti-related provisions in the Local Government Act that drives a genuine partnership in the exercise of kāwanatanga and rangatiratanga in a local context and explicitly recognises te ao Māori values and conceptions of wellbeing.

R7: That councils develop with hapū/iwi and significant Māori organisations within a local authority area, a partnership framework that complements existing co-governance arrangements by ensuring all groups in a council area are involved in local governance in a meaningful way.

R8: That central government introduces a statutory requirement for local government chief executives to develop and maintain the capacity and capability of council staff to grow understanding and knowledge of Te Tiriti, the whakapapa of local government, and te ao Māori values.

R9: That central government explores a stronger statutory requirement on councils to foster Māori capacity to participate in local government.

R10: That local government leads the development of coordinated organisational and workforce development plans to enhance the capability of local government to partner and engage with Māori.

R11: That central government provides a transitional fund to subsidise the cost of building both Māori and council capability and capacity for a Tiriti-based partnership in local governance.

Questions:
None

BusinessNZ response:

3.3 BusinessNZ considers that improving relationships across the board is a critical issue for local government, but any "relationships" need to be clearly defined in order to ensure property rights and democratic principles are clearly understood and upheld. If ownership is not clearly defined, uncertainty of process and/or decision-making capability is likely to debase the value of assets and make raising capital that much harder.

3.4 Co-governance arrangements or other mechanisms, such as partnership frameworks that could affect ownership/use rights to resources, are likely to increase risk thereby potentially debasing the value of public and private assets if both are not clearly defined and understood by all parties.

Chapter 4: Allocating roles and functions in a way that enhances wellbeing

Recommendations:

R12: That central and local government note that the allocation of the roles and functions is not a binary decision between being delivered centrally or locally.

R13: That local and central government, in a Tiriti-consistent manner, review the future allocations of roles and functions by applying the proposed approach, which includes three core principles:

- **the concept of subsidiarity**
- **local government's capacity to influence the conditions for wellbeing is recognised and supported**
- **te ao Māori values underpin decision-making.**

Questions:

Q2: What process would need to be created to support and agree on the allocation of roles and functions across central government, local government, and communities? What conditions will need to be in place to ensure the flexibility of the approach proposed does not create confusion or unnecessary uncertainty?

Q3: What additional principles, if any, need to be considered?

BusinessNZ response:

3.5 As previously stated, while at both a central and local government level there has been an increased focus on the 4 well-beings (economic, social, environmental, and cultural), these need to be much more clearly defined or there is the potential for local government to involve itself in many activities not necessarily in ratepayers' best interests. It's not a case of trying to be all things to all people; local government's role must be clear, with the primary emphasis on providing local public goods and services.

3.6 Local government has a vital role to play in advancing New Zealanders' the overall well-being. However, that role is not all-encompassing but must be established on a principled basis and properly circumscribed.

3.7 BusinessNZ considers it desirable for local government to focus on the provision of local public goods, since, as noted, it is likely their provision will otherwise be inadequate. There is little incentive for the private sector to provide goods and services where the return on investment is probably low or in the worst case, non-existent.

3.8 While on the margins there will always be debate about what constitutes a public or a private good, a diagram from a Local Government Business Forum (LGBF) publication, *Local Government and the Provision of Public Goods,* provides a very useful overview of some of the key goods and services many local authorities are currently providing. The intention is to categorise the goods and services either as relatively pure public goods, or as private goods, based on the fundamental tests of *rivalry in consumption* and *excludability of consumption* (private good) and *non-rivalry in consumption* and *non-excludability of consumption* (public good). The following table from that publication provides a good basis for enumerating a list of core public goods.

Figure 1: Characteristics of local government services – rivalry and excludability

Rivalry in consumption →

Excludability of consumption ↓	*Public goods*		
	Low	Medium	High
Low	Street lighting, street and traffic signs, parks and reserves, civil defence, public health and safety (eg security cameras), and democratic, representative and regulatory functions	Low-use roads, footpaths and cycleways	Remedying marine pollution, biosecurity (pests and noxious plants) and graffiti removal from public facilities and areas
Medium	Flood protection	Sports grounds, public conveniences and bus ways	High-use roads, tourism promotion, economic development
High	Museums and galleries	Public libraries, swimming pools, indoor recreation facilities and public venues	Ports, airports, public transport, water and waste water, rubbish disposal, cemeteries, car parks, cinemas and housing
			Private goods

Chapter 5: Local government as champion and activator of wellbeing

R14: That local government, in partnership with central government, explores funding and resources that enable and encourage councils to:

- **a. Lead, facilitate, and support innovation and experimentation in achieving greater social, economic, cultural, and environmental wellbeing outcomes**
- **b. Build relational, partnering, innovation, and co-design capability and capacity across their whole organisation**
- **c. Embed social/progressive procurement and supplier diversity as standard practice in local government with nationally supported organisational infrastructure and capability and capacity building**
- **d. Review their levers and assets from an equity and wellbeing perspective and identify opportunities for strategic and transformational initiatives**
- **e. Take on the anchor institution role, initially through demonstration initiatives with targeted resources and peer support**
- **f. Share the learning and emerging practice from innovation and experimentation of their enhanced wellbeing role.**

Questions:

Q4: What feedback do you have on the roles councils can play to enhance intergenerational wellbeing?

Q5: What changes would support councils to utilise their existing assets, enablers, and levers to generate more local wellbeing?

BusinessNZ response:

3.9 See previous comments on Chapter 4. In essence, BusinessNZ considers the best contribution local government can make to well-being is to focus on the efficient delivery of core local public goods.

<u>Chapter 6: A stronger relationship between central and local government</u>

<u>Recommendations:</u>
None

<u>Questions:</u>
As we work towards our final report, we want to consider the merits of the different examples. We are interested in your views as to how to rewire the system of central and local government relationships through developing an aligned and cohesive approach to co-investment in local outcomes.

Q6: To create a collaborative relationship between central and local government that builds on current strengths and resources, what are:

- **a. the conditions for success and the barriers that are preventing strong relationships,**
- **b. the factors in place now that support genuine partnership,**
- **c. the elements needed to build and support a new system,**
- **d. the best options to get there,**
- **e. potential pathways to move in that direction and where to start,**
- **f. the opportunities to trial and innovate now, how can central and local government explore options that empower and enable a role for hapū/iwi in local governance in partnership with local and central government?**

These options should recognise the contribution of hapū/iwi rangatiratanga, kaitiakitanga, and other roles.

<u>BusinessNZ response:</u>

3.10 This is an important area given central government can use its unfunded mandate (through regulations and the like) to impose all sorts of costs on local government (ratepayers) without any ability for those costs to be scrutinised or to provide feedback on what local communities are willing to trade-off. There are numerous examples of costs foisted on local government over the years, including water quality standards and earthquake strengthening requirements to name two significant costs. As local government has little ability to push back on these sorts of decisions, there needs to be more transparency as to the costs central government imposes on local government. And arguably, the reverse is true for local government. Without sound governance processes in place, central government (taxpayers) can be left to pick up the mess – lack of expenditure on water infrastructure over the years being an example.

3.11 Several issues arising from the relationship between central and local government are of concern to the business community and need to be addressed.

3.12 First, the impact of central government decision-making, imposing added costs on local government, must be considered.

3.13 There are numerous instances where central government imposes costs on local government without taking account of the full ramifications of its actions. One response might be to require central government to pay compensation to local government for the costs associated with what might be considered inappropriate controls, or where local ratepayers receive little or no benefit. BusinessNZ therefore supports the Draft Report proposal that unfunded mandates should stop.

3.14 However, although BusinessNZ is prepared to contemplate the above option, our clearly preferred approach would be to ensure central government develops a principled Regulatory Responsibility Act (RRA) to minimise the risk of introducing inappropriate regulations and controls in the first place. But in the absence of any central government desire to implement such an Act, BusinessNZ supports further consideration of a local government compensation regime.

3.15 Constraining what local government can and should do is likely to be another effective tool for ensuring the focus is on key core activities rather than on 'nice to haves' paid for by local ratepayers.

3.16 Also, it is often the case that the provision of local government goods and services is not subject to the same degree of competition as is the provision of the many everyday goods and services acquired or used by businesses and households in general (i.e., local government does not face the same competitive pressures that often apply to the private sector.)

3.17 Therefore there is considerable scope for local government to manage cost pressures by managing assets and delivering services more efficiently through:

- greater aggregation and sharing of local government resources across local and regional boundaries, thereby achieving greater economies of scale,
- greater use of user-pays principles to send users of services clear signals (in real time) as to the costs associated with the provision of certain goods and services, consequently limiting the overall cost to other ratepayers,
- divestment or recycling of assets.

3.18 In many cases, councils own assets that could be sold or partially sold to build new infrastructure. Shares in council-owned assets could be sold to pay for urgently needed infrastructure, recycling one asset into another, higher priority, asset. For example, the listing of Napier Port Holdings is an example of the investment arm of a local council using such an exchange to partially realise its assets and fund expansion opportunities.

3.19 While some councils obtain significant investment income from revenue-generating assets, the justification for continued local authority ownership is weak. Some councils try to justify their exposure as a mechanism for reducing the general rates burden, but the exposure potentially puts ratepayers at risk should returns on assets prove lower than expectations. The problem of funding expansion for local authority-owned assets is also raised, with a potential tension between a council's desire for investment returns in the form of dividends and a company's asset base need for reinvestment and growth. Moreover, given that in general private sector companies out-perform state-owned companies, logically, the private sector should be prepared to offer a premium on the current valuation of many local authority assets; hence ratepayers would receive a windfall gain from asset sales.

3.20 Arguably, although local government can obtain debt funding at lower rates than some private sector participants, this does not justify local government involvement in the provision of private good infrastructure. Lower funding rates generally reflect a lower risk because ultimately local authorities can call on their ratepayers either to fund any shortfall or to carry the risk of low investment returns. It is important to accept that local authority funding does not eliminate risk but transfers it from the private sector (which is often better placed to manage risk) to ratepayers.

3.21 There would appear to be significant scope for councils to divest themselves of their commercial businesses where there is no sound continuing rationale for ratepayer ownership e.g., electricity lines businesses, airports, and ports. This would free up significant funds either as returns to shareholders (i.e., ratepayers) or to invest in core local public goods activity. The difficult part is encouraging local councils to give up their commercial activities voluntarily, without either covert or overt pressure from central government.

3.22 It might also be possible to provide for more of what are in effect, "government to government" joint funding initiatives, where assets are transferred between government agencies to boost balance sheets, e.g., the Accident Compensation Corporation (ACC) and the New Zealand Superfund purchasing a stake in KiwiBank (subsequently sold back to government.) Some local government assets could be commercially acceptable to private sector investors but given the public's general resistance, and government's effective commitment to no substantial asset sales, government to government transfer might be an alternative mechanism. Officials could explore this option further as a way of reducing the rates burden.

3.23 The public-private partnership (PPP) model is also well-suited to meeting infrastructure needs – private partners can cover a project's upfront costs while over time, recovering the costs from end users. Consideration should be given to greater private sector participation in infrastructure development, operation, and service provision.

Chapter 7: Replenishing and building on representative democracy

Recommendations:

R15: That the Electoral Commission be responsible for overseeing the administration of local body elections.

R16: That central government undertakes a review of the legislation to:

- **a. adopt Single Transferrable Vote as the voting method for council elections**
- **b. lower the eligible voting age in local body elections to the age of 16**
- **c. provide for a 4-year local electoral term**
- **d. amend the employment provisions of chief executives to match those in the wider public sector, and include mechanisms to assist in managing the employment relationship.**

R17: That central and local government, in conjunction with the Remuneration Authority, review the criteria for setting elected member remuneration to recognise the increasing complexity of the role and enable a more diverse range of people to consider standing for election.

R18: That local government develops a mandatory professional development and support programme for elected members; and local and central government develop a shared executive professional development and secondment programme to achieve greater integration across the two sectors.

R19: That central and local government:

- **a. support and enable councils to undertake regular health checks of their democratic performance**
- **b. develop guidance and mechanisms to support councils resolving complaints under their code of conduct and explore a specific option for local government to refer complaints to an independent**

investigation process, conducted and led by a national organisation

c. **subject to the findings of current relevant ombudsman's investigations, assess whether the provisions of the Local Government Official Information and Meetings Act 1987, and how it is being applied, support high standards of openness and transparency.**

R20: That central government retain the Māori wards and constituencies mechanism (subject to amendment in current policy processes) but consider additional options that provide for a Tiriti-based partnership at the council table.

<u>Questions:</u>

Q7: How can local government enhance its capability to undertake representation reviews and, in particular, should the Local Government Commission play a more proactive role in leading or advising councils about representation reviews?

Q8: To support a differentiated liberal citizenship, what are the essential key steps, parameters, and considerations that would enable both Tiriti- and capability-based appointments to be made to supplement elected members?

<u>BusinessNZ response:</u>

3.24 While the Draft Report proposes a range of initiatives to enhance input into council processes (a laudable objective) including citizen assembly models and imposing greater obligations on councils to give due consideration to engagement processes etc., there is little to suggest these mechanisms will improve outcomes or prove acceptable to ratepayers who must fund them.

3.25 Proposals for greater participation from some sectors (e.g., lowering the voting age to 16 and citizen assembly models) and requiring greater participation of iwi/Māori in decision-making, may in fact lead to even greater uncertainty and slower and more contracted decision-making than is currently the case. Uncertainty is likely to be exacerbated by some Draft Report proposals, although these are specifically said to target increasing democracy and participation in local government affairs.

3.26 A fundamental principle on which a market economy (such as New Zealand) is based is that property owners (including businesses) have relative security in their property rights with the right to use their property in the manner they choose (while respecting the rights of other property owners.)

Chapter 8: Building an equitable, sustainable funding and financing system

Recommendations:

R21: That central government expands its regulatory impact statement assessments to include the impacts on local government; and that it undertakes an assessment of regulation currently in force that is likely to have significant future funding impacts for local government and makes funding provision to reflect the national public-good benefits that accrue from those regulations.

R22: That central and local government agree on arrangements and mechanisms for them to co-invest to meet community wellbeing priorities, and that central government makes funding provisions accordingly.

R23: That central government develops an intergenerational fund for climate change, with the application of the fund requiring appropriate regional and local decision-making input.

R24: That central government reviews relevant legislation to:
- **a. enable councils to introduce new funding mechanisms,**
- **b. retain rating as the principal mechanism for funding local government, while redesigning long-term planning and rating provisions to allow a more simplified and streamlined process.**

R25: That central government agencies pay local government rates and charges on all properties.

Question:

Q9: What is the most appropriate basis and process for allocating central government funding to meet community priorities?

BusinessNZ's response:

3.27 In this chapter, the Draft Report outlines several options for new funding streams as a way of improving infrastructure to accommodate growth. BusinessNZ strongly agrees with the Draft Report contention that unfunded mandates should cease and that it is important regulatory decision-making be improved to ensure the cost and benefits of proposed interventions are much more transparent. Moreover, the importance of central government paying rates and charges should not be underestimated.

3.28 While the search for new funding tools should be seen as positive, there is a distinct danger of new funding mechanisms being used to source additional revenue without any clear understanding of the proper role of local government. There are already arguable cases where targeted rates (including development contributions) have not been based on sound economic principles, quite apart from the widespread continued use of business rating differentials.

3.29 A clear recommendation coming from the Productivity Commission's work on funding and financing local government was the need to observe the "beneficiaries pay principle" i.e., those that benefit should pay for the costs associated with local government activity.

3.30 It is noted in the Draft Report (p.194) that they consider there are problems associated with the beneficiary pays principle because (a) some people have differing ideas about public versus private benefit and (b) councils are required to measure and identify who the beneficiaries of public goods are over a specific time horizon.

3.31 While it is accepted that on the margin there will be some cases where it is difficult to access accurately where the private and public benefits of an activity may lie, the case provided in the draft report of swimming pool costs is a no brainer. Swimming pool users by and large receive private benefits. In respect to the Draft Report's second concern - requiring councils to measure the public versus private benefits associated with council investments - it will be important to determine the rationale for a council infrastructure investment and how it will be paid for. Sure, there will be cases where it is apparent there will be some public (or private) benefit, but it is nevertheless important to have at least a rough back of the envelope analysis in order to determine council's role in funding an activity. Without such analysis, Council will simply have to rely on some other "feel good" factor to determine investment and pricing decisions. Ratepayers deserve much better analysis of decision-making than currently occurs.

3.32 From the business community's perspective, councils should arguably receive better guidance on the use of available funding tools to ensure greater consistency across the country. This should be underpinned by an economically principled approach to funding activities and greater clarity in distinguishing between:

e. ***Appropriate pricing and user charges for local authority services.*** Charging for the use of private goods and services would bring greater efficiencies. Some councils charge for water and waste on a user-pays basis, but many still fund such activities out of general rates, sending strictly limited signals to consumers as to the real costs of their behaviour.

f. ***Taxes imposed on a subset of a local authority's ratepayers to fund local public goods of clear benefit to subset members.*** There might be isolated cases where levying additional rates (taxes) on a particular class of ratepayer is appropriate, for example, where specific local public goods benefit a clearly defined subset of ratepayers such as flood control schemes.

g. ***An appropriate tax to fund local public goods of benefit to all residents.*** Council administrative costs could fall into this category, along with the cost of other public goods such as footpaths and street lighting.

h. ***Charges justified as internalising external costs imposed on people or firms.*** For example, these could include emission charges (if these were not already covered under other existing legislation e.g., the Emissions Trading Scheme (ETS)).

User charges

3.33 Councils currently provide a range of private goods and services, often funded via general rates. Putting aside debate on the role of councils in providing private goods and services, charging for the use of private goods and services would bring greater efficiencies. For example, funding waste disposal out of general rates and supplying every ratepayer with a rubbish disposal bin takes no account of the amount of rubbish generated. To a certain extent this could actively encourage waste generation because effective cross-subsidisation means the full costs of waste disposal are not sheeted home to every household. Water is another good example where clear user-pays pricing principles would encourage greater efficiencies.

3.34 While some councils charge for water and waste on a user-pays basis, many still fund these activities out of general rates, sending strictly limited signals to consumers as to the real costs associated with their behaviour.

Differential and targeted rating

3.35 Differential and targeted rating should only be permitted where a clearly identified community (such as a remote rural area) is provided with a distinctly different level of public goods from that of other ratepayers and the differential or targeted tax reflects the difference in the level of service supplied. There should also be an objective test for benefits received to ensure a consistency of approach. Rating differentials, if used at all, should be used sparingly not, as some councils have done, as a general revenue raising device, on unprincipled and unsubstantiated grounds.

3.36 Sometimes differential rating is applied to the business sector on the unsubstantiated ground that the business sector benefits proportionately more from council services. More than one report has found such thinking to be groundless, yet councils continue to apply significant differentials simply because they can, rather than on any principled economic basis. Where councils have agreed to reduce such differentials, any reduction has generally proceeded at a snail's pace, councils being mindful not to upset the many residential ratepayers who enjoy the advantage of a lower rates burden courtesy of the business sector.

3.37 In the past, numerous people have argued (and many still do) that businesses are advantaged relative to residential ratepayers because they can deduct rates for income tax purposes and claim a credit for GST paid on them. These claims have been discredited by reputable economists for the following reasons: first, a firm can only claim a tax deduction for rates because its income is subject to tax. Nobody could seriously argue it is an advantage to be subject to income tax. Second, a GST registered person or firm can claim a credit for GST paid on inputs because supplies (outputs) are subject to GST. The net GST collected is paid to Inland Revenue, so a business receives no advantage.

3.38 BusinessNZ is concerned about references to the GST status of a business as an alleged justification for imposing local government charges. As indicated above, we do not consider the tax status (including presumed tax status) of a business to have any relevance to the level of charge a council can impose. An unprofitable business logically remains as liable for the use of council-provided services as a profitable one, given the cost of providing the service remains the same.

3.39 There may be isolated cases where levying additional rates (taxes) on a particular class of ratepayers is appropriate - for example, where specific local public goods benefit a clearly defined subset of ratepayers, such as schemes to control floods. However, for taxes of this kind to be justified on both economic efficiency and equity grounds, the target group must be clearly identified and share equally in the benefits. Ideally, the consent of the affected group should be sought before any targeted taxes are considered. And it is important targeted taxes are not used for tapping previously untapped pockets of revenue-raising potential – a distinct danger in the absence of clear controls on when and how such tools can be used.

Value Uplift

3.40 BusinessNZ notes the Draft Reports states that in respect to value capture using targeted rates *"The Panel is aware that crafting value capture provisions that are fair and equitable is challenging."* BusinessNZ strongly agrees with this statement.

3.41 Policy makers need to be very careful to differentiate between property rights adversely affected by government or local government action and acts of nature or people's changing preferences which might similarly affect land values. The latter effect has been visible in recent years in areas in NZ which, almost overnight, have become "trendy areas" where people are prepared to pay significant amounts of money to buy land or houses.

3.42 It would be nonsense to assume that if a railway station is established very close to someone's house that person will receive a direct benefit and will therefore have an enhanced property right. It is assumed use will automatically be made of nearby rail transport but that is not necessarily the case. It might equally be claimed that someone who dislikes skateboarding but is able to walk to a local, rate payer funded, skateboard park is receiving a benefit, requiring a contribution to the cost. What constitutes a benefit is in the eye of the beholder.

3.43 Identifying which properties will benefit from council investment is no easy task since whatever is decided on will likely conflict directly with individual values – that is, with what is valued and what is not. For example, as noted, a flood prevention rate targeted to a clearly identified group of ratepayers can be considered relatively straightforward and appropriate. But trying to determine how land values have changed following an infrastructure upgrade would be extremely difficult, taking no account of individual preferences. For example, a proposed council road extension in Churton Park (Westchester Drive Extension), Wellington, saw residents in the street close to the proposed development, for a variety of reasons, either strongly supporting, strongly opposing or neutral to the extension proposal. Similarly with a private sector (New World) investment decision in the same area – with no council funding involved. Whether individuals consider they benefit from, or are disadvantaged by, any development will inevitably vary, although on the margin at least, associated land prices – depending, of course, on the nature of the development - will more probably have gone up rather than down.

3.44 While land values will likely be tied to much more than the provision of council (or publicly) funded infrastructure, where people choose to live will be based on factors that might or might not be related to specific infrastructure provision (apart perhaps, from obvious services such as sewerage and water.)

3.45 Except where everyone affected benefits (as with a flood control scheme), the council investment approach suggested in the Draft Report raises real issues as to where the boundaries of any council scheme should start and end. The result could be the promotion of public infrastructure which many people affected by it would not support. Consider the numerous activities in which councils are currently involved, cycleways are a case in point (benefitting the relatively few at the expense of the very many others forced to pay for them.)

3.46 There could be specific, isolated cases where land prices radically increase because of public investment provision of infrastructure, but BusinessNZ would caution about using any such proposals generally without rigorous analysis of the overall costs and benefits. This will be particularly pertinent if councils have a relatively free rein when deciding what to be involved with. Just about every investment decision will have some impact on land values but this does not justify using targeted rates as a mechanism to extract money from householders who personally see little or no value in the specific development.

3.47 At its worst, an investment proposal could be seen as an easy funding mechanism for councils wanting to involve themselves in all sorts of projects which do not necessarily meet a rigorous public goods test – or if they do – are not necessarily sought (and happily paid for) by ratepayers.

3.48 With private investments, there are externalities that might sometimes positively affect, for example, land prices but this does not justify subsidising developers to build infrastructure they would ordinarily have market incentives to provide anyway – as with the provision of most private goods and services.

3.49 Virtually every activity has spillover consequences which do not necessarily justify government/local government involvement to address such externalities. For involvement to be justified in a specific case, the externalities must be particularly large to the extent that the benefit of involvement (taxpayers/ratepayers support) is warranted.

3.50 Goods of a largely private good nature should ideally be paid for by users. On the other hand, goods that clearly meet the definition of public goods are generally best funded by ratepayers, if they benefit a region, or central government (taxpayer) funded, if they constitute a national public good (e.g., national defence systems.)

Revenue bonds as an alternative financing mechanism

3.51 The Draft Report suggests a possible option would be to create a replacement infrastructure financing mechanism in the form of revenue bonds.

3.52 It is suggested that more explicit permission could be given to allow infrastructure bonds to be sold by a territorial authority, or presumably a Council Controlled Organisation (CCO), to pay for all infrastructure services required to service a development. Presumably payment of the bond principal and interest costs would then be recovered through regular instalment payments until the bonds and interest were paid off.

3.53 BusinessNZ considers that flexibility in funding approaches is desirable and agrees with the Draft Report that the use of revenue bonds should be investigated further.

3.54 Notwithstanding the above, what constitutes private good infrastructure (the costs of which should be internalised to the extent practicable), as opposed to public infrastructure (where the costs should be socialised), would need to be clearly identified, whatever the funding mechanism developed.

Tolling and Congestion Charging

3.55 Business NZ has long supported moves to allow tolling, public private partnerships (PPPs) and other investment options for urgently needed, high-cost road transport initiatives that have significant community support. The Independent Inquiry into Local Government Rates recommended removing legislative barriers to the funding of transport projects by using tolls[2].

3.56 Tolling would mean people (particularly road users) could seriously question a project's value since the cost would be transparent and up-front. This would put more heat on decision-makers to ensure only efficient transport options made the grade rather than "nice to have" projects.

3.57 It is important to distinguish clearly between tolling related to congestion charging and tolling directed to paying for new roads. Tolling for new roads and congestion charging are two totally different concepts and need to be treated as such rather than lumped together.

3.58 In effect, congestion charging is a system of charging users to manage demand effectively (as with peak pricing in the electricity sector.) The pricing strategy makes it possible to manage congestion without increasing supply. According to market economic theory, under a congestion pricing regime users must pay for the negative externalities created, making them conscious of the costs imposed when consuming during peak demand. It is not, as such, a pricing mechanism that should necessarily be used to pay for new roads – a main concern of road users and taxpayers around the world with congestion charging regimes.

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[2] *Funding Local Government*, report of the Local Government Rates Inquiry (August 2007). See discussion on pages 157-158 of the Report and Recommendation 21.

3.59 Notwithstanding general support for tolling as the most efficient way of funding new roads, BusinessNZ generally opposes the use of this mechanism on existing roads to subside new roads. For all intents and purposes such usage would amount to double taxation (paying twice for assets that have already been paid for.) Tolls should arguably apply only to new roads so that the public and road users have advance notice of the total cost involved and understand the trade-offs required for infrastructure development. Fudging cost by using a wide range of funding mechanisms well beyond tolling new roads (e.g., rates hikes, regional fuel taxes etc.) waters down the signals which road users should receive about the true cost of the various transport options.

Other Funding Mechanisms

3.60 BusinessNZ notes the suggested changes to some of the funding mechanisms outlined in various reports over the years, including funding tools such as:

- A local income tax,
- Local consumption tax,
- Industry and commodity-specific taxation,
- Land tax,
- Citizen's tax (poll tax),
- Payroll tax,
- Royalties.

3.61 All the above mechanisms have inherent weaknesses. A local income or consumption tax would be heavily discounted given it would be necessary to identify where individuals and businesses earn their income. This would be well-nigh impossible given the many complex business arrangements of both businesses and individual ratepayers. Moreover, low income or consumption taxes may have little relationship to the amount of goods or services consumed via local government.

3.62 Industry or specific-commodity taxes (such as "bed taxes" or visitor levies) are inherently distortionary as there is often little or no relationship between the "payer" and the alleged benefits received.

3.63 Narrowly based taxes on certain sectors without clear identification of use (benefit) are highly undesirable and defy good tax principles for economic efficiency, administrative simplicity, flexibility, and fairness (equity.)

3.64 In respect to land taxes, BusinessNZ notes that a land tax is nothing new. NZ had a land tax up until 1992 but the exemptions were considerable so that only a small group of taxpayers was affected, making the tax highly distortionary. As with a

Capital Gains Tax (CGT), the temptation to grant exemptions over time is often politically hard to ignore, potentially undermining the benefits associated with any comprehensive form of land tax.

3.65 The history of poll taxes suggests they are highly unpalatable. There would be practical difficulties in relation to enforcement and fairness and the experience in the United Kingdom in the late 1980s indicates a poll tax would be most unpopular. Poll taxes often provide a very poor indication of the actual use of services provided by central or local government, or of ability or willingness to pay. However, people-based payments may be appropriate where goods and services provided are of benefit to all citizens e.g., in respect to democracy and local government administration.

3.66 Payroll taxes are inherently distortionary by targeting one particular of production – labour. A report prepared for Business NZ[3] found that:

> *"[A payroll tax] …would distort the economy by making one factor relatively more expensive i.e., labour, and with this distortion comes deadweight losses to the economy. The size of this deadweight loss may be considerable since this tax would be across the entire New Zealand labour market. Thus, although the government may aim for it to be revenue neutral, they should consider the indirect deadweight losses within this decision. The deadweight losses come from reduced efficiency of markets, artificially high labour costs, which will lead to capital being substituted for labour, higher administrative costs, and knocking marginal companies out of business." (p.3)*

3.67 In addition, a payroll tax would be a highly targeted tax based on salary and wages rather than bearing any relationship at all to the consumption of local government goods and services. It would penalise wage and salary earners while other potentially asset rich ratepayers would be exempt from the tax.

3.68 Another option promoted by various groups and organisations is for local government to move towards receiving a partial share of any royalty payments both as a funding mechanism and to incentivise the issue of consents. The BusinessNZ Energy Council considers this has significant risks *(see p21-22 under "Should local authorities have a prior claim on exploration royalties".*
http://www.bec.org.nz/__data/assets/pdf_file/0005/89420/BusinessNZ-Energy-Council-Energy-Briefing-2014.pdf

3.69 The publication found that: *"On the face of it, the case for such a diversion of monies is seductive …. However, there are also reasons not to support it."*

[3] Is there a case for a payroll tax? Report to Business New Zealand by Business and Economic Research Ltd (BERL) February 2006

BusinessNZ urges policy makers carefully to consider fully the implications of pursuing a local share of royalties' solution given the issues outlined in the BusinessNZ Energy Council publication referred to above.

Climate Change Funding

3.70 BusinessNZ would suggest any moves towards adopting an intergenerational fund for climate change, as outlined in the Draft report should be approached with a considerable degree of caution for a range of reasons, including the potential for unintended consequences and gaming. Principally, such a move could provide added incentives for individuals and councils to try and offload risk on to third parties, in this case, general taxpayers.

3.71 This is not to say there won't be some issues which will need to be dealt with on a national basis, but by and large, management of risk is best left up to those closest to the actual situation, so they are aware of the costs and benefits of taking or not taking a specific action.

3.72 Notwithstanding the above, BusinessNZ acknowledges the current and future effects of more frequent extreme weather events on New Zealand and its infrastructure, including transport, energy, water, and so on. More long-term thinking is needed to make sure our responses and infrastructure are future-proofed to deal with any additional stress caused by climate change.

3.73 BusinessNZ considers that as a general guiding principle, costs and benefits should be internalised and passed on to individuals as much as possible. In other words, individuals should manage their own risk whether through insurance or through normal market mechanisms (i.e., high risk generally means lower cost property.)

3.74 There should be a very high threshold for central and local government intervention. Intervention should be restricted to cases where there is significant public risk to the wider community (e.g., oil tank next to a waterway or where a building is close to the sea and if not moved away there might be significant environmental and economic damage or public health issues affecting third parties that cannot be mitigated through bonds etc. from property owners.

3.75 There are many possibilities in terms of solutions for local problems and the following might be particularly worth investigating further. Where the costs of continually providing infrastructure are increasing prohibitively due to climate change, it might be possible for local and/or central government to gift assets to local communities to manage as they see fit (provided standards of hygiene for sewage disposal etc. are met.) Alternatively, assets could be sold to communities for heavily discounted values accompanied (or not) by compensation. Contract details would need to be carefully worked through to ensure each party was clear as to what liabilities would arise from such agreements.

3.76 There are other examples of funding arrangements, such as the Lake Taupo "clean-up", where contributions to reducing nutrient emissions going into the lake have been shared between several parties. This has been necessary because of the difficulty of clearly determining who precisely has caused nutrient leaching where leaching has taken place over many years and cannot entirely be pinned on current landowners.

3.77 There is a strong argument for grandparenting current rights (i.e., individuals, businesses/households are compensated if they must move under a high threshold test.) Unless businesses and individuals have reasonable security over their property rights so these are not subject to confiscation or regulatory takings by the state, they will have little incentive to invest. However, given new investors should be aware of the risks to which climate change (and other risks) may give rise, there is a strong argument that in these circumstances, new investors should bear the costs involved (of land erosion etc.)

3.78 A complicating factor for businesses and industries making decisions on climate change mitigation policies is that several industries (in, for example, the energy sector) are regulated by the Commerce Commission and/or other agencies of government in terms of their Rate of Return (ROR) and supply/service agreements. This limits their ability to take account of potential climate risks/hazards without the danger of falling foul of government agency requirements. Therefore, some cost sharing arrangements between government and industry might be needed in dealing with the current and/or future risks associated with investment in climate change mitigation measures.

Rating Exemptions

3.79 BusinessNZ is pleased that the Draft Report recommends that government pay rates, alongside all other ratepayers.

3.80 There is a long list of land that is exempt from rates. For some local authorities, especially those with large areas of DOC estate, this can be a considerable proportion of the total land. These exemptions mean there is a narrower rates' base and place a greater burden on those that must pay rates. It is particularly unfair that the Crown makes no rates contribution, especially as local authority infrastructure and services can be put under severe pressure by visitors attracted to national parks and other reserves.

3.81 The solution to this issue is to review the list of non-rateable categories of land contained in Part 1 of Schedule 1 of the Local Government (Rating) Act 2002 with a view to making the rating system "broad-base, low-rate".

Chapter 9: Designing the local government system to enable the change we need

Recommendations:

R26: That central and local government explore and agree to a new Tiriti-consistent structural and system design that will give effect to the design principles.

R27: That local government, supported by central government, invests in a programme that identifies and implements the opportunities for greater shared services collaboration.

R28: That local government establishes a Local Government Digital Partnership to develop a digital transformation roadmap for local government.

Questions:

Q10: What other design principles, if any, need to be considered?

Q11: What feedback have you got on the structural examples presented in the report?

BusinessNZ response:

3.82 No specific comments.

Chapter 10: System stewardship and support

Recommendations:

R29: That central and local government considers the best model of stewardship and which entities are best placed to play system stewardship roles in a revised system of local government.

Questions:

Q12: How can system stewardship be reimagined so that it is led across local government, hapū/iwi, and central government?

- **How do we embed Te Tiriti in local government system stewardship?**
- **How should the roles and responsibilities of 'stewardship' organisations (including the Secretary of Local Government (Department of Internal Affairs), the Local Government Commission, LGNZ, and Taituarā) evolve and change?**

BusinessNZ response:

3.83 No specific comments.

Appendix One - Background information on BusinessNZ

The BusinessNZ Network is New Zealand's largest business organisation, representing:

- Business groups EMA, Business Central, Canterbury Employers' Chamber of Commerce, and Business South
- BusinessNZ policy and advocacy services
- 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

The BusinessNZ Network 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.

The BusinessNZ Network contributes to Government, tripartite working parties and international bodies including the International Labour Organisation (ILO), the International Organisation of Employers (IOE) and Business at OECD (BIAC).