



Submission
on the
The Local Government Rates Inquiry
from
The New Zealand Chambers of Commerce (Inc)
April 2007

Introduction

The New Zealand Chambers of Commerce (Inc), NZCCI, is an umbrella organisation serving the interests of 34 Chambers of Commerce nationwide. These, in turn, represent over 24,000 businesses around the country. While many of our members are in the SME category our membership includes most of the largest corporations in New Zealand.

This submission is made to the Inquiry panel established by the Minister for Local Government inquiring into the funding of local government. It addresses issues raised in the panel's Terms of Reference and the document produced by the panel, "Background Information for Interested Parties".

Summary and Recommendations

Inflation adjusted rates per head of population grew by almost 30% in the last 20 years. That amounts to a per capita increase of around 1.3% per annum above the inflation rate.

The reason for the rapid growth in the aggregate rate take, and overall level of funding generally, is the growth in the total cost of council activities. This has increased over recent years as the size of local government has expanded and efficiencies have not been great enough to compensate.

Funding of local government activities needs to better reflect the benefits principle than is currently the case. That is, ratepayers should pay for the services they benefit from.

The business sector pays about half of the country's total rates bill but consumes a relatively small proportion of council services. Businesses are often charged more under the dubious grounds that they benefit more from council services but this is seldom substantiated.

It is not in councils' interests to shift the rates burden onto business. Businesses provide employment, pay wages, produce goods and services, and determine the depth of the rating base. If businesses are ill-treated by council rating they are liable to either relocate, close down or contract. The single most helpful thing councils can

do to keep businesses in their area and attract new businesses is to constrain the rates burden and certainly not put the distribution disproportionately on businesses vis a vis residential properties.

In spite of the weaknesses of rates as a revenue raising mechanism, the alternatives (local GST, local income tax, poll tax and industry specific taxes) have different sets of strengths and weaknesses and on balance none are any better.

Councils generally are not highly geared. In aggregate, ratepayers' equity amounts to 94% of total assets. Councils should be encouraged to use debt to fund projects so the cost is spread across future generations of ratepayers who will benefit from them, and to ease the rates burden on today's ratepayers.

Councils should focus on their core business and steer away from ownership of activities such as ports, airports, farming operations, and property investment.

Rating differentials should be used only to facilitate equitable distribution of rates so that cost of services falls on the ratepayers that benefit from them. Business differentials should not be used as a revenue-raising tool and councils should be required to substantiate the benefits before applying them.

Because of a widespread apathy toward local government politics in this country the consultative processes that are used are not sufficiently meaningful. Additional mechanisms are necessary to enhance accountability.

Because local government has a monopoly in the provision of many of its services and because much of its income is guaranteed by legislation, many of its services are inefficiently delivered and/or overpriced. This is a major driver of local government expenditure.

Increased use of benchmarking across councils would enable ratepayers to better assess council performance and allow best practices to come to the fore. Consistent reporting standards and procedures across councils are very important for this. The use of itemised rates assessments facilitates benchmarking and steps should be taken to strengthen this practice.

Rating exemptions should not be allowed to apply to government-owned and Maori land per-se.

We have yet to see quantification of the often-quoted problem of central government regulatory requirements being imposed on local government and would like the Inquiry to investigate this issue further.

NZCCI believes developers should only be required to pay development contributions to council expenditure where they benefit from that expenditure. Councils should not view such contributions as another revenue raising mechanism.

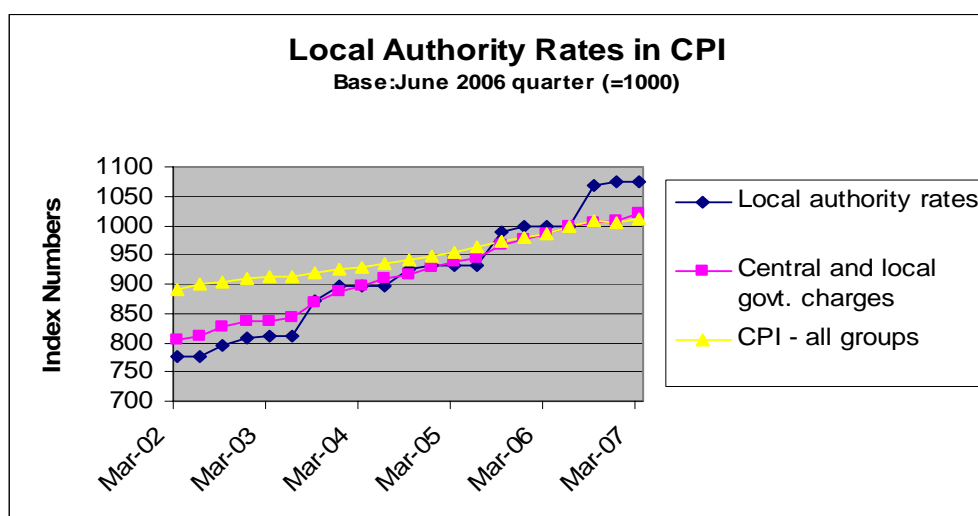
Relief provided through the Rates Rebate Scheme, should be administered centrally through Work and Income New Zealand rather than by councils.

Increasing Cost of Council Activities

The Rates Inquiry has arisen as a consequence of public concern over projected and historic increases in rates.

Inflation adjusted rates per head of population grew by almost 30% in the last 20 years. That amounts to a per capita¹ increase of around 1.3% per annum above the inflation rate. Between 2000/01 and 2004/05, total rates, other taxes, licence fees and fines increased by an average of 6.5% a year, which was well ahead of the rate of inflation and population growth.

The chart below shows that local authority rate increases have far outstripped growth in the consumer price index and its central and local govt charges sub-component.



There is a misconception amongst a large part of the community that rate increases are a consequence of the buoyant property market. On the contrary, it is the rise in property values *relative* to the average that influences the level of rates faced by individual ratepayers not the increase in *absolute* value. The Background Information document clearly points this out and the work of the inquiry offers an opportunity to give further dispel this mistaken belief.

The real reason for the rapid growth in the aggregate rate take, and overall level of funding generally, has been the growth in the total cost of council activities. This has increased over recent years as local government has expanded and efficiencies have not been great enough to compensate.

This illustrates how important the role and function of local government is when considering the issue of rates rises. Unfortunately, role and function of local government is outside the terms of reference. In general, NZCCI believes the core function of local government is the funding and provision of local 'public goods'. Where 'private goods', are provided, NZCCI supports use of user charges and fees or mechanisms which better reflect ratepayers' consumption of services.

¹ We note the Background Information Paper uses rates per household data. Because the number of households is increasing at a faster rate than the population, we believe this understates the increase and consider rates per capita to be a better measure.

While role and function is outside the terms of reference, the panel is tasked with investigating the drivers of local authority expenditure. This is important as the total rate take and expenditure are inextricably linked. Efficiency of local authorities is another driver of local authority expenditure and this should also be investigated by the panel.

As well as increasing expenditure and questions around efficiency of local authorities, funding policies which govern the distribution of rates across categories of ratepayers are to be considered.

Rating policies must not penalise business

Too often councils endeavour to shift the burden of rates and the costs of services onto minority groups that are poorly represented at the ballot box. The business sector, for example, pays about half of the country's total rates bill but consumes a relatively small proportion of council services. Businesses are often charged more under the dubious grounds that they benefit more from council services but this is seldom substantiated.

In spite of businesses being an easy touch (not being well represented at the ballot box) it is not in councils' interests to shift the rates burden onto business. Businesses are the lifeblood of the local economy. They provide employment, pay wages, produce goods and services, and determine the depth of the rating base. If businesses are ill-treated by council rating policies (for example the rating differential – see below) they either relocate, closedown or contract -or, if they can, simply pass the cost onto customers. If businesses flourish cities and districts prosper; if business is in recession the standard of living of the people suffers. The single most helpful thing councils can do to keep businesses in their area and attract new businesses is to constrain the rates burden and certainly not put the distribution disproportionately on businesses vis a vis residential properties.

Rates as a Tax or a Payment for Services?

Much of the controversy and concern around the distribution of rates relates firstly to the confusion as to whether rates are a tax or a payment for services and secondly to whether rates should most appropriately reflect ratepayers' consumption of services or their ability to pay.

Part of the problem is the confusion as to whether rates are a tax or a payment for services. On one hand they are levied as a property tax but on the other hand they are levied as charges for services received. Based on a number of rulings as well as the fact that GST is applied to rates, rates should best be viewed as a payment for services not a tax.

A generally recognised principle is that where local authority functions are "public goods" they should be funded by taxes. Where they are "private goods" they should be funded by charges. The difficulty is in knowing where to draw the line between a public and private good.

Ability to Pay vs Consumption of Services

Two alternative principles are available to dictate how rates should be most fairly distributed across ratepayers: the "benefits principle" (payment in proportion of consumption of services received); and "ability to pay" (payment according to how much the ratepayer can afford).

The problem with rates as a funding tool is that being based on property valuations they do not reflect the ratepayers' usage of council services². Neither do they necessarily reflect their ability to pay.

NZCCI believes that funding of local government activities needs to better reflect the benefits principle than is currently the case. That is, ratepayers should pay for the services they use. Ability to pay should always be taken into account but as a rule income distribution is the responsibility of central government not local government. Unlike central government (with the information it has through income tax), local authorities have no information on the incomes of their residents so any decisions they make to assist people in this regard have the potential to be flawed.

Ostensibly to address the problem of rates not reflecting consumption of services, councils have made increasing use of instruments such as targeted rates, differential rates and the uniform annual general charge (UAGC). These are all designed to better match services received, but none of these are able to do this as well as direct user charges can, and in many cases (particularly with regard to differential rating – see discussion below) they do the opposite.

Targeted rates enable certain services to be separated out and paid for by groups (or even all) ratepayers. Used correctly, targeted and differential rates can allow better distribution of costs on to those ratepayers that use them but, as concluded by the 2005/06, Department of Internal Affairs-led Local Authority Funding Project, too often they are used by councils to tap previously untapped pockets of revenue raising potential.

Other Revenue Raising Mechanisms

As an alternative to rates, a number of different tax bases are available. The Background Information document lists and briefly discusses some of these, namely; a local income tax, a local GST, industry specific taxes (specifically a "bed" tax and petrol tax), a payroll tax and a citizens or poll tax.

The Funding Project evaluated these alternatives. We endorse their conclusion that despite the weaknesses of rates as a revenue raising mechanism, on balance none of these alternatives are any better. While rates have their strengths and weaknesses, the alternatives have a different set of strengths and weaknesses and do not provide a compelling substitute.

Of the alternatives, we are totally opposed to bed taxes and payroll taxes because of their selective impact on specific sectors and employers respectively, and their complete disregard for the benefits principle.

Poll taxes are not favoured because they also disregard the benefits principle. However, as a means of funding a public good where it is deemed that all ratepayers benefit equally, a small poll tax component could have a place.

We would suggest that it would be impractical for local income tax and local GST to be set and collected regionally. Such taxes would only be workable if government were to effectively share its nationally collected revenue with local authorities under

² We do not accept the argument sometimes put by some councils that council services enhance property values and so rates as a property tax ultimately reflect council services received.

an agreed formula. In return local government would have to reduce rates by the same amount. However, this would be difficult to enforce and so all in all, we do not see any gains from this.

If the Inquiry concludes that an alternative tax is required to replace or supplement rates, we would suggest revenue sharing of centrally collected GST (which is a more efficient tax than income tax) would be the best of a bad bunch but as stated earlier there is no compelling case to change.

Debt

Councils generally are not highly geared. In aggregate ratepayers' equity amounts to 94% of total assets.

During the next 10 years, councils in aggregate expect to spend almost \$31 billion on capital expenditure, 2.4 times as much as they spent in 10 years to 2004/05. Councils should be encouraged to use appropriate levels of borrowing to fund these projects to ease the rates burden on today's ratepayers.

The main argument for increased debt relates to inter-generational equity. A considerable amount of local authority capital spending on infrastructure is paid for by today's ratepayers but provides benefits for future ratepayers. Increased debt would spread this cost.

An appropriate level of debt would encourage more scrutiny from lenders. It would also restrict the scope of councils to undertake large, low-priority projects without going to ratepayers.

We note that the 2006 Funding Project found that local authorities are not making full use of debt. Almost 70% of local authorities are not projecting to come within 20% of their self-imposed debt limits between now and 2012/13.

Investment Income

Some local authorities receive a large proportion of their revenue from investment income from assets, such as ports, airports, farming operations and trading companies. The average was 6.1% of their total revenue in 2006 but there was a wide range with a much higher figure for some local authorities.

While such investments may be a good revenue source in the current environment, they may not always be profitable and so it is inappropriate for councils to be holding such risky assets. NZCCI believes that in general, ownership of these activities should be left to the private sector. Many councils hold such assets while at the same time their infrastructure (such as stormwater, sewerage and roading assets) is in a poor state of repair. Councils should focus on their core business assets and steer away from ownership of activities such as ports, airports, farming operations, and property investment.

Rating Differential

As mentioned earlier, differential rates are commonly applied to rateable land used by businesses.

The business differential determines how much more commercial ratepayers pay than residential ratepayers per dollar of rateable land. Currently businesses pay 4.4

times as much as residential ratepayers in Wellington City; 3.1 times as much in Dunedin City; 2.8 times in Christchurch City and 2.1 times in Auckland City.

This means that in Wellington, for example, business ratepayers subsidise residential ratepayers by an average of about \$630 a year each according to figures supplied by Wellington City Council. The rateable value of commercial and industrial property represents 22% of the city's total rateable value but the city collects 50% of its total rate from the commercial and industrial sector.

The main argument advanced by councils for the differential is that businesses benefit disproportionately from the services provided and so the higher rate is justified but this is seldom the case. For example, the owner of a \$465,000 house in suburban Wellington would pay \$1,683 annually in general rates while a suburban business next door in an identical property would pay a commercial rate equivalent of \$6,253. The latter does not receive proportionately as much benefit.

Rating differentials should be used only to facilitate equitable distribution of rates whereby ratepayers bear the cost of the services they benefit from. Differentials should not be used as a revenue raising tool and councils should be required to substantiate the benefits before applying them to businesses.

Consultation

Local authorities are required by the Local Government Act 2002 to consult with their communities about their LTCCPs, the financial policies that underpin them, the levels of service being delivered, and the rates that will be required.

The local government sector places considerable weight on these consultative processes to justify its expenditure and rating policies. We are pleased the Inquiry intends to consider how well these processes are working. We doubt that they are meaningful and consider additional mechanisms are necessary to impose constraints on scope and improve accountability of local government.

The problem is, that relative to national politics at least, there is widespread apathy toward local government politics in this country. This is evidenced by low voter turnouts as well as poor participation in the consultative processes. Councils are also subject to much less scrutiny by the media and independent agencies than central government.

This lack of interest in local government politics goes a long way to explaining the creeping growth of local authority activities and expenditure and the consequential increase in the rating burden.

Chambers of Commerce throughout New Zealand intend to take an interest in the upcoming local government elections this year. They will scrutinise policies and annual plans, publicise findings and draw attention to issues. The proper role of local government will be explored as part of this process.

As public dissatisfaction with increasing rates grows we can expect more interest and scrutiny of council rating policies. But notwithstanding this, the problem suggests that an alternative process is needed rather than reliance on consultation.

Efficiency and Benchmarking

Local government generally has a monopoly in the provision of many of its services and consequently many of these services are inefficient and/or overpriced. The fact that its income is guaranteed by legislation is also a factor. Inefficiency is a major driver of local government expenditure and is a problem that needs to be addressed if rating increases and levels are to be constrained.

There is much anecdotal evidence of local authority inefficiency. For example, a seemingly ad hoc approach to road maintenance and holes being re-dug several times.

One way to mitigate this is through the increased use of benchmarking across councils. This would enable ratepayers to assess council performance and allow best practices to come to the fore. Consistent reporting standards and procedures across councils are very important for this.

Councils have not been very receptive toward increased benchmarking and an important outcome from this Inquiry will be steps introduced to facilitate this, combined with council acceptance of its importance. We do not accept that differences between local authorities, including physical conditions and the varying services provided are as substantial a barrier to benchmarking as is implied by many councils.

Itemised Rates Assessments

NZCCI strongly supports the use of itemised rates assessments. This practice helps ratepayers see exactly how much they are paying for certain council activities. It enhances transparency, enables improved scrutiny by ratepayers and facilitates benchmarking comparisons across councils. Compliance with the legislative requirement, and the degree that itemisation is currently occurring, varies across the country but overall the practice of providing itemised rates assessments has not been good. The Inquiry should recommend that steps be taken to strengthen this practice.

Exemptions

A range of categories of property are exempt from local government rating. These include government-owned DoC land, schools, public hospitals and Maori customary land. There is no good rationale for these exemptions. Where government-owned, they amount to a subsidy to the taxpayer from relatively less well-off local authorities leaving a greater burden on those ratepayers that must pay rates. Ratepayers in councils with a disproportionate share of such land are disadvantaged as they have to pay more to compensate.

NZCCI is opposed to such exemptions and recommends this issue be addressed by the Inquiry. Banning exemptions would result in reduced claims from councils on other private-owned properties.

Unfunded Mandate

Local government often claims that central government regulatory requirements are being imposed on local government without sufficient compensation ('the unfunded mandate') and that this has implications for rates. We note that the Funding Project has investigated this issue and concluded that such mandates have not been a

significant driver of costs. We have yet to see quantification of the problem and would like the Inquiry to investigate this issue further.

Development Contributions

Development contributions from property developers can be required by local authorities to help meet the costs of certain capital expenditure associated with developments (eg public parks as part of a new subdivision).

NZCCI believes developers should only be required to pay development contributions to councils where they benefit from that expenditure. Councils should not view such contributions as another revenue raising mechanism.

A user charge should, in general, be made for services supplied by councils to developers where such services are acquired voluntarily. A mandatory use-related charge might also be appropriate if the charge reflects the value of the services supplied. However, where financial and development contributions are mandatory and where the level of such contributions is unrelated to the specific services used by the developer, they constitute a selective tax.

The implicit presumption is that the benefit from such services accrues to the owners of new property within the development and that would be reflected in the price of the property. However, experience is that the higher price tends to discourage new developments. Because the cost of new developments is increased, the price of existing homes and other affected property would tend to be higher than otherwise. In contrast, general rates tend to reduce the expected return on housing and commercial property, and property prices would tend to be lower than otherwise.

Rates Rebate Scheme

The Rates Rebate Scheme provides a subsidy to ratepayers on low incomes who have difficulty meeting rate payments. NZCCI believes the scheme is not an appropriate response to the affordability issues surrounding the rapid growth in rates. While the scheme provides some relief for selected ratepayers, it is small and costly to administer. The scheme weakens the link between the accountability of councils for their spending and their funding decisions.

If the Government wishes to provide relief through a Rates Rebate Scheme, then we consider it should be administered centrally through Work and Income New Zealand rather than by councils.