

Beyond Cap in Hand:

The case for change in local government funding

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Is there a case?

Yes there is

The lack of adequate funding and funding sources that disincentivise elected members from making strategic investment decisions can impede effective local government and hence the vital role local government plays in achieving the nation's economic, social, environmental, and cultural objectives.

The Government's view

Many of the challenges local communities face depend on local government to meet them
(Minister Mahuta)

For example: safe drinking water, treating waste water, catchment management, planning and development, local transport, properly functioning property market, waste services, moving to a zero-carbon economy, community leadership, and representation on issues that matter to local communities.

The Government's view (continued)

- Local communities face other large, complex challenges such as climate change, natural hazards and emergencies, tourism demand, migration, and demand for changing land use.
- However, councils vary widely in area, population, infrastructure assets, community needs, rating base, and financial resources (*Hon Nanaia Mahuta, Minister of Local Government July 2018*).

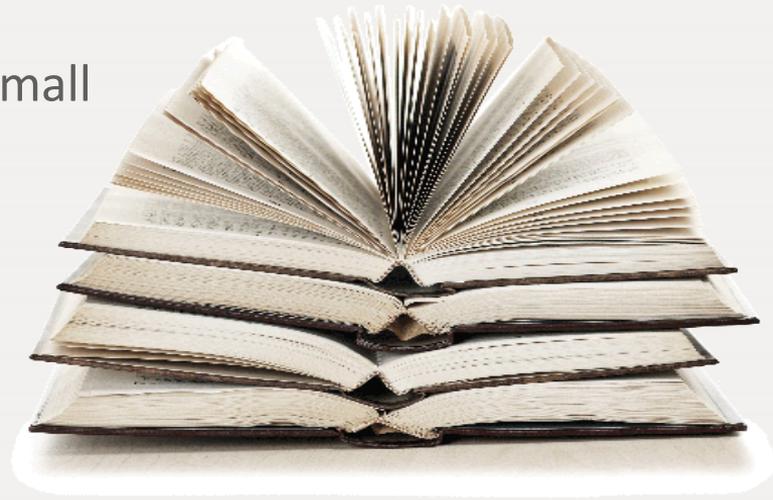
The concerns are not new

- The 2007 Inquiry into local government rates concluded:
 - Forecast level of rates increases not sustainable for some parts of the community
 - Costs largely driven by infrastructure growth and renewal (\$31.5B over 10 years)
 - Councils should make more use of debt
 - A contestable infrastructure equalisation fund should be established
 - International visitors environmental levy should be put in place to fund new tourism related infrastructure (finally underway)
 - The Crown should pay rates

The issue of our narrow funding base

- Too much reliance on property rates
 - Need a broad tax base
 - Rates fail to incentivise councils to invest
- Citizen opposition to increases
 - Need buoyant taxes that rise with GDP
- Councils' share of the nation's revenue too small
 - Need a bigger share to meet expectations

NZ an outlier by world standards



Limited revenue sources

	Revenue source	Strengths/weaknesses
Cash flow	Rates, fees , charges	Political decision Clearly defined consultation process
	Cost savings	Material savings through service level reductions would require extensive analysis, planning and consultation
	Government transfers	Relate to specific projects (e.g. transport) so not available to meet unrelated funding requirements
Balance sheet	Debt	Debt capacity limited by lender considerations – ie covenants, credit rating
	Commercial operations (dividend)	Constrained by performance / cash requirements of commercial investment
	Commercial capital (divestments)	Political decision required Flow on implications to the dividend returns Tax efficiency considerations
	Surplus assets	Processes needed to recognise and sell surplus assets
	Equity partnerships	Relate to specific projects

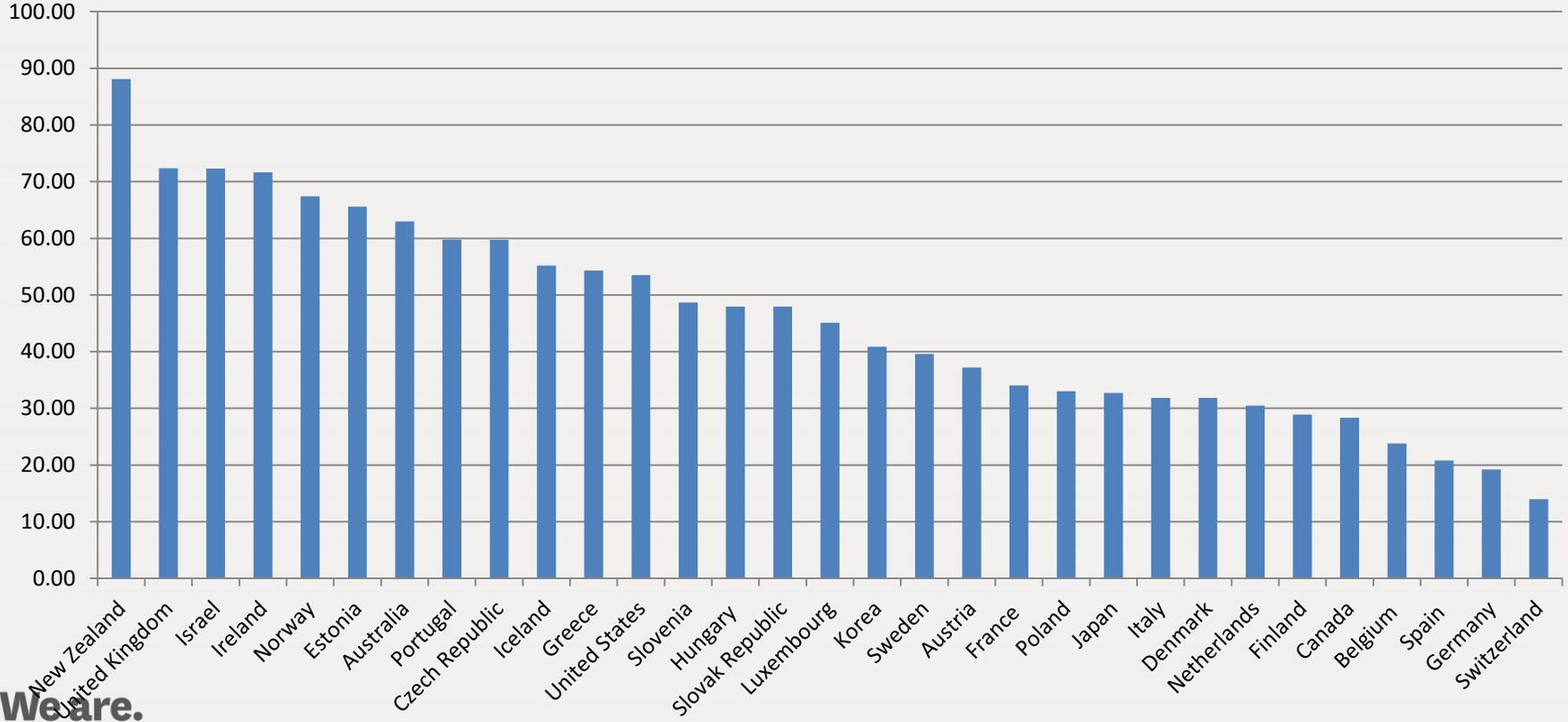
How we compare

Countries	Share of total taxes %	LG taxes as a share of GDP %
Netherlands	2.7	1.1
United Kingdom	3.9	1.4
New Zealand	5.3	2
Iceland	20.4	6.4
Switzerland	35.8	11.9
Denmark	31.3	15.5
Sweden	32.6	15.5

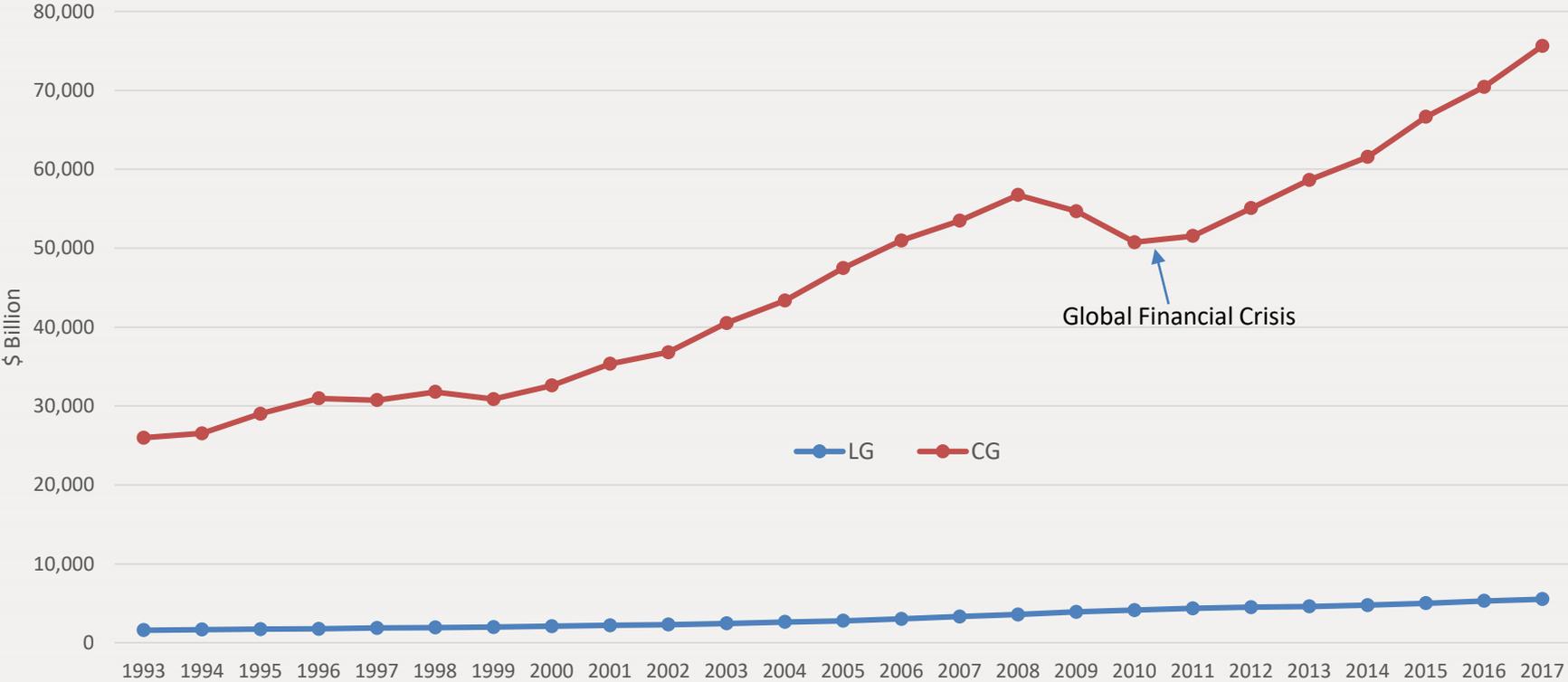
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Central government expenditure as a % of total government expenditure

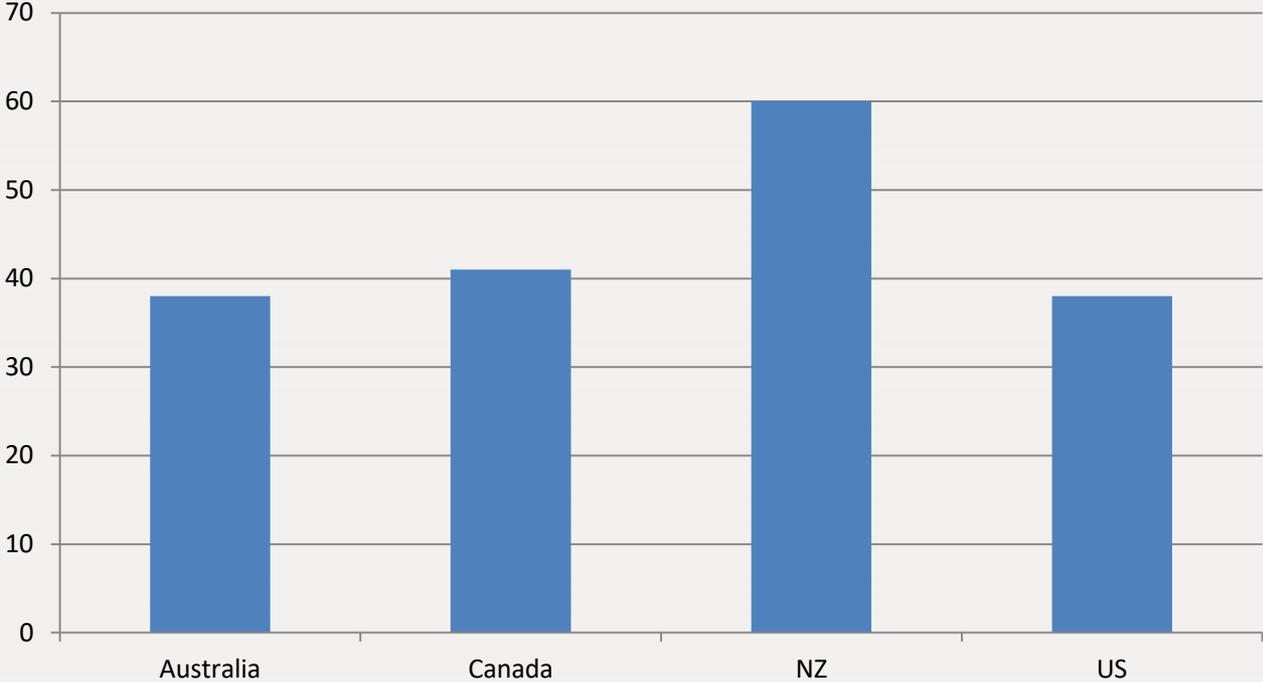


Change in central and local government tax revenue



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Rates as a share of council revenue



How do our cities compare?

Auckland

- General and targeted rates
- Development contributions
- Fees and user charges
- Petrol tax

Paris

- Property tax on developed land
- Property tax on undeveloped land
- Residence tax
- Local economic contribution (on business premises and business value added)
- Tax on refuse/garbage collection
- Front walk sweeping tax
- Parking fees
- Electricity consumption tax
- Real estate taxes (e.g. land transfer tax)

Berlin

State taxes

- Wealth tax
- Inheritance tax
- Real estate transfer tax
- Motor vehicle tax
- Racing and betting tax
- Beer tax
- Fire protection tax

Local taxes

- Land tax
- Trade tax allocation
- Entertainment tax
- Dog license fee
- Second home tax

State share of national taxes

- Wage tax
- Assessed income tax
- Non assessed tax on earnings
- Interest income tax
- Corporation VAT
- Import VAT

Local share of state taxes

- VAT
- Wage and income tax
- Withholding tax

Finding solutions – principles

- Local authorities' resources and their allocation must be commensurate with the need to carry out their responsibilities effectively and they should be entitled, within national economic policy, to raise adequate resources of their own;
- councils should have access to buoyant local taxes which, along with user charges, enable them to be largely self-financing. **Such taxes are not likely to incentivise councils to invest for growth.**
- central government transfers should primarily be concerned with resolving spill-overs and financial inequities (councils with low finance-raising potential).

Where are we at?

- The introduction of a regional fuel tax a significant step forward as is the decision to have the Productivity Commission review our funding.
- Government officials are also working on options, e.g.
 - Special Purpose Vehicles which allow finance to be raised for investment independent of a council's balance sheet;
 - Value capture financing which are designed to “capture” the “future uplift of benefits and revenue from public investments

To make progress we need to remove legislative constraints and “free up” councils to design “fit for purpose financing and funding” solutions.

Local government needs its own Revenue Act.

How do we get there?

International experience tells us that, for the political economy of changing institutional and financial structures, incremental bottom up changes tend to be more successful than top down proposals *(Enid Slack 2013)*



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