

# Funding: Local Government New Zealand Conference July 2008

## Introduction

In the policy development for the Local Government Act 2002 (LGA) it was noted that central and local government are “two arms of the system of government”. Both need to work together to achieve effective community outcomes and contribute to government goals such as economic transformation. One of the themes of economic transformation is world class infrastructure to support growth. Local government is both a provider and a key stakeholder in this area.<sup>1</sup> The Executive Summary of the Report of the Local Government Rates Inquiry (the Rates Inquiry)<sup>2</sup> notes as the first of the main actions required from central government the need for “*providing some new funding sources, some of which involve increased funding from central government, to enable the level of rates to be held at sustainable levels over the next 10 years*”.

*Local Government New Zealand* commissioned a report from Professor Brian Dollery to assess how international practice might support the case for additional government funding or funding tools for local government.<sup>3</sup> The report looks at the economic rationale for inter-governmental transfers, and specifically examines a number of proposals from the Rates Inquiry.

The Dollery report is not local government policy, but could be useful to consider in conjunction with other work and ideas in developing a solution for local government’s current funding issues.

## Questions for councils

When you are reading the Dollery report and preparing for the *Local Government New Zealand* Conference 2008, it would be useful to think about the following questions:

1. Where are your funding pressures arising in the next ten years?
2. How much of your expenditure goes on different types of infrastructure, eg water, roads, hazard protection, etc?
3. What other things would your council like to do or support, and how? What barriers are there to doing this?
4. Where do you think central funding would be appropriate, at what level, and why?
5. What types of funding sources (including new funding sources) could you see being useful for particular areas, apart from direct central government funding and current sources?
6. If you were designing a model funding system, what type(s) of things would it cover and how would it be administered? For example:
  - what types of things would be jointly funded?
  - ideas (and reasons) for percentages/amounts of central/local contributions?
  - how and when would funding be allocated?
  - what structure(s)/department(s) would assess funding?
  - what additional tools or resources would be useful?
  - what accountability mechanisms need to be in place for central and local government?

1 More on the world class infrastructure sub-themes can be found at: <http://www.med.govt.nz/>

2 The Rates Inquiry reports are available from <http://www.ratesinquiry.govt.nz/>

3 The full report is available to download from <http://www.lgnz.co.nz/library/publications/>



## The main recommendations of the Dollery report are for:

- all existing transfer schemes to be subsumed within an Infrastructure Equalization Fund (IEF)
- the IEF to be augmented by a share of an increased Local Authority Petroleum Tax (LAPT) – (revenue-sharing rather than a transfer of the power to tax in the form of a Regional Petrol Tax) and an international visitor environmental levy rolled together for joint administration by one body
- a single administrative authority “probably contained within the New Zealand Treasury”
- providing local government the power to tax in the form of an environmental waste levy.



## Summary points from the Dollery report

A key conclusion in the report is that central and local government need to work together to provide core services. The transfer of powers to local government started well before the LGA, which further raised expectations of local government. Other new roles or changed requirements have also been imposed. The subsequent impact of additional responsibilities and community expectations on local government roles, combined with a lack of additional funding tools and a reluctance to increase general transfers of centrally collected tax, has heightened a funding imbalance (specifically a “vertical fiscal imbalance”). Central government in New Zealand has yet to acknowledge and thus to address this need.

### The Dollery report makes the following observations:

- agreement with the Rates Inquiry that a combination of intergovernmental transfers and new “own-source” revenue streams for local councils are the best means to reduce or maintain the current rates burden. In other words, funds AND funding tools
- property taxes almost invariably do not adequately finance local government service provision responsibilities. This can be addressed by:
  - grants
  - tax sharing (eg GST collected by the Commonwealth government in Australia is shared with state governments, and the LAPT in New Zealand is gathered by central government and distributed to local councils)
  - allowing additional taxes, fees and levies at local levels, eg poll tax, payroll tax, commercial/commodity tax, environmental levies (particularly waste levies), petrol taxes and road tolls etc or by
  - transfer of functional responsibilities (from local government back to central government)
  - fees and charges can sometimes also be used to recover costs.
- New Zealand local government receives a lower proportion of transfer funding from central government than similar systems, such as the Australian state and territory local governments. Australian local government collects only about 40 percent of total revenue from rates, compared to around 57 percent in New Zealand. As noted by the Rates Inquiry, this places a heavy cost on local ratepayers and is likely to rise in the near future.
- Australia, even with comparably higher funding, still has a “fiscal gap” between expenditure and responsibilities in local government.
- because of economies of scale and other considerations most taxation is collected at a national level through corporate tax, income tax, sales taxes and other revenue sources. Some redistribution of this taxation is appropriate where activity and services are provided at a local and regional level. A fiscal gap exists because central government revenue-raising powers and opportunities exceed expenditure responsibilities, while local government expenditure is greater than its own revenue sources – what is called a “vertical fiscal imbalance” (VFI)

### Summary points (continued)

- horizontal fiscal imbalance (HFI) also occurs, where local councils have hugely varying rates bases and access to non-rates revenue, but are all expected to provide broadly similar functions. Some councils are compact with a high population and rating base, whereas other councils provide infrastructure and services for dispersed, small populations, with limited rates revenues. Without horizontal funding redistribution, increasing inequalities between districts is inevitable. Clear principles need to apply to ensure infrastructure can be provided to broadly the same level for all New Zealanders.<sup>4</sup>
- addressing fiscal gaps requires central government policy and funding (tax sharing with local government) to address VFI and HFI, and to ensure capacity for providing services, achieving outcomes and working jointly and effectively
- Dollery's analysis of the Rates Inquiry shows the same ingredients for a solution as we currently advocate:
  - with the exception of the Financial Assistance Rate (FAR) "there is a need for a more consistent rationale in the pattern of grants"
  - a need for increased "three waters" funding
  - FAR's relevance as "a partnership between central and local government that could be replicated in water infrastructure" (Rates Inquiry)
- the report specifically identified three core proposals from the Rates Inquiry as suitable measures to augment rates:
  - an international visitor environmental levy
  - an increase in the Local Authority Petroleum Tax (LAPT) by 2c per litre
  - an Infrastructure Equalisation Fund (IEF)
- the Rates Inquiry also considered a municipal waste levy (not explored in detail), which Dollery suggests would be useful. Local environmental charges for local government in New Zealand, in light of the likely future impact of the Government's Emissions Trading Scheme (ETS) and its implications for transport policy, may prove to be an inspired choice. Councils would need the mandate and administrative capacity to implement the instruments, monitor their operation and enforce the system. The financial and political effects of environment levies on different groups would vary in different areas. Waste levies can be targeted as "user-pays" and to predominantly affect large businesses<sup>5</sup>
- Dollery concludes that a single authority collecting these revenues and providing grants, (as well as the FAR), would be simpler and effective. *(Editorial note: this may be useful from a pure administrative point of view, but specialist expertise is also a factor.)*
- local government is often the best placed delivery unit to ensure that services provided are meeting specific local needs, and are responsive to the voting community. It can also provide more flexibility and innovation
- local government is in the position of enforcing national standards, providing mandated services or facilities (often with limited or short-term funding) and responding to local needs, while balancing cost pressures to both support national affordability measures and avoid disincentives developing for ratepayers to live in particular areas
- however, competitive policies to attract industry can result in lower revenues and service provision. Capacity, capability and economies of scale also affect councils differently. There is no "one size fits all" model. Central funding can be targeted to help ensure services are able to be provided at an appropriate local level, and in ways that reduce negative competitive behaviours between areas
- inter-governmental transfers also make sense where one local authority provides services with benefits for neighbouring districts, and where collective benefits and individual benefits are hard to separate. They are also a way to address equity issues by targeting additional funding to areas with higher need
- grants can be general-purpose ("untied funding") or specific-purpose. The appropriate type of grant can vary depending on local need, circumstance and objectives, and Dollery recommends principles and lessons to consider in developing grant schemes.

4 This general principle is modified for practical purposes, as for example reticulation of water services is not practical in remote areas.

5 User-pays residential and commercial waste charges are already used in many communities, often in conjunction with providing recycling opportunities. Unintended effects of further or higher charges might include: theft of official rubbish bags; illegal dumping and stockpiling of waste.

## Australian Comparison

In Australia, the Federal Government provides \$1.9 billion of financial assistance grants (2008-09).

The majority is untied money that can contribute to local roads, swimming pools, sports fields, childcare, aged care, community services, cleaning, garbage collection and other local priorities.

Jurisdiction	Population <sup>6</sup>	General purpose \$	Local roads \$	Subtotal \$
New South Wales	6.9m	421.4m	165.8m	587.2m
Victoria	5.2m	319.1m	117.8m	436.9m
Queensland	4.2m	256.8m	107.1m	363.9m
Western Australia	2.1m	129.6m	87.4m	217.0m
South Australia	1.6m	96.9m	31.4m	128.8m
Tasmania	0.5m	30.2m	30.3m	60.5m
Northern Territory	0.2m	13.2m	13.4m	26.6m
Australian Capital Territory	0.3m	20.8m	18.3m	39.1m
<b>Total Australia</b>	<b>21.2m</b>	<b>1,288.0m</b>	<b>571.5m</b>	<b>1,859.5m</b>

Source: Local Government FOCUS. Volume 24, Number 6. June 2008. Figures rounded.

### Notes:

- total direct funding for Local Government in Australia in 2008-09 including other specific purpose payments (~\$688.3m) will be \$2,547.8m
- adjustments recognise the local road length and other factors in South Australia
- an additional \$20b in a Building Australia Fund to finance roads, ports, rail and broadband
- an additional \$22.3b over five years investment in land transport infrastructure under Auslink2
- \$12.6m has been allocated to implement basic security measures at regional airports
- \$270.7m has been allocated for the Australian Broadband Guarantee
- The Australian Local Government Association (ALGA) calling to have the grants set at one percent of total Commonwealth tax revenue.

Central government funding in New Zealand is often highly targeted at either major cities or at small, poor communities. Local authorities' operating revenue in New Zealand has averaged around 56 percent from rates between 2003 and 2007 (with actual figures increasing from \$2439.5m to \$3317.5m). Government contributions increased from 11.36 to 13.89 percent over this time to \$827.5m, which combined with increased fees/sales income largely offset reduced investment income, and covered approximately 20 percent of the increased operating costs over this five year period.<sup>7</sup> Much of the cost increase was driven by infrastructure and changed responsibilities.

Government funding includes: Land transport, Housing, Capital cost contribution sewerage and drinking water: Sanitary Works Subsidy Scheme (SWSS) and Drinking Water Assistance Programme (DWAP), Tourism, Aquaculture Planning Fund, Regional Strategy Fund. Additional amounts have been allocated to tasks with national sustainability drivers and priorities such as contaminated sites and water quality remediation. The Waste Minimisation Bill may provide for a waste disposal levy to be shared between Ministry for the Environment and territorial authorities (by population). A regional fuel tax may also be enabled at some point.

<sup>6</sup> at end Dec quarter 2007

<sup>7</sup> Source: Statistics New Zealand June 2007 Local Authority statistics tables. Excludes items such as purchase of fixed assets.