



# New Zealand Business Roundtable

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9 October 1995

Ms Sherry Phipps  
Secretary  
Internal Affairs and Local Government Committee  
Parliament Buildings  
WELLINGTON

Dear Ms Phipps

Further to my letter of 2 October 1995 to Hon Graeme Lee, I enclose 20 copies of a supplementary submission on the Local Government Reform Bill on behalf of the following organisations:

Auckland Regional Chamber of Commerce & Industry  
Building Owners & Managers Association of New Zealand  
Federated Farmers of New Zealand  
New Zealand Business Roundtable  
New Zealand Manufacturers Federation  
Wellington Chamber of Commerce

We would appreciate the opportunity to appear before the committee to speak to the submission. As many as possible of the chief executives of the organisations involved would be present, together with our consultant, Dr Bryce Wilkinson of CS First Boston NZ Limited.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R. L. Kerr', is written over a horizontal line.

R L Kerr  
EXECUTIVE DIRECTOR

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**Submission to the Internal Affairs  
and  
Local Government Committee  
on the Local Government Law  
Reform Bill**

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**Auckland Regional Chamber of Commerce & Industry**  
**Building Owners & Managers Association of New Zealand**  
**Federated Farmers of New Zealand**  
**New Zealand Business Roundtable**  
**New Zealand Manufacturers Federation**  
**Wellington Chamber of Commerce**

**October 1995**

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## Summary

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- 1 This submission on the Local Government Law Reform Bill ("the Bill") is made jointly by the Auckland Regional Chamber of Commerce & Industry, the Building Owners & Managers Association of New Zealand (BOMA), Federated Farmers of New Zealand, the New Zealand Business Roundtable (NZBR), the New Zealand Manufacturers Federation and the Wellington Chamber of Commerce. It is in response to the September 1995 submission made by the New Zealand Local Government Association ("the LGA's submission").
- 2 Our submission strongly opposes any explicit or implicit statutory recognition of the concept that local authorities should be permitted to set rates and levies on the basis of ability to pay as distinct from user pays. Charging on the basis of ability to pay has the effect of redistributing income from those who are deemed to have a high ability to pay to those who are deemed to be more deserving. However, income redistribution is a central government function. Conflicts, confusion of roles and lack of coherence would result if local authorities were given autonomous powers to pursue such goals. Instead, local authorities should focus on their core functions of regulating local activities and ensuring the efficient provision and funding of goods and services which cannot be as efficiently provided without local government action.
- 3 The funding policies of local authorities should be driven by efficiency considerations. The fundamental funding principle should be that those who benefit pay. This would mean direct user charges in many instances. Rates and levies are valid funding mechanisms where they are more efficient than direct charges for particular services.
- 4 If, notwithstanding these views, local authorities are to be permitted under the Bill to depart from efficient funding principles, such departures should be specifically justified and quantified. Departures from efficient pricing principles represent a tax on some individuals and a subsidy for others. Transparency in government requires that the extent of such subsidies is identified and subject to public scrutiny and debate.
- 5 In terms of the LGA's specific proposed changes to the Bill, the parties to this submission:
  - (1) are comfortable with introducing a new section 122AB in the Bill which would explain the purpose of Part VIIA of the Act;
  - (2) oppose the LGA's proposed subsection 122AB(d) on local autonomy;
  - (3) strongly disagree that the purposes of the Bill should include recognition of tax-based funding as in the LGA's proposed subsection 122AB(e);
  - (4) are comfortable with moving the funding principles currently in section 122B(d) of the Bill into a new section, 122BA;
  - (5) strongly oppose the LGA's section 122BA, as drafted, since it is intended to ensure that efficient funding has no higher status than other funding principles such as ability to pay. As drafted, section 122BA would serve little purpose as it would provide local authorities with no guidance as to how to weight conflicting funding principles;

- (6) strongly favour retaining and improving the funding principles currently in subsections 122B(d)(i)-(iv) of the Bill. Specific improvements were recommended in BOMA's earlier submission.
- (7) favour, particularly given the degree to which the local authorities have expressed, through the LGA's submission, a preference for being able to depart at will from efficient pricing, modifications to the current subsections 122B(d)(iv)-(vi) of the Bill to make it explicit that these provisions do not represent a departure from efficient pricing;
- (8) oppose the LGA's omission of subsection 122D(5)(b) of the Bill. This subsection usefully requires local authorities to specify, in the long-term financial strategy, the reasons for engaging in activities. Indeed, in our view this subsection should be expanded (see below);
- (9) strongly oppose any attempt to limit the ability of ratepayers to obtain judicial reviews of local authority decisions, particularly where rates and levies are onerous in relation to benefits received;
- (10) oppose the LGA's deletion of the cost of capital from the list of estimated expenses in subsection 122D(5)(a) of the Bill. The opportunity cost of capital is a cost of undertaking an activity, even when capital is equity-funded; and
- (11) question the LGA's proposal to extend the implementation dates for various sections of the Bill from 1 July 1996 to 1 July 1998.

6 Given the late and sweeping nature of the LGA's submission, there is a risk that its proposed changes may receive undue emphasis. Section 4 identifies a number of additional matters which we believe are also important. These include the need to require:

- the long-term financial strategy to take a broader fiscal perspective, as does the Fiscal Responsibility Act in relation to central government, encompassing optimal net worth and indebtedness and provision for transitional operating surpluses *or* deficits;
- the long-term financial strategy to indicate funding intentions in relation to categories of persons and to specify the reasons for undertaking activities;
- clearer statements of investment policies and objectives; and
- a broader focus on liability management policy as distinct from borrowing management policy.

7 We submit that in considering further changes to the Bill, the Committee should place greatest weight on the interests of the users rather than the providers of local government services, consistent with the thrust of policies of recent governments.

## 1 Introduction

- 1.1 This submission on the Local Government Law Reform Bill ("the Bill") is made jointly by the Auckland Regional Chamber of Commerce & Industry, the Building Owners & Managers Association of New Zealand (BOMA), Federated Farmers of New Zealand, the New Zealand Business Roundtable (NZBR), the New Zealand Manufacturers Federation and the Wellington Chamber of Commerce.
- 1.2 For our more detailed views on the Bill, the Committee should refer to the submissions on the Bill made earlier this year by our individual organisations. The following remarks are motivated by the changes to Part I of the Bill which have been proposed in the September 1995 submission made by the New Zealand Local Government Association ("the LGA's submission").
- 1.3 The parties to this submission are united as a group in our concern that local authorities too often fail to confine themselves to core functions, spend excessively, and levy the business community far more heavily than can be justified on the basis of benefits provided. These excess funding burdens are necessarily distributed variously between owners of property, suppliers, funders, employees and customers of businesses. Making local government more transparent, accountable and efficient should bring considerable benefits to local communities. Key concepts contained in Part I of the Bill have the potential to contribute significantly towards the achievement of this goal, although improvements could be made (see section 4 below).
- 1.4 The LGA's submission proposes material changes to the structure of the original Bill. These include:
  - a proposed new section, 122AB, which would state the purposes of Part VIIA, recognising in particular a tax (ability-to-pay) basis for local authority funding;
  - a major restructuring of section 122B, shifting some key funding principles to a new section 122BA, and incorporating a new section 122BB covering compliance issues. A key intention appears to be to prevent local authorities from being required to relate funding burdens on groups to benefits received; and
  - a new section 122KA limiting the basis for judicial reviews.
- 1.5 These proposals provide a set of conflicting principles for funding and appear to be designed in good part to remove any *required* link between rates paid by any group of ratepayers and value received. They also attempt to limit the scope for judicial challenge by ratepayers. Their effect would appear to be to markedly increase the ability of local authorities to act in an arbitrary and discriminatory manner. Local authorities would be free to make funding decisions on the basis of user-pays or ability to pay, as they saw fit.
- 1.6 Our case against the proposal to provide statutory recognition for tax-based funding of local authority expenditures on an ability-to-pay basis is set out in section 2 below. This is our major point of disagreement with the LGA's submission.
- 1.7 Section 3 considers a number of more minor matters raised in the LGA's submission, notably limits to judicial review, the incorporation of the cost of capital in expenses and the proposed extension of the implementation timetable to 1 July 1998.
- 1.8 Section 4 reviews a number of related issues not raised by the LGA's submission, but which were raised in some of our earlier submissions.

## 2 Statutory Recognition of the Power to Tax

- 2.1 This section argues against statutory recognition for local authorities of the right to rate and levy so as to redistribute income. The parties to this submission consider that local authorities should be unequivocally required to relate the financial burdens imposed by local authorities on individuals and groups within the community to the value of benefits received. This user-pays approach allows rates and levies to be used for funding purposes where they are more efficient than alternative forms of funding.
- 2.2 In contrast, the LGA's proposals would permit rates and levies to be set with the aim of redistributing income within the community in favour of those who are regarded as more deserving.
- 2.3 Determining the statutory powers of local authorities is entirely a matter for Parliament. Local authorities have no powers except those which are conferred on them by Parliament. Local authorities have important local responsibilities of a regulatory nature and responsibilities for the provision of local goods and services which have public good characteristics. They are not required to have powers to duplicate or complicate the social welfare and/or income redistribution activities of central government.
- 2.4 Rates and levies have a potential role in funding local *public* goods and services where direct user charges may not be efficient. This is because public goods have unusual characteristics. For example, direct user charges may not be practical because it might be impossible to prevent someone who refuses to pay from benefiting from the provision of a public good. Alternatively, the public good may be such that one person's consumption does not reduce anyone else's. In this case it may not be desirable to impose a direct user-charge and deter consumption. (Expenditures on national and civil defence are classic examples.) In such (albeit limited) cases, a rate or levy on the benefiting population may be efficient. While we see a potential role for rates and levies as an efficient form of funding a limited range of local government activities, we strongly oppose the suggestion that central government should confer on local government the authority to use rates and levies to tax some individuals or groups in order to benefit others.
- 2.5 There should generally be greater emphasis on direct user-pays charges. We strongly oppose recognition of using rates and levies other than as an efficient form of funding for the supply of local public goods and services.
- 2.6 Currently Parliament has not defined precisely the purposes for which local government can levy rates. Section 37K of the Local Government Act provides a statement of the purposes of local government. These recognise that local communities may have different identities and values. In particular, local government can provide for trading undertakings on a competitively neutral basis and can deliver facilities and services on behalf of central government. Although the statement of purpose does not tightly define the role of local government, it does not confer any explicit right on local authorities to tax, let alone to tax independently of benefits provided for social welfare or income redistribution reasons.
- 2.7 Tellingly in this context, central government has insisted, since the introduction of GST, that rates be subject to GST, rejecting the view that the legal status of rates should be changed so that they can be regarded as a tax rather than as the payment for a service.

- 2.8 A prescriptive approach by central government towards funding principles for local authorities would be consistent with its approach to other local government activities. Central government acts to constrain and guide the activities of local government in respect of reporting arrangements, investment and borrowing management policy and in the Resource Management Act and the Building Act. The LGA's resistance to central government direction in respect of funding principles appears to be inconsistent with its acceptance of a prescriptive approach by central government in other areas. In our view local authorities should be constrained to act within coherent principles; they should not be permitted to override principles.
- 2.9 In addition, local authorities are not well placed to implement income redistribution policies. They do not have the required information, infrastructure or tax base to equitably undertake such a role. Moreover, only central government can redistribute income across regions. If local government were to take over this role, it seems likely that 'deserving' people in poorer regions would be less well treated than similar people in other regions.
- 2.10 Where both central and local government have the role of redistributing income, conflicts and lack of coherence would seem inevitable. Autonomous local redistributive policies could conflict with central government's policies.
- 2.11 Local government redistributive activities would, by definition, come into conflict with the efficient funding of local government activities. Local authorities who take on, as a valid activity in its own right, compelling some ratepayers to pay for benefits accruing to other 'more deserving' classes of ratepayers inevitably attract wasteful rent-seeking behaviour by would-be beneficiary groups. Such groups will aim to induce local authorities to spend more on activities which benefit their group than is commensurate with a non-partisan balancing of benefits and costs. Pressures to raise rates and levies to fund uneconomic activities would be exacerbated by such a redistributive policy.
- 2.12 Providing services to users at below cost and funding the difference out of general or differential rates, when it is not efficient to do so, will typically cause over-production - the value derived from these goods at the margin would be less than their cost of supply. This inefficiency will be compounded if one effect of rates-based funding of local government provision is to preclude competing providers. Efficiency considerations therefore require putting primary emphasis on searching for charging systems which confront those benefiting from those services with cost-related charges.
- 2.13 There is ample evidence that some local authorities are averse to pricing services efficiently. Many authorities have provided services to groups of ratepayers at less than the cost of supply, thereby swelling the demand for those services, and have sought to impose an undue portion of the funding burden on the business community. BOMA's March 1995 submission noted three High Court findings supporting the need to relate rating burdens to the cost of supply and the benefit derived, and presented research which found that the commercial and industrial general rate in a number of regions was between 180 and 315 percent higher than could be justified on the basis of the cost of the service.
- 2.14 There is a sound case for strong central government action, through the Bill, to increase the pressures on local authorities to focus on performing core regulatory and local public good activities more efficiently given the notable resistance within some authorities to efficient pricing, the slowness of some to make the provision of services more contestable, and the persistence in putting forward spurious reasons for not relating rating burdens on the commercial community more closely to the value of the services provided to that community.



- 2.15 For these reasons, we strongly oppose all the LGA's proposals which would free local authorities from a fundamental requirement to charge for goods and services efficiently. **We recommend that:**
- (i) **the LGA's proposed subsections 122AB(d) (local autonomy) and (e) (recognition of tax-based funding) be excluded from any statement of purpose for the Act;**
  - (ii) **the principles of financial management established in section 122B of the Bill (and/or the LGA's proposed section 122BA) should require funding mechanisms to be efficient, based on the principle that the costs of services should be borne by the users of those services; and**
  - (iii) **the LGA's proposed subsections 122BB(4) and (5) should be amended and deleted respectively so as to ensure that they do not conflict with efficient funding principles.**
- 2.16 In respect of recommendation (i), we refer the Committee to recommendation 1 in BOMA's earlier submission. This would make efficiency, and equitable funding, the driving principle. Other recommendations in the BOMA submission would clarify this intent elsewhere in the Bill.
- 2.17 If, contrary to these recommendations, central government does not wish to entirely preclude local authorities from making funding decisions which violate the efficiency criterion, provision could be made for such departures to be explicitly identified in the long-term funding strategy and in the funding policy. Local authorities should be required to provide the reasons for these departures and a quantitative assessment of the degree to which particular groups were being overcharged and/or undercharged for those activities compared to the charges which would have otherwise prevailed. For example, if local authorities choose to subsidise library facilities out of rates, when an efficiency analysis might have indicated that they should be funded from an annual membership charge plus fees based on usage, then the amount of those subsidies for users should be made explicit. Of course, implementing the most efficient arrangements might require further legislative changes, but further changes are contemplated in the LGA's submission in any case.

### **3 Other Issues in Relation to the LGA's Submission**

#### **3.1 Limits on Judicial Review**

- 3.1.1 Section 122KA proposes limits on the challenges which can be made to a local authority's decisions under Part VIIA of the Act. The thrust of these limits is to restrict judicial review by ratepayers to cases where the local authority has not considered due processes, is behaving unlawfully or has taken a decision that is not "so unreasonable that no reasonable local authority would have contemplated it".
- 3.1.2 We strongly believe that local authorities should be held accountable for rating fairly and efficiently in relation to the benefits provided. Local authorities should not be permitted generalised defences of reasonableness, particularly in relation to a situation in which they could appeal to arbitrary weightings applied to conflicting funding principles. The best way of reducing the risks of litigation is to make legislation as clear and unambiguous as possible in its intent.

3.13 Recent court decisions have found that some councils have failed to discharge their fiduciary duty of fairness to all ratepayers. The ability to take councils to court where they act unfairly towards particular individuals or groups should not be circumscribed.

### **3.2 Cost of Capital**

3.2.1 The LGA's submission proposes dropping the requirement in section 122D(a) that an allowance for the cost of capital be included in estimated expenses. The basis for this proposal is that "[m]ost local authorities set the cost of capital charge at zero" (see page 19).

3.2.2 This reason is spurious. The cost of capital is the opportunity cost of the funds tied up in the assets utilised by local authorities. Local authorities which set the cost of capital at zero for these purposes are simply declaring that they do not recognise that their activities tie up valuable resources which could be usefully used differently. They thereby fail to acknowledge that these opportunity costs are part of the cost to the community of those activities.

3.2.3 The cost of capital should be retained in section 122D(a).

### **3.3 Extension of Time**

3.3.1 The Bill proposes a 1 July 1996 implementation date for the funding, investment, and borrowing management policies. It proposes a 1 July 1997 implementation date for the long-term financial strategy.

3.3.2 The LGA's submission would instead require a common 1 July 1998 implementation date. The main objective should be to get the best possible reforms in place. It is undesirable to rush that process unduly, or to allow an unduly slow pace of adjustment. We do not support a 1 July 1988 implementation date unless the local authorities can make a convincing case that such a delay is required.

3.3.3 The NZBR's March submission made it clear that it saw transitional arrangements as being important for the successful implementation of the processes proscribed in the Bill. Good transitional arrangements would facilitate earlier implementation than might otherwise be prudent.

## **4 Other Important Issues**

This section reviews a number of other important issues which were addressed in some of our earlier individual submissions.

### **4.1 Transitional Operating Deficits**

4.1.1 Section 122B(1)(d)(f) of the Bill requires operating revenues to cover operating expenditures. This may impede the ability of a local authority to run operating deficits for a number of years in order to reduce net worth to a target level which may be set in the long-term financial strategy. We believe that there is a strong case that net worth in local government should be reduced by asset sales and some means must be available for distributing the proceeds. Running operating deficits should be permitted for a transitional period as part of a well-debated long-term financial

strategy - just as running surpluses for a period in order to increase net worth is permitted.

## **4.2 Broader Fiscal Objectives**

4.2.1 In our view, the Bill's subsections 122B(1)(e) and (f) and 122D are more limited than is desirable and should be expanded so as to be more in accord with those embodied in the Fiscal Responsibility Act. In particular, each local authority should be required in formulating its long-term financial strategy to:

- set a target for net worth which would provide an adequate buffer against adverse shocks and specify policies and a timetable for achieving and maintaining that target;
- similarly determine prudent levels for total liabilities and specify how those levels are going to be achieved and maintained;
- comprehensively list its fiscal risks, including off-budget risks, and put in place policies for prudently managing those risks; and
- have regard to policies which provide a reasonable degree of predictability and stability concerning local government tax burdens.

## **4.3 Other Amendments to the Long-Term Strategy Provisions**

4.3.1 The long-term financial strategy should identify any foreseeable build-up in capital expenditure and debt repayment obligations and require explicit policy statements on the major expenditure and revenue aggregate targets and the measures planned to achieve them rather than detailed 10-year forecasts in relation to each and every major activity.

4.3.2 Recommendations (4) and (5) in BOMA's earlier submission contained suggestions for increasing accountability through a clearer statement of reasons for activities and a specific statement of funding intentions in relation to categories of persons.

4.3.3 In a similar vein, the NZBR recommended that subsection 122D(5)(b) be expanded so to require the long-term financial strategy to state, in a more specific way, principles, criteria, reasons for selecting those criteria and reasons for engaging in specific activities.

## **4.4 Investment Strategy**

4.4.1 Clearer statements of policies and objectives and the nature and scope of significant activities to be undertaken should be required. Performance measures and risk assessment procedures should be detailed. The degree to which local authorities are involved in commercial, profit-making and risky commercial investments reflects their asset-rich state and is a concern. Recommendation 7 in BOMA's submission provides a detailed drafting suggestion.

## 4.5 **Liability Management**

- 4.5.1 Permitting local authorities to actively manage their liabilities would require allowing them to manage their risks continuously, rather than just at the time of borrowing. The NZBR has argued that changes in section 122O and in other sections may be required in order to confer this power on local authorities.
- 4.5.2 The NZBR has recommended that the proposed prohibition on borrowing in foreign currency should be dropped from the Bill and section 122G should be amended to include a requirement to state the proposed foreign exchange exposure policy. Valid concerns about the degree to which local authorities might get into financial difficulty should be tackled by more general measures such as those discussed in section 3.1 of this submission.