

The background is a solid brown color. It is decorated with several white circles of varying sizes scattered across the upper and middle sections. In the bottom-left corner, there is a dense cluster of white lines of various lengths and orientations, some intersecting to form small 'X' shapes.

# Democracy *and* Performance

A MANIFESTO FOR LOCAL GOVERNMENT

LOCAL GOVERNMENT  
**FORUM**

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LOCAL GOVERNMENT  
F O R U M

February 2007

# **Democracy *and* Performance**

A MANIFESTO FOR LOCAL GOVERNMENT

The Local Government Forum comprises organisations that have a vital interest in the activities of local government. Its members include Business New Zealand, the Electricity Networks Association, Federated Farmers of New Zealand, New Zealand Business Roundtable, New Zealand Chambers of Commerce, and the New Zealand Forest Owners Association. The Forum was established in 1994 to promote greater efficiency in local government and to contribute to debate on policy issues affecting it.

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# I OVERVIEW

Local government is a vitally important institution. It provides for democratic decision making within local communities and touches most aspects of people's lives. It produces a diverse range of goods and services, and undertakes extensive regulatory functions.

Local government spending is equivalent to over 3 percent of gross domestic product (GDP). 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. Ratepayers' equity is a massive \$67 billion or \$16,300 per capita. It is equivalent to the value of all securities listed on the NZX and is almost double taxpayers' equity in central government.

In terms of revenue, spending and assets, many councils rank with New Zealand's largest enterprises. In addition, the regulatory functions performed by councils have a significant effect on overall community welfare.

The reforms implemented since 1989 have substantially improved the local government sector. Many councils, especially the smaller ones, are responsive to their communities, and endeavour to focus on their core roles. Despite the progress that has been made, enhancing efficiency is an ongoing requirement if material living standards are to continue to rise in keeping with community expectations.

New Zealand's economic performance is falling well short of the level required to achieve the government's 'economic transformation' goals. Our rate of economic growth has improved in the two decades following the start of the economic reforms but remains well below its potential.

Unless New Zealand's institutional and policy framework is strengthened, the government has little hope of raising New Zealand's per capita income to at least the median for member countries of the Organisation for Economic Cooperation and Development (OECD).

A significant improvement in the contribution of local government to the well-being of all New Zealanders must be a top priority in an effective growth strategy. With such a significant proportion of resources devoted to a sector of the economy that is not primarily focused on wealth creation, it is not surprising that our per capita income has not increased relative to that of the median for the OECD.

Unless the resources used by local government yield an overall return to the community at least equal to that which could be earned elsewhere, potential national income is forgone. Because rates and other taxes bias the choices that individuals and firms make, it costs more than a dollar of national income to raise a dollar of revenue. The return to the community on projects that are funded, or part funded, by rates is after taking

account of such economic or deadweight costs of rates. It is implausible that all proposed council spending proposals provide anywhere near the required level of return.

Some councils engage in activities such as ports, airports, commercial forestry and farming operations, and property investment and development that should be left to the private sector. Others have neglected their stormwater, sewerage and roading activities. As a consequence, infrastructure, such as stormwater systems, is in a poor state of repair in certain areas and some roads are inadequate.

The level of rates payable by households increased by over 220 percent between the March quarters of 1986 and 2006, whereas the consumers price index increased by 98 percent. After taking account of an increase in population by about a quarter, real rates per head of population grew by almost 30 percent in the last 20 years.

The business sector pays about half of the country's total rates bill, which has increased at a disturbing pace. The level of rates that businesses pay is often significantly disproportionate to the level of services supplied to them.

This report outlines future policy directions that would assist local government to make a better contribution to the overall welfare of all New Zealanders. The next section (section 2) describes the local government sector. Section 3 discusses the role of government and present council activities, and outlines the grounds for imposing further constraints on the scope of local government. Section 4 discusses funding. Section 5 outlines proposed policy directions. Conclusions are presented in section 6.

# 2

## THE LOCAL GOVERNMENT SECTOR

### 2.1 Purpose and structure

Local government is an autonomous branch of government created by statute. Its purpose is broadly defined in the Local Government Act 2002 in the following terms:

- to enable democratic local decision making and action by, and on behalf of, communities; and
- to promote the social, economic, environmental, and cultural well-being of communities, in the present and for the future.

Local government comprises the following councils:

- twelve regional councils – they encompass every part of New Zealand (other than the Chatham Islands) that is within the district of a territorial authority; and
- seventy-three territorial authorities.<sup>1</sup>

Regional and territorial councils are independent authorities. Four territorial authorities also undertake the activities of regional councils in their districts and are known as unitary authorities.<sup>2</sup>

For the purposes of performing its role, a local authority has “full capacity to carry on or undertake any activity or business, do any act, or enter into any transaction” and “full rights, powers and privileges”, subject to other enactments and the general law.<sup>3</sup>

A community board may be established for any part of a district. Its purpose is to represent and advocate for its community and to undertake any responsibilities that are delegated to it by the related territorial authority.

### 2.2 Council activities

Local authorities undertake a vast range of activities. The main ones are summarised in Table 1 in the appendix. Not all regional and territorial councils undertake the activities listed for each class of council.

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<sup>1</sup> The former Banks Peninsula District Council merged with the Christchurch City Council in March 2006. In addition, the minister responsible for the administration of the Local Government Act 2002 is the territorial authority for any part of New Zealand (except certain remote islands) that does not form part of the district of a territorial authority. There are also some special purpose local authorities that are not discussed.

<sup>2</sup> They are: Gisborne, Tasman and Marlborough district councils and Nelson City Council.

<sup>3</sup> Local Government Act 2002, section 12.



An indication of the overall size and significance of local authority activities can be seen in Table 2 and Table 3 in the appendix. They show the aggregate operating revenue, assets, liabilities and ratepayers' equity for all local authorities.<sup>4</sup>

The tables understate the extent of local authority activities because they exclude those undertaken through council-controlled organisations. This leads to inconsistencies because some, but not all, councils have corporatised activities, such as water supply.

Local authorities are major undertakings as the following data, which are taken from the tables referred to above, show:

- Total operating revenue for all local authorities (comprising user charges, rates and other taxes, fees, fines, grants and investment income) amounted to \$5 billion in 2004/05.
- Total rates, other taxes, licence fees and fines for all local authorities amounted to \$3.1 billion in 2004/05, or an average of about \$750 per person.<sup>5</sup> Such revenue increased by an average of 6.5 percent a year between 2000/01 and 2004/05, which was well ahead of the rate of inflation and population growth.
- Total operating spending by local authorities amounted to \$4.7 billion in 2004/05. Such spending is equivalent to about 3.2 percent of GDP. It increased faster than rates and related revenue, growing by an average of 7.4 percent a year, between 2000/01 and 2004/05.
- The total of additions to fixed assets, a measure of capital expenditure, amounted to \$2.1 billion in 2004/05.<sup>6</sup>
- The total assets of all local authorities amounted to \$71 billion at June 2005. The largest assets by value relate to roads, water and wastewater, and property.
- Aggregate ratepayers' equity was stated at \$67 billion at June 2005. It is equal to an average of \$16,300 per capita and is 90 percent larger than taxpayers' equity in central government. It is equivalent to the market value of all securities listed on the NZX.
- Councils are generally lightly indebted. Aggregate ratepayers' equity is equal to 94 percent of total assets.

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<sup>4</sup> Statistics New Zealand surveys local authority revenue and spending on a quarterly basis (Local Authority Statistics). It also publishes information on the assets and liabilities of local authorities (Local Authority Financial Statistics by Council) which is collected by a census of local authorities. Because the census is less timely, the most recent aggregate data on the financial position of councils relates to 2004/05. For that reason, information presented on the aggregate financial performance of councils also relates to 2004/05.

<sup>5</sup> The distributions of rates per head and rates per ratepayer are not known.

<sup>6</sup> This amount, which is not shown in the appendix, is computed from the Local Authority Financial Statistics by Council.

# 3

## THE ROLE OF LOCAL GOVERNMENT

### 3.1 Primary functions of government

There are two primary functions of government. The first is to maintain order, the second to facilitate the provision of public goods and services.<sup>7</sup>

The former refers to the general framework in which all interactions within society take place. The establishment and maintenance of the legal system is a key element. It provides people with protection for their lives, liberties and property, and thereby promotes social cooperation and prosperity. The maintenance of order includes a monopoly on the legitimate use of force to protect citizens from each other and from outsiders, and defining and enforcing property rights.

The government may also be able to enhance the well-being of citizens by facilitating the provision of goods and services that cannot be supplied efficiently through voluntary transactions by individuals, firms and not-for-profit organisations. Such activities involve the provision, funding, or both, of public goods and services.

In broad terms, public goods cannot be produced by the private sector with known technology, except under contract. It is usually not possible to charge for them. National defence and street lighting are commonly cited examples of public goods.

Public goods have the following distinct characteristics:

- Non-payers cannot be excluded from benefiting from public goods. This gives rise to a free-rider problem. Many people would not voluntarily pay for national defence if the security that it provides could be obtained without paying.
- Secondly, one person's use of public goods does not limit their enjoyment by other people. The number of people walking along a footpath, for example, does not diminish the illumination provided by a street light.<sup>8</sup>

The number of genuine public goods is quite small. However, some goods and services may be partly private goods and partly public goods. Patents provide private returns to inventors but on their expiry, the invention becomes a public good.

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<sup>7</sup> A simplified discussion of public goods is presented here. For a further non-technical discussion see Cowen, Tyler (undated), 'Public Goods and Externalities', *The Concise Encyclopedia of Economics*, Library of Economics and Liberty. <<http://www.econlib.org/library/Enc/PublicGoodsandExternalities.html>> (last accessed January 2007).

<sup>8</sup> Public goods are said to be non-excludable and non-rivalrous in consumption.

Markets can overcome some of the problems that arise with public goods. The lighting of common spaces in shopping malls is an example. It is similar to street lighting in that an individual user does not diminish the light available to other users. The cost can, however, be recovered indirectly from shoppers through the prices that they pay for goods.

With advances in technology, what were once public goods (for example, basic science research) are sometimes capable of being produced privately. Celera's private human genome project is an example. People may also be able to come together voluntarily (for instance, in environmental and cultural organisations) and provide a tolerably efficient level of public goods.

The technical definition of public goods is essential to a proper analysis of the role of government. Often, government goods and services are described as public goods, or a widespread pattern of benefits is alleged when a careful analysis would reveal that the goods or services have few or no public good characteristics.

Public transport is an example. Users can be charged when they get on a bus or train and once a seat is taken it is not available for another potential passenger. Used loosely, the term public good becomes no more than an assertion that the government should support a particular activity.

Externalities or spill-overs may be another possible ground for government action.<sup>9</sup> A garden may provide enjoyment for neighbours who do not contribute to its cost (an external benefit). Uncontrolled pests on land managed by a government agency may impose external costs on nearby farmers.

External benefits and costs are ubiquitous. Most do not warrant government action and some may take the form of private nuisances that are addressed by common law.<sup>10</sup>

Externalities may help to explain the provision of certain stormwater and refuse services by local government. They are also a reason for certain regulations. Abandoned refuse and cars impose external costs on affected neighbourhoods.

Public goods and externalities are often referred to as 'market failures'. Market failure is commonly cited as a sufficient reason for government action. It is necessary, however, to show that a government solution would improve overall community well-being. A government solution may not be better because inadequate information and special interest politics bedevil government. Both government action and private markets fail. Government failure may be considerably more costly than market failure.<sup>11</sup>

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<sup>9</sup> Externalities occur when one person's actions affect another person's well-being and the relevant costs and benefits are not reflected in market prices.

<sup>10</sup> Private nuisances comprise anything done to the hurt or annoyance of the lands, tenements, or hereditaments of another.

<sup>11</sup> Brookings Institution researcher Clifford Winston reached this conclusion after examining empirical studies for the United States conducted over 30 years. See Winston, Clifford (2006), *Government Failure Versus Market Failure: Microeconomics Policy Research and Government Performance*, AEI-Brookings Joint Center for Regulatory Studies, American Enterprise Institute for Public Policy Research and Brookings Institution, Washington, p 3.

There should, therefore, be no presumption that government funding, provision, or both, is justified simply because particular goods or services appear to have public good characteristics or externalities might seem to arise. Government is just one of many agencies that can facilitate the provision or funding of such goods and services, or address externality problems. It should not step in to assist when other arrangements might be more efficient and equitable.

### 3.2 The roles of central and local government

The discussion to this point has not distinguished between the functions of central and local government. There are circumstances where the role of government can most appropriately be undertaken by central government rather than local government, and vice versa.

The most common circumstances where local government is likely to be more efficient than central government are where the following apply:

- local knowledge is required;
- the costs and benefits of government action accrue locally; and
- appropriate incentives apply at the local level.

This approach is consistent with the principle of subsidiarity. According to this principle, activities should be the responsibility of the lowest competent authority.

Most activities related to the maintenance of order are properly undertaken by central government in New Zealand. It has responsibility for defence, police, the criminal and commercial laws, and the courts. Local government, however, has some responsibilities in respect of civil defence (emergency management) and law and order (for example, certain public nuisances), and administers many regulations related to the maintenance of order.

Beyond those activities, the core function of local government relates to the funding and, where appropriate, the provision of local public goods. These comprise activities related to democratic, representative and governance processes; emergency management; roading and related activities (under current arrangements); stormwater and wastewater systems (also under current arrangements); parks and reserves; certain library services; and public health and safety such as the control of contagious diseases and food safety.

The provision of social services, the alleviation of hardship and income distribution are central government responsibilities in New Zealand.

### 3.3 Constraining councils

#### *The fundamental problem*

There is a fundamental tension between the need to empower government to undertake those activities that are essential to maintain order and to advance prosperity on the one hand, and to prevent the abuse of those powers on the other. Taken to its extreme,

a government might, for example, use its powers to harass political opponents or minority groups, take property from one group and give it to another, or inflate the cost of developing new factories and houses by unduly restricting the supply of land or by imposing excessive user charges.

A government may also undertake activities that should properly be left to the private sector. It may be encouraged to do so by citizens who lobby for services that they value, knowing that the cost will be spread thinly over other taxpayers or ratepayers who are poorly represented in the political system. Elected representatives and council officers who stand to benefit from a larger budget may also encourage councils to encroach on the domain of the private sector.

For these reasons, unrestrained majoritarian rule could threaten the liberty and property of citizens. It has been necessary to constrain government by taking the following steps:

- requiring government to act only in accordance with laws adopted and to enforce such rules in accordance with established procedure (the rule of law);
- dividing powers among elected representatives, the executive and the courts;
- holding regular and fair elections; and
- upholding informal norms and conventions, and adopting processes that restrain opportunistic behaviour. High quality consultative processes, such as the generic tax policy process, are an example. Access to official information and a free press that can scrutinise government actions are further examples.<sup>12</sup>

Despite existing constraints, government grew beyond its proper role in the twentieth century to an extent that would have been unimaginable 100 or even 50 years ago. The greater role assumed by government does not appear to have been beneficial from an overall community perspective.<sup>13</sup>

Many local government services relate to the provision of private goods and services. They include the following:

- the provision of transport-related services, such as ports, airports and off-street parking facilities;
- commercial forestry and farming operations, commercial property investment and development, and portfolio investment;
- recreational and entertainment facilities (where it is feasible to charge users and to exclude non-payers and where externalities are small) such as marinas, swimming pools and holiday accommodation; and

<sup>12</sup> For further discussion see Wilkinson, Bryce (2004), *Restraining Leviathan: A Review of the Fiscal Responsibility Act 1994*, New Zealand Business Roundtable, Wellington.

<sup>13</sup> Tanzi, Vito and Schuknecht, Ludger (2000), *Public Spending in the 20th Century: A Global Perspective*, Cambridge University Press, Cambridge.

- subsidies for passenger transport services, so-called economic development and tourism.

A more egregious list of activities undertaken in the recent past or proposed by one or more councils include sock and plastic manufacture, the operation of a gaming (Lotto) outlet and a high street café, the supply of infrastructure work and maintenance services to the private as well as the public sector, the establishment of an open-access wireless telecommunication service for Auckland's central business district, subsidies for rugby league matches involving the Warriors and the operation of a lawn-mowing business in Queensland.

Some councils have neglected their traditional public good functions because they have increased their focus on private good and peripheral activities. As a consequence, infrastructure, such as stormwater systems, is in a poor state of repair in certain areas and some roads are inadequate. Stormwater and wastewater systems overflow and pollute Auckland beaches when there is heavy rain (although the problem has been reduced). Wellington City took many years to decide to upgrade its sewerage system and then chose an expensive option. Sewage spills arising from dilapidated wastewater systems operated by the Far North District Council are alleged to have harmed the local aquaculture industry.

Local authority regulatory activities can also be excessive. Such regulations may remove or restrict private property rights without providing just compensation where it is warranted. Councils may change their district plans allowing higher density residential buildings to be erected, blocking sunlight and diminishing the privacy of existing property owners. A council may introduce permits for water abstraction without recognising fully the historical use of water by existing users.

Many problems relating to regulation arise from poorly conceived regulatory policies of central government, which councils are required to administer (for example, parts of the Resource Management Act 1991). However, the extent of council regulatory activities also reflects the decisions that councils make (for instance, some councils have extensive policies aimed at protecting native and exotic trees on private property, whereas others protect landmark trees only or do not protect them at all).

Councils have been required to administer new regulations relating, for example, to buildings, brothels and dogs. In some cases, higher standards or the preparation of mandatory policy statements have been required by central government, for instance in relation to air pollution, drinking water and dangerous, earthquake-prone and insanitary buildings.

While such developments, together with voluminous change in legislation affecting local government itself, have increased council spending, they are unlikely to explain much of the rapid growth in such spending and rates over recent years and projected for the next 10 years. Some of the additional spending has been reflected in user charges rather than rates. Council spending on regulatory activities is usually modest relative to the

total spending by councils. Moreover, the local government sector has lobbied for much of the legislation that affects it.<sup>14</sup>

A proper identification and quantification of the additional costs imposed on councils by central government, as planned by Local Government New Zealand, would be useful. However, it is most unlikely to demonstrate that the rapid growth in spending and rates over recent years was largely caused by factors that are beyond the control of councils.

### *Local democracy is insufficient*

A 1988 officials' discussion paper proposed that the key role of local government should be to provide local public goods that could not be more efficiently provided by the private sector. The local government sector opposed the proposal. It argued that councils should be free to respond to the democratically expressed wishes of their diverse communities. The local government sector places considerable weight on the efficacy of consultative processes.

A key problem with this approach is that councils are generally poorly placed to judge the diverse preferences of ratepayers. Consultations often fail to generate the information required to evaluate proposals. Less than half of all voters participate in elections, whereas over 80 percent of voters participate in parliamentary elections. Voters often know little about the candidates or their policies. A poll in September 2004 – less than two months before a local body election – found that almost 90 percent of Aucklanders surveyed could not name one member of the then controversial Auckland Regional Council. Councils are also subject to much less scrutiny by the media and independent agencies than central government.

Few ratepayers participate in consultative exercises. Such exercises are sometimes perceived to be a sham or a waste of time, perhaps because citizens do not believe that their views are likely to influence council decisions. Some of the most complex council plans ever prepared have incorporated unsustainable rate increases for the next 10 years.<sup>15</sup>

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<sup>14</sup> The National Party claimed in July 2006 that Labour-led governments had passed 67 Acts between 2000 and 2006 that directly or indirectly impacted on rates. The government responded that a preliminary analysis showed that 26 of the Acts did not appear to impose any costs on local government while 28 were specifically requested by the local government sector.

<sup>15</sup> Auckland City's annual plan for 1996/97 comprised 62 pages, whereas its draft long-term council community plan for 2006–2016 comprised 478 pages and, like 2006 plans for other councils, did not disclose revenue and spending for 2005/06. Is it any wonder there is confusion over the growth in council spending and the reason for large rate increases?

The preferences of citizens are unlikely to be disclosed by consultation exercises and opinion surveys. It is only when a citizen freely gives up one good (often money) for another that real preferences are revealed.<sup>16</sup>

The local government sector supported the thrust and much of the detail of the Local Government Act 2002. The Act incorporated a very broad purpose statement, authorised councils to decide what activities they may undertake (subject only to the operation of the general law and prescribed consultation processes), blurred the distinction between regional and territorial authorities (subject to consultation among affected territorial authorities) and permitted councils to operate outside of their regions and districts.

The local government sector also supported the adoption of a power of general competence. The Local Government Act 1974 permitted councils to undertake a vast range of activities, although a number of local Acts were also passed to authorise certain proposals. Councils, most notably the larger city councils, were able to expand their activities well beyond the traditional 'three Rs' of roads, rubbish and rates.

The principles reflected in the Local Government Act 2002 departed from the direction of policy that had been pursued since the mid-1980s. Policy had aimed at focusing councils on their public good roles in conjunction with broader economic policies aimed at encouraging economic growth. In keeping with this approach, the financial management provisions inserted into the Local Government Act 1974 by the Local Government Amendment Act (No 3) 1996, sought to apply the principles that were reflected in the Fiscal Responsibility Act 1994 to local government. The relevant provisions had been watered down in response to lobbying by the local government sector and were too weak to constrain councils sufficiently.

### *New constraints required*

The mandate of local authorities should be more tightly constrained in the interests of protecting property and promoting prosperity. As a general rule, councils should only be permitted to engage in those activities, including regulatory activities, that fall within the proper role of government and that should be the responsibility of local rather than central government. This is referred to as the core role of councils.

The core role of councils should be spelled out in legislation just as the powers of the legislative branch of the United States federal government are specified in the US Constitution. This approach is also broadly consistent with our constitutional arrangements in which local government can only exercise the powers explicitly granted to it. Individuals cede to government some of their rights. It is not for government to decide its scope with the balance left for the private sector.

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<sup>16</sup> The establishment of a bus service between Waipukurau and Waipawa by the Hawke's Bay Regional Council is an example. One submission in 2005 prompted the Council to investigate the service. A subsequent survey of local residents indicated support for it. The bus carried no more than a couple of dozen passengers in total before the trial was terminated. Total fare revenue was less than \$100, whereas the service cost about \$3,500.



In some cases, councils may wish to respond to the democratically expressed wishes of ratepayers to engage in activities that are not enumerated. Councils should be permitted to engage in such activities if there are more effective safeguards than at present to protect minority interests and to limit the scope for special interests to advance their position at the expense of ratepayers generally.

The best safeguard might be to require councils that wish to undertake significant activities that extend beyond those explicitly enumerated to subject their proposals to binding referenda. Councils hold non-binding referenda from time to time.<sup>17</sup> The following councils, for example, have recently held referenda:

- Hastings District Council on whether land close to the business centre of Hastings City that is currently used for recreation and sport should be made available for the development of large-format retail shopping and thereby prevent the development of such shopping away from the business centre.
- Timaru District Council on whether the council should build and fund an aquatic centre.
- Grey District Council on whether the local water supply should be fluoridated.
- Hamilton City Council on fluoridation and on whether to adopt the single transferable vote system.

Some other jurisdictions, for instance, the United Kingdom and Switzerland, commonly use referenda. They are also frequently used by states within the United States.

Referenda can be costly, especially when they are held on a stand-alone basis rather than in conjunction with an election. Tauranga City Council planned to hold a referendum on whether it should construct a museum on its waterfront. Because of the cost, a telephone opinion poll was held instead.

Referenda work best where the choice is between distinct alternatives rather than among a range of options. The examples cited are consistent with this approach. It is also necessary to make appropriate information available to voters, including information on the implications of the options for rates. Voters should also have ample time to evaluate and debate the options before a vote is cast.

A majority greater than 50 percent of votes cast should be required where referenda are held to approve significant activities that extend beyond the core activities of councils because minority groups would be compelled to contribute to the cost of the activity. In comparable circumstances, for instance, where a company proposes to undertake a 'major transaction', 75 percent support is required.<sup>18</sup>

Consideration should also be given to capping the rate of growth in council operating spending to help control the growth of local government. Annual adjustments could be made for the increase in population and general inflation. Spending limits apply in some

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<sup>17</sup> It is understood that a binding referendum might be deemed unlawful under the present law.

<sup>18</sup> A greater than 50 percent majority is proposed for all referenda discussed in this report.

other jurisdictions and some councils, such as Hutt City, have a strategy to keep the increase in rates within a set limit. A higher level of real per capita spending (and hence a larger rate burden) could be undertaken subject to a binding referendum of ratepayers.

Spending limits could be harder to meet in the case of councils that face a declining population or a rise in spending, for instance, because infrastructure is run-down. Ratepayers could be expected to take those, and other relevant factors, into account in deciding whether to vote for higher per capita spending. Limits on spending would potentially impact on the more profligate councils, especially those larger councils that are remote from their ratepayers.

The approach outlined is consistent with the long-established principle that taxation should only be imposed with the consent of taxpayers. This principle was applied haphazardly in much of the twentieth century. It should be reinstated to help protect individuals, firms and voluntary groups from unwarranted encroachment of the government.

There is also a case for stronger constraints of a constitutional nature on councils' regulatory activities. By analogy with the Public Works Act 1981, just compensation should be provided in many cases when councils take private property rights by regulation. A requirement to provide compensation, where appropriate, would make councils carefully consider the case for regulatory changes, for example, in district plans.



# 4

## FUNDING OF LOCAL GOVERNMENT

The main sources of finance for local government at present are user charges, rates and fines, government grants and debt. They are discussed below. Other sources of funding include the local authorities petroleum tax and investment income and liabilities (other than debt) such as creditors. These sources of finance are not examined.

A broad approach to the choice among funding sources is discussed in section 4.5.

### 4.1 User charges

Local authorities should fully fund the goods and services that they supply from user charges or use-related charges whenever it is economically efficient to do so. Such charges help to balance the cost of providing the service against the benefits that users derive. The weighing up of the costs and benefits by users leads to a better use of society's resources. Under-pricing a product or service leads to its over-provision, since the value derived by users from excess production is likely to be less than its cost to society.

A user charge may be the best way of encouraging the supply of an appropriate level of a good or service when the following circumstances apply:

- the commodity being sold is a private good;
- the good is purchased voluntarily because consent underpins the presumption that all parties benefit from the transaction;
- the supply of the good is subject to competition that encourages producers to minimise their costs; and
- the price reflects the marginal value of the good to the purchaser and to society, and the opportunity cost of supplying the good from an overall community perspective (that is, there are no externalities).

User charges have a useful role to play where a government agency provides private goods (for example, port charges). However, as a matter of best practice, private goods should be supplied privately and competitively. Thus, where user charges are most appropriate, the related activity should be considered for privatisation. Where communities choose to continue engaging in private good activities, user charges should be applied.

The relationship between user fees and the marginal cost of supply may be especially problematic when the supplier is a statutory monopoly. Charges could be too high, for instance, where fees seek to recover excessive costs. On the other hand, they could be

too low, for example, where users exercise undue political influence over the fee-setting process. A more serious problem arises where the payment for goods and services is also mandatory. In this case, incremental benefits could be negative.

## 4.2 Rates and fines

As noted above, it is generally not feasible to charge people who benefit from the provision of public goods. Virtually by definition, the funding of publicly provided public goods is a taxing (rating) rather than a pricing (charging) matter. The courts also view rates as a tax rather than a charge for services supplied.

Taxes are associated with compulsion and the inability, in most cases, to relate the size of the impost to the level of the benefit received by each taxpayer. Therefore, the allocation of rates among ratepayers should generally reflect taxing rather than pricing principles.

The principle of applying broad-base, low-rate taxes to raise general revenue is broadly applicable to central and local government.<sup>19</sup> Such taxes are generally more efficient than selective taxes that apply to particular activities or goods and services.<sup>20</sup> The latter can lead to highly variable rates of tax that bias the choice between closely substitutable goods and services. A significant tax on petrol, for example, would encourage individuals and firms to switch to diesel-powered vehicles, especially when replacing their vehicles.<sup>21</sup>

Selective taxes encourage interest groups to lobby to have their products and services excluded from the tax and to have substitute products included. When an arbitrary distinction is made between taxable and non-taxable products, for instance, between buns with or without icing, the distinction is difficult for politicians to defend and the public to accept, and is subject to excessive change over time. Selective taxes may enable elected representatives to shift the tax burden on to classes of ratepayers who are less than proportionately represented in the political process.

### *General rates*

Rates are the main tax base available to councils at present. There are several forms of rates that councils may choose to apply. The main form is a general rate.

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<sup>19</sup> The discussion that follows relates to the raising of general revenue to fund spending. It would not necessarily apply if the government were to impose a tax to address a valid externality problem. In that case, a selective tax would be required. Nor does it apply to valid use-related charges. The choice of tax base for sub-national levels of government is more limited than for national governments, for instance, because of the need to collect revenue on a regional or district basis.

<sup>20</sup> Optimal tax models suggest that tax rates should reflect the sensitivity of taxable activities and commodities to small changes in prices and thus taxes. Some of the findings of such models are not a feasible basis for tax design and the information required to apply other findings is not generally available. From a practical tax policy perspective, broad-based, low-rate taxes are usually recommended by tax experts.

<sup>21</sup> The local authorities petroleum tax applies to petrol and diesel because they are close substitutes.

A general rate may be levied on the land, capital or annual value of 'rateable land'.<sup>22</sup> Most councils use the land or capital value rating method. Auckland City and Manukau City (from 2006/07) are the only councils that use the annual value method. It reflects the annual rent that a property could earn if it were rented.

The choice of rating method has both efficiency and equity effects. Councils tend to focus on who is liable to pay the rate, and confuse this with who ultimately incurs the rating burden. Markets adjust over time. The initial incidence of rates is often shifted. A rate payable by a landlord, for instance, is likely to be shifted, at least in part, to tenants over time.

Because the burden of rates is shifted in this way, new equity issues arise when councils propose to change their rating methods. The incentive effects of proposed changes in rating methods often seem to be examined superficially by councils.

Not all ratepayers should necessarily fund all goods and services from general rates:

- There may be grounds to apply lower rates where clearly defined services (for instance, household refuse collection) are not available to ratepayers in a particular area. Offshore islands and rural areas might be examples. Tightly drawn rules are required to prevent this approach from being exploited for political reasons.
- There may also be grounds for levying additional rates on a particular class of ratepayers where specific goods and services benefit a clearly defined subset of a local authority's ratepayers and where affected ratepayers consent to the supply of the affected goods and services. Schemes to control floods are an example. It is desirable to confront people who demand such goods and services with the costs of supply by seeking their agreement to bear the cost involved before the expenditure is committed. This approach is consistent with the principle that government should only impose taxes with the consent of taxpayers.

A general rate may be set differentially on the basis of the following factors:

- the use to which land is put;
- the activities that are permitted, controlled or discretionary for the area in which the land is situated and the rules to which the land is subject under the Resource Management Act 1991;
- the activities that are proposed to be permitted, controlled or discretionary for the area in which the land is situated and the proposed rules to which the land is to be subject under the Resource Management Act 1991, provided that there are no outstanding submissions or appeals against such proposals;
- the area of the land;

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<sup>22</sup> The references that follow to 'rateable land' do not imply that rates are levied on the land value method. This terminology is used in the Local Government (Rating) Act 2002.

- the provision or availability of services provided by or on behalf of the local authority;
- where the land is situated; and
- the annual, capital and land value of the land.

Many councils impose differential rates. They may be used to shift the costs of services on to minority groups that are poorly represented at the ballot box. This could occur if the differential rate does not reflect the level of services provided to affected ratepayers and where consent is not obtained.

Differential rates are commonly applied to rateable land used by businesses. A business differential rate is seldom justified by a valid distribution of the cost of services supplied to businesses and other ratepayer groups.

The Auckland Regional Council imposed a differential rate on businesses in 2004/05. The main ground advanced by the Council for the differential was that businesses benefited disproportionately from the services it provided. The business differential rate reduced the share of rates that would have been borne by homeowners. The Council commissioned Associate Professor Basil Sharp of the University of Auckland to examine the issue. Professor Sharp could not substantiate the Council's claim.<sup>23</sup>

Elected representatives, councils and interest groups sometimes state that businesses are advantaged relative to residential ratepayers because they can claim a tax deduction for rates and an input credit for GST paid on rates. This argument is advanced in support of the imposition of a differential rate on rateable land used by businesses.

The claim is mistaken. Firms are also taxed on their income. Assessability and deductibility generally go hand-in-hand. Nobody seriously argues that it is an advantage to be subject to income tax just because of the ability to claim a tax deduction for expenditure incurred in earning taxable income.

Firms charge GST on their output, deduct GST paid on their inputs and pay the net GST to the government. There is no advantage to businesses. In respect of GST, councils are in exactly the same position as firms.

### *Targeted rates*

Councils may impose targeted rates. Revenue raised by a targeted rate is earmarked for the particular function identified in a council's long-term council community plan or annual plan.

There are 12 factors, including the value of rateable land, the area of the rating unit and the level of services, that may be taken into account in setting targeted rates.<sup>24</sup> A charge for water and wastewater may also be set as a targeted rate.

<sup>23</sup> Sharp, Basil (2005), *Beneficiary Assessment for Council Services: Report to the Auckland Regional Council, Supporting Information Auckland Regional Council – Annual Plan Hearings*, 25 May, Auckland Regional Council, Auckland.

<sup>24</sup> Rates are payable by the owner or, where rateable land is subject to a registered lease for a period of not less than 10 years, the lessee of each rating unit.

Targeted rates may be set differentially on the basis of the same factors that apply in setting a differential general rate.

### *Uniform annual general charge*

Councils may levy a uniform annual general charge in respect of each rating unit. The total rates revenue sought by a council in any year by way of a uniform annual general charge or a targeted rate set on an equivalent basis (other than a targeted rate for water or wastewater) must not exceed 30 percent of total rates revenue.

A uniform annual general charge has some similarities to an annual poll tax.<sup>25</sup> It requires each ratepayer to make a set contribution (in addition to general rates) to the funding of council services. Part of the rating bill is divided up in equal shares in much the same way as restaurant bills are often allocated among groups of diners.

Although a uniform annual general charge is sometimes imposed to fund the costs of specified services, for instance, refuse collection in Auckland City, it has no direct effect on the level of services supplied. Direct user charges are preferable in such cases. Ratepayers are compelled to pay the annual general charge whether the service is used or not. A uniform annual general charge, like other forms of rates, does not encourage ratepayers to economise on the services that they use. In these circumstances, a uniform annual charge is properly viewed as a tax rather than a user charge. It should be examined in terms of its efficiency and equity effects relative to other taxing options rather than as a user charge.

A uniform annual general charge increases the rate burden on low-value property relative to high-value property. It would tend to be regressive (that is, the level of rates would decrease as income increases) if the value of rateable land is highly correlated with income and wealth. On a similar assumption, a general rate payable by householders is broadly proportional to income and wealth.

Although these tendencies may often apply, many exceptions are also likely (for instance, retired people with relatively high-value houses but low incomes). This analysis is further complicated by debt. A farmer or homeowner with high debt, for example, may have little equity in their rateable land.

### *Financial and development contributions*

Councils may also impose financial contributions and development contributions. The former is imposed under the Resource Management Act 1991, whereas the latter is authorised by the Local Government Act 2002. However, both Acts affect financial and development contributions.

Financial contributions may be used to fund planned capital expenditure that a local authority expects to incur to meet the increased demand for community facilities

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<sup>25</sup> A uniform annual general charge would be equivalent to a poll tax if one person occupied each rating unit, if each person owned or leased one rateable unit and if rateable land owned or leased by businesses and other non-residential groups were exempt.



resulting from growth. Provision for levying financial contributions must be included in a council's district plan.

Development contributions are intended to fund reserves, network infrastructure or community infrastructure arising from subdivisions or other developments. Community infrastructure is land or development assets owned or controlled by a local authority, including land that the local authority will acquire, to provide public amenities. Financial and development contributions can be paid in money, land, or both.

The methodology specified for calculating development contributions aims to relate the growth in demand for reserves, network or community infrastructure to subdivisions or other developments. For instance, a contribution for additions to public parks generally in a district may be made in respect of a housing subdivision. The implicit presumption is that the benefit from incremental public goods accrues to the owners of new property. The efficacy of financial and development contributions largely depends on whether this presumption is valid.

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 an applicant for a resource consent or the developer, they constitute a selective tax. In this case, the relative efficiency and equity effects of development and financial contributions should be weighed against those of other forms of rates.

Financial and development contributions increase the costs of affected projects and can be expected to be passed on to property owners. They therefore tend 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.

The risk with financial and development contributions is that costs may be imposed unfairly on ratepayers who are assumed to have deep pockets. The costs of services that benefit the community in general may be imposed on a minority group of ratepayers who have limited influence at the ballot box.

### *Fines*

Local authorities may need to fund expenditure that arises from nuisances such as an overflow of the stormwater system caused by the discharge of industrial waste into it. The clean-up will often benefit ratepayers who are harmed rather than the firm that caused the nuisance.

The benefit principle is inappropriate in such cases, however, because the incentive to comply with local authority rules arises from an appropriate level of fines and the risk

of detection of offences.<sup>26</sup> The costs of policing nuisances should be funded from fines paid by persons and firms that cause the nuisance, with any balance funded from rates.

### 4.3 Government grants

The government provides certain grants to assist local authorities to undertake particular programmes. The most important relate to transport and have been substantially increased. Land Transport New Zealand provides funding to local government for the following transport activities:

- The maintenance and improvement of local roads and passenger transport infrastructure and the promotion of walking and cycling. Land Transport New Zealand provides a national average of 50 percent financial assistance for maintenance programmes and an additional 10 percent for construction projects, with rates and other local authority revenue providing the balance. Land Transport New Zealand's contribution is estimated to be \$633 million in 2006/07.
- The provision of passenger transport services, transport demand management, rail and sea freight, which is funded through regional councils and the Auckland Regional Transport Authority. Land Transport New Zealand's financial assistance for these activities is expected to amount to \$325 million in 2006/07.
- Regional development roading in Northland and Tairāwhiti. Land Transport New Zealand fully funds this activity through territorial authorities.<sup>27</sup>

Where Land Transport New Zealand part-funds council transport activities, councils must increase their funding of affected activities if additional government grants are to be spent.

According to Land Transport New Zealand, councils are expected to contribute about \$757 million in 2006/07 from rates (or other local government sources of funding) or about 44 percent of total spending on transport by local authorities of \$1,715 million (\$633 million plus \$325 million plus \$757 million).<sup>28</sup> Land Transport New Zealand's total grant of \$958 million in 2006/07 compares with government grants and subsidies for all activities of \$661 million in 2004/05 (see Table 2).

Licence fees, road user charges and excise duty on fuels (which are forms of user charges), and government appropriations from general tax revenue fund Land Transport New Zealand. The funding of transport activities would need to be reviewed if the proposals on roading and mass passenger trading contained in this report are adopted.

<sup>26</sup> Councils often apply the exacerbator or polluter pays principle in this case. They do not necessarily make the link to deterrence of offences.

<sup>27</sup> Land Transport New Zealand, National Land Transport Programme, June 2006, see <<http://www.ltsa.govt.nz/funding/nltp/funding.html>> (last accessed January 2007).

<sup>28</sup> The contribution of councils includes \$21 million, which Land Transport New Zealand expects councils to spend on administration, performance monitoring and research, and funding management.

## 4.4 Debt

From an economic perspective, debt can often be viewed as deferred rates because it is ultimately repaid from rates.<sup>29</sup> One argument for debt funding rests on considerations of intergenerational fairness. Some local authority capital spending (for example, on infrastructure) provides benefits that are realised over a long time and it is reasonable for the cost to also be spread. The key consideration is whether the proposed spending is expected to generate a commensurate level of benefits for the community.

There are also grounds for smoothing the level of rates over time. Highly variable rates, which could distort real investment and property values, would arise if current and capital spending (net of user charges) were solely funded from rates on a year-by-year basis. An appropriate level of debt might also restrict the scope of councils to undertake large low-priority projects without the need to justify an increase in rates. Such projects might otherwise be funded from debt and subject to less scrutiny on a value-for-money basis.

Relatively weak accountability and monitoring by lenders (whose security rests on the council's power to rate) underpin the need for a transparent borrowing policy and for constraints on the ability of councils to borrow. The general requirement to fund operating spending from operating revenue is a key constraint.

## 4.5 Funding mix

In broad terms, operating spending should generally be funded along the following lines:

- The level of operating spending, together with the budgeted net operating balance, should be determined. This is the amount of operating revenue that is required to be raised to fund operating spending, net of the operating surplus. As argued above, spending should be limited to the core activities of councils and such other activities as are undertaken with the consent of ratepayers.
- The total of non-operating spending, net of non-operating revenue, is then added to determine the net amount of operating revenue required to be raised.
- The following sources of funding should then be deducted:
  - government grants and other funding over which councils have no direct control;
  - user charges for goods and services supplied (as noted above, user charges should be applied where it is efficient to do so);
  - miscellaneous income, for instance, investment income (councils should be encouraged to exit from their commercial and portfolio investments – see below).

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<sup>29</sup> This analysis does not apply to goods and services that are funded by user charges.

- The net balance to be funded, after taking account of the above sources of funding, must then be funded by rates, compulsory contributions and fines. The aggregate amount to be funded through such rates and fines is allocated among the following:
  - general rates;
  - targeted rates;
  - uniform annual general charge;
  - financial and development contributions;
  - fines.

The above template focuses on the funding of operating spending. Councils must also fund capital spending, debt that falls due and other movements in assets. Those items impact on operating revenue via the budgeted operating balance and adjustments for non-cash items (such as depreciation) included in operating revenue and spending. In addition, movements in liabilities (other than debt) and new borrowing enable councils to fund their assets.



## 5 FUTURE DIRECTIONS

The following broad policy directions would assist the local government sector to make an enhanced contribution to the overall well-being of the community.

### 5.1 Investment

#### *Commercial businesses*

Some councils hold investments in private good activities, such as ports, airports, farming and commercial forestry. There is overwhelming evidence that private ownership, is on average and over time, more efficient than public ownership.<sup>30</sup> There is no compelling strategic or public policy reason for councils to own such businesses. The sale of commercial businesses would initially strengthen the financial position of councils relative to continued ownership because the price received would tend to reflect efficiencies that bidders expect to make.

The rationalisation of ports will be required in response to changes in the shipping industry. It may be impeded by the continued council ownership of port companies because parochial and other political considerations are likely to override commercial considerations.

Councils should generally focus on their core activities including appropriate regulatory activities. They should concentrate on doing them well. Councils should be encouraged to exit from their commercial investments. Privatisation has been implemented in many countries by governments of vastly different persuasions.

If councils are not willing to sell their interests in commercial businesses, they could distribute shares to ratepayers (although they may need to be empowered to do this). In this event, the ratepayers could decide whether to continue to hold their interests.

#### *Investment portfolios*

Some local authorities, such as Environment Waikato and the New Plymouth District Council, have invested the proceeds from the sale of businesses in financial assets. An investment portfolio was also vested in the Auckland Regional Council. These investments are inappropriate for the following reasons:

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<sup>30</sup> Megginson, William L and Netter, Jeffrey M (2001), 'From State to Market: A Survey of Empirical Studies on Privatization', *Journal of Economic Literature*, vol 39, no 2, pp 321–389 and Barry, Phil (2002), *The Changing Balance Between the Public and Private Sectors*, New Zealand Business Roundtable, Wellington.

- Investment of the proceeds of asset sales in equities, bonds and other financial assets merely exchanges one class of risky asset for another. Risk could best be minimised by returning surplus funds to ratepayers.
- There is no reason to believe that councils on average and over time make better investment decisions than citizens.
- Local authorities should focus on retiring debt and then reduce rates. Lower rates would help ratepayers satisfy their preferences for personal spending, saving, or independent investment.
- Income from revenue-generating activities is not needed to finance valid operating spending. It should generally be funded by user charges and rates. Local authorities should not try to conceal the true burden of their activities by funding them from income-generating assets.

Councils should be encouraged to realise their financial portfolios and use the proceeds to retire debt. In the absence of an explicit power to return surplus capital to ratepayers, councils could fund operating spending by realising assets and thus indirectly lower rates once debt is eliminated.

## 5.2 Supply of goods and services

### *Roading*

An efficient transport system is vital for people's quality of life and prosperity. The quality of roads, including access and safety, is an ongoing issue in all regions of New Zealand. The levels of congestion in the Auckland, Wellington, Tauranga and some other urban areas are rarely found in urban areas of other developed countries of comparable size and geography.

Insufficient urgency is being given to addressing the underlying causes of roading problems. Inadequate weight is being afforded to economic efficiency, which should be the key criterion for new investment. Extensive environmental mitigation and excessive provision for alternative transport modes are contributing to the exorbitant cost of some roading projects and crowding out other projects.

As proposed in the 1998 report, *Better Transport, Better Roads*,<sup>31</sup> improved governance arrangements and more efficient road pricing are necessary to focus roading authorities on providing value for money for road users. Technological advances have made direct pricing options feasible in many locations. Councils seem reluctant to voluntarily introduce more efficient road pricing in the foreseeable future although, along with Transit New Zealand, some support toll roads where alternative roads are available.

The main roading activities of central and local government should be corporatised, either as a single public entity or as a small number of public entities. Central

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<sup>31</sup> Ministry of Transport (1998), *Better Transport, Better Roads*, Ministry of Transport, Wellington.

government, local government or a combination of both would own these entities. The roading entities should be required to move toward direct pricing in a competitively neutral environment. Rates would no longer be used to part-fund local roading projects. Taxpayers or ratepayers should, however, fund services that are not appropriate to charge to motorists, for example footpaths, and any valid net external costs.

Corporatisation has produced large benefits in other areas. It would produce useful information on the willingness of road users to pay for the use of roads of a particular quality and lead to more appropriate investment and use decisions. Commercial arrangements for the management of existing and new roads are becoming increasingly common overseas.

More efficient road pricing should be introduced, even if Transit New Zealand and local authorities continue to be responsible for roads. Efficient road pricing focuses on the proper pricing of roading – not the funding of other activities, such as rail transport, as some local authority representatives have suggested.

### **Public transport**

The provision of train, bus and taxi services is a private good activity. The grounds for the subsidisation of public transport are weak, especially where appropriate road pricing applies. Such pricing is likely to apply during the life of new long-lived projects.

Massive capital expenditure is being committed or projected for rail projects in the Auckland region that are likely to be grossly uneconomic and will do little to ease road congestion. It will crowd out worthwhile road projects in other regions. Some rail corridors might be able to be put to better use as road corridors.

Rail fares in the Auckland region are expected to cover only about 18 percent of operating costs in 2006/07.<sup>32</sup> The Auckland Regional Council plans to raise \$60 million in rates in 2006/07, rising to \$122 million in 2015/16, to help fund public transport activities undertaken by the Auckland Regional Transport Authority. Subsidies for public transport should be scaled back and new investment projects should be subject to rigorous value-for-money evaluation. If public transport services were to be subsidised, bus services would generally be less costly and more flexible than new rail services.

### **Water and wastewater**

The parliamentary commissioner for the environment identified the main problems with urban water supply and wastewater systems in his 2000 and 2001 reports, *Ageing Pipes and Murky Waters: Urban Water System Issues for the 21st Century* and *Beyond Ageing Pipes: Urban Water Systems for the 21st Century*.<sup>33</sup> They include:

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<sup>32</sup> The subsidy for rail is based on the Auckland Regional Council's draft long-term council community plan. It is not possible to compute the comparable subsidy for bus services from data disclosed in the Auckland Regional Council's long-term council community plan or its draft plan.

<sup>33</sup> Parliamentary Commissioner for the Environment (2000), *Ageing Pipes and Murky Waters: Urban Water System Issues for the 21st Century*, Parliamentary Commissioner for the Environment, Wellington and Parliamentary Commissioner for the Environment (2001), *Beyond Ageing Pipes and Murky Waters: Urban Water System Issues for the 21st Century*, Parliamentary Commissioner for the Environment, Wellington.



- poor drinking-water quality;
- contamination of surface water and groundwater from uncontrolled or poorly managed stormwater drainage and wastewater disposal;
- inadequate investment and a backlog of deferred maintenance;
- the potential risk of infrastructure failure; and
- institutional and regulatory barriers to improved management.

There has been insufficient improvement since 2001. Attempts to reform water and wastewater businesses have been allowed to peter out.

The problems identified by the parliamentary commissioner for the environment can be traced in large part to the multiple and conflicting roles of the public agencies involved with water, blurred accountabilities, the absence of customer choice and a lack of commercial focus.

A more commercial approach to water and wastewater is required. Other network industries, such as electricity and telecommunications, have been reformed. As with roading, such activities should be corporatised, while retaining local government ownership, at least in the first instance. A review of the regulatory framework for water and wastewater should be undertaken.

The prohibition on the sale of a council water supply business (other than to another local government organisation) should be repealed. While water is essential for life, that is not an argument against private ownership of potable water businesses, including bottled water.

Similarly, concerns about the ability of people on low incomes to pay for water supply and other necessities are better addressed through social assistance programmes than through the ownership of water businesses. Many councils apply use-related charges to water. To the extent that private participation in water businesses improves efficiency, prices would be lower than otherwise.

Various forms of private participation in water supply and wastewater disposal, including franchising and contracting for services, have generally produced major benefits for consumers and the wider community in New Zealand and other countries, including Australia and England. Moreover, water supply in rural areas is a private responsibility.

The government's water programme of action is addressing some of these issues, but a bolder approach is required.

### *Other goods and services*

Councils should focus on their core roles and be encouraged to exit from other activities. Subsidies should not be provided for the supply of private goods and services except where there are valid grounds to do so, or where the consent of ratepayers is obtained.

There is scope to review the level and timing of spending on the core activities that councils undertake. Benchmarking of councils against each other may be helpful, just

as the Local Government Forum's 2004 survey of councils highlighted large differences in the levels of rates per capita levied.<sup>34</sup>

There will generally be uneconomic demand for goods and services that are supplied free of use-related charges. Councils should evaluate the merit of community calls for such services against the opportunity cost involved, including forgone opportunities for higher private spending or saving.

Overall community welfare is reduced if resources used by councils yield a lower return than they would earn in the private sector. The yield on resources that are funded by rates must be at least equal to the return that could be obtained if those resources were used in the private sector (opportunity cost of capital) plus a margin for the deadweight cost of rates. These costs reflect the disincentive effects of rates. Rates, for instance, may discourage investment in rateable land. The level of investment in housing is lower than otherwise with capital value and annual value rating.

### *Social assistance*

Local government engages in social activities such as the provision of housing (mainly for elderly persons but also for employees and other persons), pre-school and out of school childcare, employment initiatives and crime prevention. Central government has encouraged councils to engage in such activities. Most are private good activities that should be left to the private sector (crime prevention is an exception).

Social assistance and the alleviation of hardship is a central rather than local government responsibility in New Zealand. Councils are usually poorly placed to undertake such activities on an informed basis because they do not have access to the necessary information on incomes or wealth.

## **5.3 Inputs**

Inputs acquired by councils account for about half of their total operating spending (see Table 2). Even so, there is further scope to contract for the supply of goods and services where agreements can be appropriately specified and monitored. The key advantage of contracting for goods and services is that it helps to contain costs.

Employee costs account for almost 25 percent of council operating spending (see Table 2). The decisions that councils take on the activities they engage in and the way in which they are performed affect the level of staffing. Appropriate controls over the level of staff and their remuneration (which should reflect recruitment and retention factors) are important in limiting the growth in council spending.

### *Depreciation*

Councils are required to account for depreciation in accordance with the Local Government Act 2002 and generally accepted accounting practice. Depreciation expense accounts for about 20 percent of the sector's aggregate operating expenses (see Table 2).

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<sup>34</sup> Local Government Forum media statement, 27 April 2004.

Councils often elect to revalue upward infrastructure and certain other assets, although they are not compelled to do so by the Local Government Act 2002 or the relevant accounting standard (Financial Reporting Standard No 3). The related credit is made direct to a revaluation reserve (ratepayers' equity). If assets are revalued, depreciation must be charged on the revalued amount. This leads to higher depreciation charges and may lead to higher rates than otherwise because operating revenue is generally required to fund operating expenses (including depreciation).

From an accounting perspective, a charge for depreciation is required to match costs with revenue and thus report fairly the operating performance of councils. It is not directly related to the funding of replacement assets. If the funding of replacement assets is of concern then arguably sinking funds for the purpose should be established.

The upward revaluation of assets is doubtful where assets, such as infrastructural assets, are used in situ, have no comparable alternative use, no readily determined market value and generate little or no income. Some assets have been revalued upward on a replacement cost basis when it is most unlikely that the economic benefits generated or the income earned could justify their stated value. Moreover, it is unclear how the revaluation of such assets informs any relevant decisions relating to their use.

The treatment of depreciation and its impact on the level of rates should be reviewed.

### *Capital expenditure*

Capital expenditure proposals should be subject to a rigorous evaluation. Some projects extend beyond the proper role of local government. They should be left to the private sector. Other projects, such as Auckland's Britomart transport centre, were grossly uneconomic.<sup>35</sup> Excessively optimistic assumptions are sometimes made to justify projects that ultimately yield a very poor return on ratepayers' funds. Major investment projects should be subject to a formal post-implementation review.

## 5.4 Funding

The level of rates is excessive. Their distribution is patently unfair.<sup>36</sup> The business sector pays far too much. At the same time, rates are said to be incapable of raising sufficient revenue to fund council activities.

An underlying cause of such claims is the level and growth of council spending. The funding of activities such as roads (other than state highways) and water supply from rates when user charges should play a larger role is another reason for them.

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<sup>35</sup> The Britomart transport centre cost about \$100 million to construct (excluding the land and its precincts) and was opened in July 2003. Auckland City Council has written it off in its accounts to 30 June 2006. The Council is to transfer the centre to the Auckland Regional Transport Authority, a subsidiary of the Auckland Regional Council, at a nil value. This valuation can be assumed to reflect the expected future earnings of the centre. From an economic perspective, the entire investment seems to have been wasted.

<sup>36</sup> One dairy farmer pays \$55,000 in rates to the Waitaki District Council.

These problems cannot be addressed without constraining the level of council spending, applying user charges (including road pricing) where it is efficient to do so, corporatising council businesses where appropriate and encouraging councils to exit from commercial businesses. The proposals on these matters outlined in this paper would significantly reduce the level of rates.

The rates rebate scheme is not a satisfactory or sustainable response to the rapid growth in rates. While it provides some relief for selected ratepayers, the scheme is small and costly to administer.<sup>37</sup> It weakens the nexus between the accountability of councils for their spending and their funding decisions.

Rates have been the main tax available to local authorities for over a century. Several official inquiries have examined the scope for alternative sources of revenue but have not led to the adoption of significant alternative funding sources. Property rates are an important source of funding for local government in many countries.

The search for more efficient and equitable funding arrangements should, however, continue. The government has established a committee to review rates, which is due to report in July 2007. The committee should undertake a first principles review of local authority funding.

It is sometimes suggested that the government should share its GST or income tax with councils. Central government is most unlikely to agree to reintroduce revenue sharing because that would make it responsible for taxing while local representatives would be responsible for spending.<sup>38</sup> Councils would be encouraged to make excessive spending promises to curry favour with electors. They are unlikely to welcome the increase in control by central government that would accompany significant revenue sharing.

Another suggestion is that GST should be taken off rates. That is also a bad idea. Local government goods and services that compete (or potentially compete) with private sector goods and services should not be tax-favoured because that would lead to an inefficient expansion of local government at the expense of the private sector. To the extent that rates substitute for user charges for the supply of private goods and services, they should arguably be subject to GST.

The case for applying GST to goods and services provided by councils that do not compete with goods and services supplied by the private sector largely rests on the judgment that it is better to impose GST on all council activities rather than on most. If some activities are subject to GST and others are not, GST paid on inputs would have to be allocated between the two categories. No credit would be given for GST paid on

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<sup>37</sup> Approvals under the rates rebate scheme amounted to \$26 million (less than 1 percent of total rates revenue) by mid-October 2006. It only assisted about 4 percent of households.

<sup>38</sup> The government ended a revenue sharing scheme in 1989 on the grounds that it had not had the intended effect of holding down rates. The government's announcement pointed to the separation of spending and funding decisions, blurred lines of accountability and poor-quality spending decisions by councils.

inputs used to produce GST-exempt outputs. Thus, GST would not be collected in respect of value added by local authorities in producing such outputs. Attempts to erode the breadth of the GST base should generally be discouraged.

Funding arrangements could be improved by limiting the scope for councils to impose inefficient and inequitable funding arrangements. The measures proposed include the following:

- The core activities that councils can undertake would be enumerated in legislation governing local authorities.
- Councils should be required to obtain the explicit consent of affected taxpayers before undertaking significant activities that extend beyond their core business. The principle of consent would usually take the place of the benefit principle in determining the funding of council activities. The benefit principle was emphasised by some councils following the implementation of the Local Government Amendment Act (No 3) 1996. It is impossible to apply rigorously in most cases because councils cannot determine who ultimately benefits from council services.
- The general rate would continue in the meantime to be the main tax available to raise revenue for councils. Councils would be permitted to apply an additional rate to a subset of ratepayers to fund a particular project (or projects) or a significant activity (or activities) provided that affected ratepayers consented to the additional spending before it was committed. Targeted rates would be permitted on a similar basis.
- Councils would also be permitted to apply a lower general rate to all ratepayers in a defined area where clearly specified services available to ratepayers in general were not available to those in the affected area (for example, services available to rural ratepayers and ratepayers on islands).
- Councils would continue to apply uniform annual general charges with the current 30 percent cap removed.
- The power of councils to impose financial and development contributions should emphasise efficient pricing (for example, where contributions relate to services that developers elect to use) and taxing principles (where charges are compulsory and unrelated to the particular services supplied to the developer).
- All government-owned land used should be rateable.
- Councils should be required to supply ratepayers with an itemised rate demand.

## 5.5 Regulation

### *Resource Management Act 1991*

From a regulatory perspective, the Resource Management Act 1991 is the most important statute for local government. It governs many of the regulatory activities undertaken by regional and territorial councils, and has a pervasive effect on individuals and

businesses. Three enquiries are made each year to Auckland City Environments for every four citizens.<sup>39</sup>

The aspirations of the original advocates of the Resource Management Act 1991 remain unfulfilled. The former 'command and control' planning regime was to be replaced by an approach that emphasised the sustainable management of natural and physical resources, including lakes, rivers, coastal and geothermal areas, land, air, buildings and other structures. It was to focus on the effects on the environment of a proposed activity but this is not what has happened in practice. The key problems with the Resource Management Act 1991 include the following:

- It applies where private agreement or common law would provide solutions. It therefore unnecessarily politicises resource-use decisions and is socially divisive.
- Private property rights are overridden without just cause or fair compensation. A requirement to provide compensation where appropriate when such rights are taken would force public agencies to weigh the cost of such compensation against the wider community benefits that are expected to arise.
- The Act contains many ill-defined terms such as 'sustainable management'. The former central planning approaches have continued to be applied. Flaws in the Act rather than poor incentives facing agencies are the primary cause of such problems.
- Consent authorities continue to protect incumbent traders from competition.
- The Act leads to excessive uncertainty, inconsistencies, delays and costs that discourage development. One estimate is that a major project takes an average of 24 months from the date of lodgement of the application to the final court hearing. The delays affecting some projects are legendary. There is excessive scope for insubstantial, vexatious and frivolous objections, including by parties who would be no more affected by the proposed activity than the general public.

The International Institute for Management Development of Switzerland conducts an annual assessment of business competitiveness that is reported in *The World Competitiveness Yearbook*. In the 2006 survey, New Zealand's environmental laws and compliance were reported to hinder the competitiveness of businesses more than those of any of the other 60 countries examined. In 2003, New Zealand's environmental regulation was ranked the tenth most stringent out of 117 countries in *The Index of Economic Freedom* published by the Heritage Foundation and the *Wall Street Journal*.

While such harsh assessments might be questioned, there can be little doubt that the Resource Management Act 1991 is flawed. Past attempts to ameliorate concerns have largely failed.

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<sup>39</sup> Not all enquiries relate to the Resource Management Act 1991.

A first principles review of the Resource Management Act 1991 should be a top priority for any government committed to lifting New Zealand's rate of economic growth and enhancing the overall welfare of the community.

### ***Building Act 2004***

The construction of new buildings and the alteration, maintenance and demolition of existing buildings are subject to the Building Act 2004 and related regulations. The Act replaces the Building Act 1991. Some of its provisions came into force on 30 November 2004 while others are to be implemented over the next three-to-five years.

The main changes include the following:

- a review of the building code;
- the certification of proprietary building products;
- the licensing of builder practitioners;
- accreditation and registration of building consent authorities; and
- the introduction of new provisions relating to building consent and inspection.

Some 28,000 builders, designers (including architects) and tradespeople will be required to apply for one of 13 classes of licences. Building consent authorities (public and private building certifiers) will be subject to licensing for the first time from November 2007. Councils have been performing this task for over 100 years. Licensing is to be progressively implemented from late 2007 to 2011. The government has not yet determined how applicants for licences are to be assessed.

The Building Act 2004 provides for a large extension of consumer, product and occupational regulation, whereas in other areas and in many other countries the trend has been to reduce activity-specific regulation in the interest of promoting innovation and efficiency. The Department of Building and Housing has an extended regulatory role, arising from the restructuring of former agencies and an expanded role for central government.

High-profile problems relating to watertightness and other deficiencies encouraged the government to increase regulation and replace established court and other processes for resolving disputes and settling claims. Some of those problems were accentuated by the shortcomings of government agencies. The alternative settlement processes have not yet provided the speedy settlement of claims that was expected.

According to the government, the new policies are necessary to rid the sector of 'cowboy operators'. Competition and the enforcement of contracts generally provide the best protection for consumers, although public health and safety concerns may warrant specific regulation.

The regulatory approach adopted is unduly heavy handed and is likely to prove costly. It places excessive faith in the efficacy of specific regulation and is a disproportionate response to the problems that have been experienced in the recent past. The new regime should be subject to a first principles review.

### *Other regulation*

As noted above, councils administer a vast range of regulation. It is unlikely that all such regulation is warranted today. Why, for example, are billiard rooms or amusement galleries licensed? Where regulation is justified, there may be less costly forms of regulation. A systematic review of regulation administered by local government should be initiated by central government with the objective of reducing regulatory burdens on citizens and businesses.

## 5.6 Structure and governance

The role and functions of local government should be determined before the structure of local government is re-examined.<sup>40</sup> If the proposals outlined above were adopted, the role of territorial authorities would be substantially reduced, with new public entities taking responsibility for major responsibilities such as roading and water and wastewater. In those circumstances, the number of territorial authorities and community boards would need to be reviewed.

The merit of separating regional and territorial authorities would also need to be revisited. Conflicts of interest arising from the provision of goods and services on the one hand and regulatory responsibilities on the other, which were a main reason for the establishment of separate regional and territorial local government, would be reduced if councils were to focus on their core roles.

There may be scope to reduce the number of elected representatives on large councils, the number of council committees where they are excessive and the number of community boards where there are many, even if the activities of councils are not reduced as proposed. Councils can be too large for efficient decision making.

An excessive number of elected representatives, council committees and community boards is inefficient and wasteful. There are, for example, 264 elected representatives in the Auckland region, which is equivalent to about one for every 5,000 people. This level of elected representation can be compared with the national average of one member of parliament for every 34,000 people. The scope for cost savings, however, needs to be weighed against the principle of fair and effective representation for different communities of interest (such as rural ratepayers).

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<sup>40</sup> This view seems to be consistent with the lessons for New Zealand drawn in a recent report by McKinlay Douglas Limited. It states: "The changing role of local government is placing a twofold emphasis on the question of scale. At one level it concerns what type of structure/scale is necessary to deal with issues ... which are recognised as requiring a genuinely regional focus. At another level it is around the intimacy of place and the relationship between council and citizen ... [N]either of these roles necessarily implies significant structural reform – unless it is reform to reduce the size of overly large local authorities. Instead, the focus should be on councils themselves creating or facilitating the structures that fit the issue they are seeking to address. If it is something which is genuinely regional or subregional in scope, then the need is for a structure (not necessarily formally incorporated) which has that scope ... If it is something which is best handled at a district or sub-district level, then the issue becomes one of how best to engage at that level whether through strategic partnerships, community boards or whatever other means seems appropriate". See McKinlay Douglas Limited (2006), *Local Government Structure and Efficiency: A Report Prepared for Local Government New Zealand*, Wellington, p 52.



The separation of the representational and governance role of elected representatives from the management role of the chief executive should be fully implemented in all councils. Chief executives (and their staff) should provide independent professional advice to councils, which councils can accept or decline, rather than report the views of councillors as is common in some councils today.

### *Auckland issues*

The structure of local government in the Auckland region was not settled when the Local Government Act 2002 was passed. Certain so-called 'Auckland issues' were put to one side for further review.

Some structural changes were made in 2004. They included the following:

- Infrastructure Auckland was abolished. It had been established to hold investments that were once held by the Auckland Regional Council, most notably shares in Ports of Auckland Limited, and to fund transport and stormwater projects. Its assets were vested in a new entity, Auckland Regional Holdings Limited.
- The Auckland Regional Transport Authority was also established. It has extensive responsibilities for the implementation of the Auckland regional land transport strategy. The Auckland Regional Transport Authority contracts for the supply of bus, rail and ferry services and owns certain transport infrastructure.
- Auckland Regional Holdings Limited and Auckland Regional Transport Authority are subsidiaries of the Auckland Regional Council but they have separate statutory functions and powers.

A range of institutions had been established before 2004 to further the coordination of local government decisions in the Auckland region that might affect more than one council. They included the Regional Growth Forum, Regional Land Transport Committee, Auckland Regional Economic Development Forum and the Mayoral Forum.

Despite the 2004 changes and the institutions put in place before then, governance arrangements in the Auckland region remain a concern. Commentators commonly highlight the following key problems:

- Decision-making processes in relation to activities that extend beyond one district, particularly relating to transport planning, roads and public transport services, are difficult and inefficient. These activities may involve central government agencies, territorial authorities, the Auckland Regional Council and its subsidiaries, various coordinating bodies and private service providers. Wholesale water and wastewater services are also supplied on a regional basis, but governance issues in relation to those services are far less problematic than for transport.
- Very substantial expenditure growth has been foreshadowed in the relevant long-term council community plans. In addition, there is a massive funding gap between the Auckland Regional Transport Authority's plan for public transport, which includes electrification of the suburban rail network, and the funding provision that has been

made in the Auckland Regional Council's long-term council community plan. Ratepayers may be unwilling to bear future rate increases.

- Certain so-called 'regional' amenities, such as the Auckland City Art Gallery and Auckland Zoo, are currently provided and funded by Auckland City. Auckland City argues that other councils in the region should help fund those amenities and a range of organisations or activities that it also subsidises. Other councils in the region also provide facilities that arguably service the region.
- Some 11 organisations or activities would be funded on a regional basis if a planned private bill were passed by parliament. Examples include the: Auckland Philharmonia Orchestra, Auckland Rescue Helicopter, Auckland Theatre Company and the Coastguard Northern Region. The Museum of Transport and Technology and Auckland War Memorial Museum are presently funded on a similar basis to that proposed for the 11 organisations.
- The perceived inability of the Auckland region to speak with one voice. The government is reported to be frustrated by the divergent views expressed on Auckland issues by elected local government representatives in the Auckland region.

A number of proposals to address these concerns have been advanced. Councils in the region have endorsed the direction and principles of certain governance proposals put forward by council chief executives and central government officials, subject to significant and contrasting reservations and modifications.<sup>41</sup> Their proposals took account of council feedback on the Roche Committee's discussion document, *Strengthening Auckland's Regional Governance: Issues and Options*.<sup>42</sup> There has been no formal consultation with the people most affected, the ratepayers and citizens of the region. The government must now decide on the next step.

The following broad approach may help to improve governance arrangements in the Auckland region:

- A clear distinction should be drawn between those functions and activities that are region-wide in nature and those that relate to a single district. The chairman of the Auckland Regional Council, Michael Lee, was correct to emphasise that debate about governance arrangements should start by focusing on functions that are to be undertaken rather than organisational structures.<sup>43</sup> The Roche Committee's discussion seems to have largely ignored that approach and proposed poorly conceived options.

<sup>41</sup> *Strengthening Auckland's Regional Governance: Proposal for Consideration by the Councils of the Auckland Region* (2006), <[www.strongerauckland.org.nz](http://www.strongerauckland.org.nz)> (last accessed January 2007) and Robertson, John (2006), 'Strengthening Auckland's Regional Governance', press release, 18 December, Auckland Regional Council, Auckland.

<sup>42</sup> Roche Brian *et al* (2006), *Strengthening Auckland's Regional Governance: Issues and Options*, Discussion Paper for the Councils of the Auckland Region, <[www.strongerauckland.org.nz](http://www.strongerauckland.org.nz)> (last accessed January 2007).

<sup>43</sup> Lee, Michael (2006), 'Local Government Reform – Where to from here?', presentation to the Mayoral Forum, 15 September, Auckland Regional Council, Auckland.

The proposals advanced by chief executives and officials recognise the issue, but reflect an inconsistent approach to it.

- The principle of subsidiarity should also apply. There should be no presumption that bigger local authorities are necessarily more efficient for the following reasons:
  - Smaller councils that are close to their communities have generally focused on their core roles and avoided excessive regulation and a large bureaucracy. It is the larger councils that have expanded well beyond their proper role and are relatively unresponsive to their communities. The accountability of larger councils is often weak. These reasons, together with the benefit of competition among councils for residents and businesses, argue against amalgamation for its own sake.
  - It is doubtful whether any significant economies of scope and scale would arise from the amalgamation of the territorial councils, or territorial and regional councils, in the Auckland region. Larger councils might lead to diseconomies of scope and scale in some areas. Those functions and activities that are regional in nature can be undertaken on a regional basis without requiring other activities to be organised in a similar way.<sup>44</sup>
- A key activity that needs to be better coordinated is transport:
  - Land transport planning should remain the responsibility of the Auckland Regional Council.
  - As proposed above, a more commercial approach, involving the establishment of public entities to own and operate roads, should be adopted. One or two entities might have responsibility for roading in the Auckland region or for a larger area, for instance, the North Island.
  - A separate regional entity, like the Auckland Regional Transport Authority or the Auckland Regional Council, would be required to fund public transport services if they are to be subsidised. With more efficient road pricing, the case for subsidising public transport services essentially disappears and such services can be supplied privately with limited involvement of local government, as is the case for taxi services at present.
- Water is also a region-wide activity. As argued above, water should be supplied on a more commercial basis. This would require the establishment of separate water businesses which may extend beyond the region. The question of whether wholesale supply and distribution should be vertically integrated with local supply and reticulation would need to be examined.

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<sup>44</sup> The McKinlay Douglas Limited report stated: "Evidence from examples both of sector-wide initiatives equivalent to New Zealand's 1989 experience, and of individual amalgamation initiatives, is at best equivocal on whether amalgamation has produced the promised gains in efficiency and cost effectiveness. The evidence does often suggest that costs may have exceeded benefits". See McKinlay Douglas Limited (2006), above n 40, pp 2–3.

- There are several straightforward solutions in respect of most of the activities that Auckland City and other councils argue should be funded regionally. The Auckland City Art Gallery and Auckland Zoo could become the responsibility of the Auckland Regional Council or they could be corporatised and funded by a levy payable by territorial councils in the region. Another option would be for Auckland City to charge non-residents (or all residents) admittance fees to recover costs. Responsibility for subsidising organisations that supply services on a region-wide basis, such as marine safety, could either rest with the Auckland Regional Council or be funded by a levy on territorial councils within the region.
- The suggestion that a single local authority would speak with one voice for the Auckland region is predicated on the assumption that the interests of all sections of the region are the same. This is not true. It may be more convenient for central government to interact with one entity, but that does not necessarily mean that the interests of the citizens of Auckland are best served by compromises made behind closed doors. Taken to its limit, the argument would justify a single council for all of New Zealand.
- Following an analysis and allocation of functions and activities among regional and territorial councils and the establishment of separate entities (as discussed above), the existing boundaries of territorial authorities might be examined. This is unlikely, however, to yield major additional gains.

## 5.7 Legislative framework

The Local Government Act 2002 should be reworked to reflect the principle that local government has a vital, but limited, role. The key proposals (in addition to those noted above) include the following:

- The purpose of local government should focus on democratic decision making in respect of the core activities of councils (that is, activities that cannot be undertaken efficiently by individuals, firms and voluntary groups and that are not performed by central government).
- The activities of local government should focus on the following:
  - funding and, where appropriate, the provision of those core activities that are enumerated in the Act;
  - the undertaking of any other functions or duties imposed on local government by any statute;
  - the undertaking of other significant activities supported by more than a simple majority of ratepayers in a poll; and
  - the administration of regulations at the local level.
- The funding powers of councils should reflect the proposals contained in section 5.4.

- Councils should be required to compensate individuals and firms for the taking of private property rights where appropriate.
- Consideration should be given to limiting the growth in council spending. The maximum annual growth in operating spending could be limited to an adjustment for inflation (general price level change) and any increase in population. Spending growth beyond that ceiling should also require approval by a majority of ratepayers.
- Part 6 of the Local Government Act 2002, which relates to planning, decision making and accountability, should be more tightly focused and less onerous on councils and ratepayers. Changes could include the following:
  - the long-term council community plan and annual planning processes should be restricted to activities for which councils are responsible and simplified; and
  - the number of mandatory policy statements should be reduced, and those that are required should be simplified.

## 6 CONCLUSION

Key conclusions are summarised below:

- Local government has a vital but limited role.
- The activities of some councils presently extend well beyond their proper role, thereby threatening private property and prosperity through excessive and inappropriate spending and regulation.
- The level of rates is excessive and their distribution is unfair.
- Local government should focus on activities that cannot be undertaken efficiently by individuals, firms and voluntary groups, and that are not performed by central government. It should administer appropriate regulation at the local level.
- Core activities of local government should be enumerated in the Local Government Act 2002. Other significant activities could be undertaken provided that more than a simple majority of ratepayers approve of such activities in a referendum.
- A first principles review should be undertaken of the Resource Management Act 1991, the Building Act 2004 and other regulations that councils administer.
- A first principles review of the funding of local government should be undertaken.
- Part 6 of the Local Government Act 2002, which relates to planning, decision making and accountability, should be revised to reduce the cost to councils and ratepayers of financial management.



# Appendix

## Background information

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Table 1: Activities commonly undertaken by councils

| <b>Regional councils</b>   | <b>Territorial authorities</b>  |
|--|---|
| <p><i>Regulatory activities</i></p> <ul style="list-style-type: none"> <li>· Resource management (especially the environmental effects of discharges to air and water, the abstraction of water and coastal management).</li> <li>· Building (dam construction and safety).</li> <li>· Regional land transport planning.</li> <li>· Harbour, lake and river safety and administration, including harbourmaster services and marine pollution.</li> <li>· Regional civil defence and emergency management.</li> <li>· Hazardous substances, new organisms and biosecurity (control of pests and noxious plants).</li> </ul> <p><i>Provision and/or funding of services</i></p> <ul style="list-style-type: none"> <li>· Mass passenger transport services.</li> <li>· Regional parks, reserves and other recreation and sports facilities.</li> <li>· Bulk water supply.</li> <li>· Flood protection.</li> <li>· Economic development.</li> </ul> | <p><i>Regulatory activities</i></p> <ul style="list-style-type: none"> <li>· Resource management (especially district plans and resource consents).</li> <li>· Building (building consents and inspection).</li> <li>· District land transport planning.</li> <li>· Public health and safety relating to the supply of water, food and liquor, wastewater, waste disposal, the fencing of swimming pools and dog control.</li> <li>· District civil defence and emergency management.</li> <li>· Hazardous substances, new organisms and biosecurity.</li> <li>· Public nuisances.</li> </ul> <p><i>Provision and/or Funding of Services</i></p> <ul style="list-style-type: none"> <li>· Roading and related services.</li> <li>· Stormwater and wastewater collection, treatment and disposal.</li> <li>· Water supply.</li> <li>· Refuse collection and disposal.</li> <li>· Parks, reserves and other sport and recreation facilities.</li> <li>· Libraries, museums, art galleries and zoos.</li> <li>· Public halls and other venues.</li> <li>· Cemeteries and crematoria.</li> <li>· Public conveniences.</li> <li>· Flood protection.</li> <li>· Car parking facilities.</li> <li>· Housing.</li> <li>· Childcare and grants for community activities.</li> <li>· Rural fire services.</li> <li>· Airfields and wharves.</li> <li>· Economic development and tourism promotion.</li> </ul> |

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Table 2: Aggregate income, spending and surplus 2004/05

|   | \$m   | Percent |
|---|-------|---------|
| <i>Operating revenue</i>                                  |       |         |
| Rates, petroleum tax, licence fees and fines              | 3,080 | 62      |
| Sale of goods and services and other income               | 948   | 19      |
| Government grants and subsidies                           | 661   | 13      |
| Investment income   | 307   | 6       |
| <i>Total operating revenue</i>                            | 4,996 | 100     |
| <i>Operating spending</i>                                 |       |         |
| Purchase of goods and services, grants and other spending | 2,534 | 54      |
| Employee costs  | 1,098 | 23      |
| Depreciation  | 957   | 20      |
| Interest  | 158   | 3       |
| <i>Total operating spending</i>                           | 4,747 | 100     |
| <i>Operating surplus</i>                                  | 249   |         |

Source: Local Authority Statistics, Statistics New Zealand, September 2005.

Note: Excludes certain local authority trading activities, non-operating revenue and spending and abnormal items.

Table 3: Aggregate assets, liabilities and ratepayers' equity at 30 June 2005

|                                       | \$m    |                                      | \$m    |
|---------------------------------------|--------|--------------------------------------|--------|
| <i>Current assets</i>                 |        | <i>Current liabilities</i>           |        |
| Cash and bank deposits                | 937    | Debt                                 | 680    |
| Other current assets                  | 1,542  | Other current liabilities            | 1,381  |
| <i>Total current assets</i>           | 2,479  | <i>Total current liabilities</i>     | 2,016  |
| <i>Non-current assets</i>             |        | <i>Non-current liabilities</i>       |        |
| Land and buildings                    | 13,594 | Debt                                 | 1,692  |
| Infrastructure and other construction | 47,379 | Other non-current liabilities        | 357    |
| Investments                           | 5,442  |                                      |        |
| Other fixed assets                    | 2,446  |                                      |        |
| <i>Total non-current assets</i>       | 68,861 | <i>Total non-current liabilities</i> | 2,049  |
|                                       |        | <i>Ratepayers' equity</i>            | 67,230 |
| <i>Total assets</i>                   | 71,340 | <i>Total liabilities</i>             | 71,340 |

Source: <www.localcouncils.govt.nz> (last accessed January 2007).

Note: Excludes activities undertaken through council-controlled organisations.