LOCAL GOVERNMENT FORUM

SUBMISSION ON *FOCUS ON THE FUTURE*

AUCKLAND CITY COUNCIL'S STRATEGIC PLAN, LONG-TERM FUNDING STRATEGY, FUNDING POLICY AND ANNUAL PLAN 2003

MAY 2002

FOCUS ON THE FUTURE

1 Overview

1.1 This submission on *Focus on the Future,* Auckland City Council's draft strategic plan, long-term financial strategy, funding policy and annual plan for 2003 (the Plan), is made by the Local Government Forum (the Forum). The Forum comprises business organisations that have a vital interest in local government (see the appendix). The members of those organisations are among the largest ratepayers in Auckland City.

1.2 The Auckland City Council (the Council) is to be commended for the steps that it is taking to concentrate on its core activities and reduce the rate of growth in spending and rates. The proposed strategic plan is also better focused and more realistic than the previous strategic plan, *The First City of the Pacific*, which has justifiably been discarded.

1.3 The thrust of the Council's policies is consistent with past submissions by the Forum to the Council. They will help to put in place an environment that encourages the growth and development of business, and fosters prosperity generally.

1.4 While the Council has made good progress in a short time, much work remains to be done if it is to make the best possible contribution to the overall welfare of Auckland citizens. The main contribution that the Council can make to growth and employment prospects in Auckland is to reduce the rates and regulatory burdens it imposes on the private sector.

1.5 Spending and rates are still excessive. A large number of reviews that are in train need to produce worthwhile savings. The Council should exit from private good activities such as the ownership of off-street car parking facilities. It should also refrain from engaging in new private good activities such as the promotion, subsidisation and/or ownership of the proposed indoor sports arena and convention centre. New proposals, including investment projects, should be rigorously scrutinised against recognised public policy criteria. The same approach should apply to regional transport projects in which the Council has a financial interest.

1.6 The Plan proposes an increase in rates of 1.6 percent. Any rate rise is unacceptable. Moreover, the rate rise is not necessary to fund budgeted operating spending. The Forum supports the proposed reduction in differential rates. There is no economic or financial justification for imposing a disproportionate rate burden on the business sector. The Council should put in place a planned programme to phase out such differentials over 3 to 5 years.

1.7 The balance of this submission is presented in 4 sections. The next section (section 2) reviews the Council's spending and revenue. Section 3 examines key issues in the Plan. Other issues are discussed in section 4. The proposed rate increase is examined in section 5.

2 Forecast spending and revenue

2.1 The forecast statement of financial performance indicates that total operating spending (excluding that undertaken by LATEs such as Metro Water Limited and the ARC levy) in 2001/02 will amount to $378.4 million, an increase of 6 percent on the outturn for the previous year. In 2002/03, spending is forecast to amount to $382.5 million, an increase of 1.1 percent.

2.2 The forecasts contained in the long-term financial strategy (which are slightly inconsistent with those referred to above) suggest that total operating spending (excluding the ARC levy) will increase by 10 percent or an average of 1 percent a year between 2001/02 and 2011/12. While the Council has taken steps to slow the rate of growth in spending, it has not reduced the overall level of spending or arrested the persistent trend growth.

2.3 There is a significant risk that new policies will add to spending levels over time. Furthermore, much spending is undertaken through LATEs. Auckland City ratepayers are also exposed to substantial financial risk through the Council's 58 percent equity holding in Auckland Regional Transport Network Limited (ARTNL). ARTNL is investing heavily in uneconomic passenger transport projects. It is unlikely that the ARC levy and planned capital grants will be sufficient to fund ARTNL. The ARC levy is forecast to increase by a massive 7 percent a year for the next 10 years.

2.4 Total rates revenue available to the Council in 2002/03 is budgeted to be 3.6 percent higher than the forecast outturn for 2001/02. This arises from the proposed increase in the level of rates and the change in the value of rateable property.

2.5 Total rates revenue (excluding the ARC levy) is forecast to rise by 21 percent or an average of 1.9 percent a year between 2001/02 and 2011/12. This is nine tenths of a percentage point a year higher than the forecast growth in spending. Revenue from activities is forecast to decline through to 2011/12. The reason for this is not explained in the long-term financial strategy.

2.6 The long-term financial strategy provides for an operating surplus of at least $17 million a year, for a reduction in total liabilities from $307.9 million in 2001/02 to $124.9 million in 2011/12, and for total assets to increase from $3.6 billion to $4.0 billion over the same period. These forecasts point to an excessive expansion of the Council's balance sheet and higher surpluses (ie higher rates than otherwise) than is appropriate given the proposed sale of Auckland International Airport Limited (AIAL) shares.

2.7 The Forum submits that the long-term financial strategy should be adjusted to incorporate further reductions in spending, no increase in the level of rates payable per dollar of rateable property and somewhat lower surpluses. There is a case for going further and reducing rates (see below). A higher proportion of planned capital expenditure could, if necessary, be financed by borrowing.

3 Key issues addressed in the Plan

Transport

3.1 The Plan reports that the number one priority of the Council is to improve the City's road network. The Forum endorses that priority. Congestion on motorways and arterial roads is imposing massive costs on businesses and the wider community. While there is much that the Council can do to reduce traffic congestion within Auckland City, prime responsibility for expanding the capacity of state highways and motorways rests with other agencies. Some, such as the ARC and the previous Council, devoted disproportionate attention to public passenger transport.

3.2 Despite the growth in bus patronage in the past year or two, public transport accounts for a tiny proportion of the transport market in Auckland and it can only solve a fraction of Auckland's traffic problems. A report by the Energy Efficiency and Conservation Authority notes that "the relative role of public transport (covering bus, rail, ferries, etc) in most of New Zealand is on the decline". This is despite the substantial subsidies provided for public transport. In contrast, private car ownership has increased rapidly. People prefer to use private transport because of its convenience and for other reasons. A recent survey by the Automobile Association found that 60 percent of respondents stated that public transport was important but only 6 percent said that they were likely to use it in the coming year.

3.3 Passenger transport services are a private good activity – not a public good activity. Unlike public goods such as city parks and streetlighting, public transport services such as buses, trains, ferries and taxis are provided by private operators and charged for in the normal way. There are no free-rider problems arising from the inability to exclude non-payers. In addition, the use of passenger transport services by one person detracts from their enjoyment by other people. Once a seat on the bus is taken it is not available for other commuters. By contrast, streetlighting – a public good – illuminates the footpath regardless of how many people pass by, and there is no feasible means of charging those who benefit from lighted footpaths.

3.4 The mistaken view that the government has a significant role in funding and/or providing passenger transport operations and infrastructure is reflected in the policies and activities of the Auckland Regional Council, the region's territorial authorities and Infrastructure Auckland. Several policies and comments contained in the Plan reflect such views. They include the Council's participation in ARTNL, projects aimed at providing preferences for buses (further subsidies for one class of road user) and cyclists (who make no direct contribution to the costs of cycle ways), and endorsement of urban intensification along passenger transport routes. The last of these policies puts the promotion of passenger transport ahead of the preferences of citizens. It is not surprising that it is being resisted by affected residents.

3.5 A more rigorous analysis of the economic merits of proposed investments in public transport infrastructure is required. The first issue to be addressed on a principled basis is whether there are valid grounds for government involvement. The country cannot hope to achieve the ambitious growth targets advocated by the major political parties if local government in the Auckland region spends hundreds of millions of dollars over the next few years on projects that generate low or negative net community benefits. The main focus of transport policies should be on roading, including better methods of road pricing. Given such initiatives, public transport should be allowed to compete with other modes without the need for planning or subsidies.

Airport shares

3.6 The Forum supports the Council's proposal to sell its shares in Auckland International Airport Limited. The provision of airport and related services (such as the supply of property for retailing and car parks) are private good activities that should be left to the private sector. The Council has no direct influence on the operation of the airport. Normal commercial incentives will encourage AIAL to supply airport services provided that it is economic to do so.

3.7 Some commentators such as Brian Gaynor have argued that the Council should retain its shares because AIAL is a good investment. Such argument is faulty. Ratepayers are exposed to unnecessary risk from an undiversified portfolio. There are no grounds for believing that the price of AIAL shares does not reflect fairly all the information that is known about AIAL's prospects. The Council should not be gambling on a risky investment by taking a different view.

3.8 For the same reason, there is no economic advantage in holding the shares until AIAL returns surplus capital by way of a special dividend. The present price of the shares can be expected to reflect AIAL's announcement on the planned distribution.

3.9 The Council's role is not to hold commercial investments on behalf of its ratepayers but to carry out those public good activities that are more efficiently undertaken by local government. There are no valid grounds for compelling ratepayers to hold an interest in AIAL through the Council. Ratepayers can invest in AIAL themselves, if they wish, and bear the risks involved.

Capital fund

3.10 The proposal to use the proceeds from the sale of AIAL shares to retire debt is appropriate. However, the establishment of a capital fund of between $200 million and $300 million in each year through to 2011/12 is not. There is no net benefit in putting up rates by $4.7 million in 2002/03, budgeting for an operating surplus of $17 million and establishing a capital fund with some of the proceeds from the sale of assets. The Council would effectively be swapping one non-core investment for another. Moreover, all too often capital funds are wasted on low priority projects.

3.11 A better strategy would be to drop the proposed increase in rates, repay debt that matures or can be profitably be retired early, provide for the retirement of other debt that will mature in the next 2 to 3 years (for instance by holding financial assets) and apply the funds to planned capital spending over the next 2 to 3 years. Any surplus beyond these provisions should effectively be returned to ratepayers. As a return of surplus capital is not permitted under current legislation, the appropriate mechanism is by way of lower rates than otherwise. There is provision for this in the Local Government Act 1974.

Pensioner and other housing

3.12 The Forum endorses the Council's proposal to exit from the provision of pensioner and other residential housing. The vast majority of people, including pensioners and those on low incomes, obtain their housing services in the private sector. The provision of housing is a costly way to address problems of income inadequacy. Moreover, such problems are the responsibility of central government.

3.13 The Council is making appropriate arrangements for existing pensioners.

Arena and convention centre

3.14 The claim that Auckland City is missing out on possible conferences and sporting events may well be true. But it is also 'missing out' on a host of other activities for the same reason, namely, that is not economic to engage in them.

3.15 The provision of an indoor sports arena and convention centre is a private activity that should be the responsibility of the private sector. The grounds for public ownership are weak. Similarly, the argument that spill-over or external benefits that accrue to the wider community justify subsidisation is not convincing.[1] Promoters can capture many spill-over benefits through sponsorship arrangements. Moreover, if subsidies were justified, they should be directed at the particular events that generate the intended benefits and not at the provision of facilities which may remain under-used.

4 Other issues

Strategic plan

4.1 The strategic plan includes the promotion of "economic growth by working with other organisations to carry out the regional economic development strategy". We understand that the policy entails the subsidisation of favoured activities or firms. This necessarily implies the taxation of other activities or firms – there is no free lunch. It rests on the belief that governments can pick winners and that planning should augment market mechanisms in allocating resources and encouraging innovation and growth. Experience in New Zealand and elsewhere with such policies shows conclusively that they do not work – they misallocate resources and the community ends up poorer.

4.2 The major contribution that the Council can make to growth and employment prospects in Auckland is to reduce its spending, rates and regulatory burdens. The Council should also carry out its public good activities as efficiently as possible and disengage from other so-called economic development projects.

4.3 The Plan states that the Council will determine, with the rest of the Auckland region, the future of water, wastewater and stormwater industries. The ownership structure that would provide the region and Auckland City with the most efficient water and wastewater services should be the focus of such deliberations.

4.4 There is compelling evidence from New Zealand and overseas that corporatised and privatised enterprises are, on average and over time, more efficient than businesses that are run by politicians. Metro Water was a sound initiative. Various forms of privatisation of water supply and wastewater disposal, including franchising and contracting for services, have also produced major benefits for consumers and the wider community in other countries. Private sector participation in Auckland's water and wastewater industries should be introduced as soon as possible.

Off-street car parking facilities

4.5 The provision of off-street car parking is an inappropriate activity for the Council, as the Birch report concluded. The establishment of a more commercial structure for the management of such facilities is not an adequate response. Such facilities should be sold.

Libraries

4.6 The City's libraries constitute a significant activity. The operating cost of libraries is budgeted to be $21.5 million in 2002/03. A further $4.3 million is allocated for capital expenditure. A review of the cost of library services is underway.

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1 New Zealand Business Roundtable (1999), *Should Governments Subsidise Stadiums and Events?*, New Zealand Business Roundtable, Wellington.

4.7 Around 80 percent of the operating cost of libraries is to be funded from general rates. This implies that the vast majority of the benefits from using the libraries accrue to non-users, including business ratepayers. This is implausible. Steps should be taken to require users to make a far greater contribution to the cost of library services. To the extent that this requires a change in the law, the Council should seek legislative amendments.

5 Proposed rate increase

5.1 The Plan proposes "a rate increase of 1.6 per cent, which is an adjustment for inflation expected during the 2003 financial year." The proposition that movements in the general level of prices justify a rate increase, which is often advanced by councils, is incorrect for three main reasons:

- Over time property values, and hence the annual value of rateable property, tend to increase in line with the rate of inflation. Thus any change in the level of rates charged for each dollar of a property's annual value is a real increase in rates and not an inflation adjustment.

- There are technical reasons why a small increase in the measured level of inflation is judged to be consistent with a stable level of general prices. Price indices, for instance, tend to be biased upward because of statistical lags and the difficulty of identifying the impact on product prices of quality improvements. Recent governments have accepted that an increase in the CPI of up to 2 or 3 percent a year is consistent with price stability. Thus, if it were appropriate to index the level of rates to the rate of inflation, a 2 or 3 percent increase in the CPI should be disregarded.

- The idea that rate or price increases are justified by reference to movements in general prices is a hangover from New Zealand's high inflation and highly regulated past. In the present environment, rate increases by councils should be justified by reference to the costs and benefits of their valid public good activities.

5.2 The proposal contrasts with the approach taken by central government where increases in rates of taxation are now rare. A change in tax rates is equivalent to a change in the level of rates applied to each dollar of a property's rateable value. There have been only two rates of GST (10 and 12.5 percent) since its introduction in October 1986. There have been few changes in personal income tax rates during the same period and most have been in a downward direction. The top rate of personal tax, for example, has been set at 48, 33 and 39 percent while the bottom effective rate has remained at 15 percent since 1986. Middle tax rates have been cut. Other things being equal, predictable rates of tax, including rates, encourage investment by reducing uncertainty.

5.3 The Council proposes that waste management services be partly funded by a new uniform annual general charge of $47 per rateable property. The charge is proposed as a first step in moving toward a full uniform annual charge for waste management over the next few years. The Plan states that "there is currently no relationship between the cost of providing the service and the amount that each ratepayer contributes." The same argument could be advanced in respect of all other categories of spending that are funded from rates. Who would suggest that Council services should generally be funded by uniform annual charges?

5.4 More importantly, the proposed uniform charge would not increase efficiency because each residential ratepayer would pay $47 regardless of the amount of waste (if any) that is collected from his or her property. From this perspective there are no valid grounds for funding waste collection from a uniform annual general charge. The position would be different if the charge paid by each ratepayer reflected the actual volume of rubbish collected from the property. In that event the charge would affect the incentive to generate and dispose of waste. Moreover, the Plan does not make a case on equity grounds for imposing a higher proportion of the cost of waste collection on ratepayers who own relatively low-value residential property. For these reasons the Forum opposes the introduction of the proposed uniform annual charge for waste collection. Moves towards a proper user pays approach would be more desirable.

5.5 The Forum supports the proposed further step in reducing differential rates. There is no economic or financial justification for imposing a disproportionate rating burden on the business sector. User charges should be applied where appropriate and remaining revenue requirements should generally be met by a uniform levy on rateable property with no discrimination between residential and non-residential ratepayers.

5.6 However, the phase-down of differential rates is proceeding at a snail's pace. Under the Council's proposal, CBD non-residential ratepayers would pay 23.2 percent of general rates and the uniform annual general charge in 2002/03 compared with 23.7 percent in 2001/02. It would take about 25 years to reduce the present CBD non-residential differential from 256 percent to the Council's target of 200 percent, which would still be double the appropriate level.

5.7 The Forum submits that differential rates should be phased out over 3 to 5 years. The impact on residential ratepayers should be moderated by reducing spending and by applying user charges where appropriate.

Appendix

The Local Government Forum

The Local Government Forum was established in 1994 to promote greater efficiency in the local government sector and to contribute to debate on policy issues affecting the sector.

The Forum comprises business organisations that have a vital interest in the activities of local government. The following organisations are members of the Forum:

- Business New Zealand
- Federated Farmers of New Zealand (Inc.)
- New Zealand Business Roundtable
- New Zealand Forest Owners' Association Inc.
- Property Council of New Zealand Inc.