

**Submission**

**by**

**THE  
NEW ZEALAND  
INITIATIVE**

**to the New Zealand Productivity Commission**

on the

**Local Government Funding and Financing  
Issues Paper November 2018**

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Prepared by:

Senior Fellow Dr Bryce Wilkinson

[bryce.wilkinson@nzinitiative.org.nz](mailto:bryce.wilkinson@nzinitiative.org.nz)

Research Fellow Dr Patrick Carvalho

[patrick.carvalho@nzinitiative.org.nz](mailto:patrick.carvalho@nzinitiative.org.nz)

The New Zealand Initiative

PO Box 10147

Wellington 6143

<https://nzinitiative.org.nz/>

### **ABOUT THE NEW ZEALAND INITIATIVE**

The New Zealand Initiative is a Wellington-based think tank that helps develop sound public policies for a competitive, open and dynamic economy and a free, prosperous, fair and cohesive society. It is funded by members who are primarily chief executives of major New Zealand businesses. In total, these businesses employ more than 150,000 New Zealanders.

As New Zealand's leading think tank, we work closely with our members, policymakers across the political spectrum, the wider business community, the media, academics and the general public.

Our researchers conduct independent research on a wide range of policy issues. From education to economic policy, poverty to housing, and local government to immigration, we are injecting new ideas into New Zealand's political debates.

We are strictly non-partisan in our work and welcome an open exchange of views and ideas. The results of our research are available to the public, free of charge, on our website.

## 1. SUMMARY

- 1.1 This submission on the New Zealand Productivity Commission’s Issues Paper, “Local Government Funding and Financing”,<sup>1</sup> is made by The New Zealand Initiative, a Wellington-based private sector public policy think tank.
- 1.2 The New Zealand Initiative has long advocated looking at issues of local government funding and financing through the lens of localism. That requires the willingness to consider the case for a more devolved model of government focused on the greater local delivery of, and accountability for, more cost-effective and targeted services along with well-calibrated incentives to facilitate economic growth and community wellbeing more generally.
- 1.3 There is a strong historical, philosophical, economic and international case for greater local democracy and growth-friendly mechanisms in New Zealand.<sup>2</sup>
- 1.4 At the core of localism is the principle of subsidiarity. This prescribes that higher tiers of government should only perform tasks that cannot be performed at a more local level. Accountability to local communities and the ability of individuals to move jurisdictions are the bedrock discipline.
- 1.5 Local communities would have greater say over what their local authority would provide and at what cost. Comparisons with other local jurisdictions would inform their choices. This would be healthy competition.
- 1.6 Done well, this structure would revitalise local democracy; citizens would have greater say and control over local services directly affecting their daily lives. Local governments would have the incentive and the tools – including funding and financing means – to do a much better job of providing local goods and services.
- 1.7 The thrust of this submission is to support moves to widen the funding mechanisms available to local communities in ways that improve local accountability and choice, and incentives to meet the needs of both growing and declining regions.
- 1.8 Particular recommendations in this submission include introducing changes to strengthen:

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<sup>1</sup> Productivity Commission. “Local Government Funding and Financing – Issues Paper” (Wellington: New Zealand Government, 2018).

<sup>2</sup> Hartwich, Oliver. “A Global Perspective on Localism” (Wellington: The New Zealand Initiative and Local Government New Zealand, 2013).

1. the scope for choice for local communities of funding and financing (Q 6 and 37); asset recycling should be on the table (Q 18)
2. financing arrangements that embody stronger incentives to accommodate growth pressures (Q 38 and 39) and with specific reference to housing (Q 41)
3. respect for private property rights (Q 8, 21 and 38)
4. benefit-cost assessment disciplines (Q 8 and 21)
5. the assessment and communication of actual likelihoods of risk factors (Q 8)
6. greater user of user charges for the provision of private goods and services (Q 11)
7. greater use of targeted rates as long as checks and balances restrict them to the beneficiary-pays tax principle (Q 32). We have the same reservation about tax increment financing (Q 48)
8. the demarcation lines between central and local government responsibilities (Q 37)
9. the degree to which compliance with national policies is funded by central government and responsibility for funding local policies is funded by those who chose them (Q 37)
10. recognition that it is commonplace for local communities overseas to access a broader range of taxing options, including income and expenditure taxes. Allowing local communities to do the same in New Zealand would be a major and distant reform, but it should be debated at some point (Q 41)
11. the role for private funding of government infrastructure (Q 47)
12. the ability of lay members of local communities to understand Council proposals and be able to effectively contribute to public debate over them (Q 48)
13. the ability of Councils to resist opportunistic after-the-event claims on them by uninsured property owners through prior conditional resources consents or zoning mechanisms (Q 8).

## 2. INTRODUCTION AND BACKGROUND

- 2.1 Many New Zealanders would like to see local authorities perform better for their communities. For decades, central government has sought to achieve this by dictating the structure and focus of local government, often on a one-size-fits-all basis.
- 2.2 From inception, The New Zealand Initiative's research has raised the option of greater, not less, localism, accompanied by heightened local accountability.<sup>3</sup> In particular, we have emphasised that current funding and financing mechanisms are not conducive to an innovative and competitive environment among councils, which thereby fail to provide the best set of local public outcomes.
- 2.3 Throughout our assessments, a recurring theme is inadequate incentives for all stakeholders – including local and central governments as well as members of local communities – to engage in the most efficient and fruitful manner.
- 2.4 In short, poor incentives lead to poor outcomes.
- 2.5 To remedy this, we have championed the idea of devolution as central to rethinking the way New Zealand funds and finances local governments.
- 2.6 We understand that localism is not the most popular (and properly understood) policy solution in a highly centralised New Zealand. Many well-informed people have reservations about giving local governments more funding options, especially when time and again news reports portray anecdotal evidence of local authority profligacy. Indeed, the goal is to transfer power over local authorities to local communities; it is not to transfer power over local communities to local authorities.<sup>4</sup>
- 2.7 This proposal only looks controversial when viewed through an isolationist lens. Any reasonable look outside New Zealand will find examples that work. If Switzerland can do it well and benefit from strong local government involvement and accountability, why should New Zealand close its eyes and cover its ears?

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<sup>3</sup> For instance, refer to some of our following publications: Hartwich, Oliver. "A Global Perspective on Localism," *Ibid.*; Bassett, Michael and Luke Malpass. "Different Places, Different Means: Why Some Countries Build More Than Others" (Wellington: The New Zealand Initiative and Local Government New Zealand, 2013); Acharya, Khyaati and Eric Crampton. "In the Zone: Creating a Toolbox for Regional Prosperity" (Wellington: The New Zealand Initiative, 2015); Krupp, Jason and Bryce Wilkinson. "The Local Formula: Myths, Facts and Challenges" (Wellington: The New Zealand Initiative, 2015); Krupp, Jason. "The Local Benchmark: When Smaller Is Better" (Wellington: The New Zealand Initiative, 2016); Krupp, Jason. "The Local Manifesto: Restoring Local Government Accountability" (Wellington: The New Zealand Initiative, 2016); Craven, Ben, Jack Goldingham-Newsom and Oliver Hartwich. "#LocalismNZ: Bringing Power to the People" (forthcoming).

<sup>4</sup> Krupp, Jason and Bryce Wilkinson. "The Local Formula: Myths, Facts and Challenges," *op. cit.*

- 2.8 The Initiative's view is that New Zealand's heavy centralist control of local authorities has blurred public service accountability and is one reason for the unsatisfactory performance of too many local authorities.
- 2.9 Local governments in New Zealand are regularly the sharp end of the public policy spear. It is through local councils that many residents most encounter government: zoning laws, business permits, clean water and wastewater management, road maintenance, pest control, garbage collection, and much more.
- 2.10 Done well, these local services go hardly noticed; done poorly, public outcry gets national attention – and ample news coverage.
- 2.11 In addition, a lot of central government policy interventions – from public education and health services to dog control – are conducted and delivered through local service providers, which have little say on their policy design but bear the brunt of any discontent regardless.
- 2.12 The fact that costs imposed on local authorities by central government appear on the rates bill unfairly compounds the antipathy towards the local entity. Rates are much more visible to ratepayers than are PAYE and GST to taxpayers.
- 2.13 Unsurprisingly, general sentiment towards local governments goes from widespread disappointment to a complete sense of hopelessness, leading to low voter turnout in local elections and poor performance in polling surveys.<sup>5</sup>
- 2.14 The usual political response amid such a love-hate attitude towards local government has been the ongoing impulse to reduce local autonomy. Centralisation and national standards rule, with one-size-fits-all solutions becoming the norm.<sup>6</sup>
- 2.15 By 1989, some 850 of our devolved ad hoc entities had been amalgamated into 86 local government bodies.<sup>7</sup> Since then, 200 city and district councils have been further reduced to current 67 territorial authorities, and the single Auckland Council is responsible for local services of a third of the national population.<sup>8</sup>

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<sup>5</sup> Local Government New Zealand (LGNZ). "The New Zealand Local Government Survey" (Wellington: New Zealand Government, 2015). Sentiment towards local authorities is not all bad – outside Wellington at least. Witness the local opposition to greater amalgamation, even in the greater Wellington region.

<sup>6</sup> The moves by the fourth Labour Government to provide local government with a power of general competence were not accompanied by adequate measures to empower local communities.

<sup>7</sup> Craven, Ben, Jack Goldingham-Newsom and Oliver Hartwich. "#LocalismNZ: Bringing Power to the People," op. cit.

<sup>8</sup> Krupp, Jason and Bryce Wilkinson. "The Local Formula: Myths, Facts and Challenges," op. cit.

- 2.16 The New Zealand Initiative supports greater consideration of a more deeply considered subsidiarity approach.
- 2.17 We propose that the solution to local government challenges is not fewer councils and top-down, catch-all national policy solutions, but rather greater autonomy and control by local communities. That includes giving local communities greater options and choice over the funding arrangements their local authority can employ.
- 2.18 We see better designed funding arrangements as a key step to removing the blockages to housing development whose costs have become so apparent, and much else beyond housing.

### 3. Specific Responses to Questions for Submitters

- 3.1 The New Zealand Initiative is very pleased with the opportunity to submit our views on specific issues raised by this important and much-welcome inquiry. We congratulate the Productivity Commission on the high quality of its Issues Paper.
- 3.2 We applaud the Commission’s concern about the potential for current funding and financing arrangements for local government to impair the “incentives for councils to facilitate population and economic growth”.<sup>9</sup>
- 3.3 The incentive issue is at the heart of our recommendations for a new localist approach to local government institutional structure.
- 3.4 We understand that rating mechanisms on Crown land and local asset privatisations, as well as changes to the current scope and responsibilities of local government, are outside the inquiry’s Terms of Reference.<sup>10</sup> However, these are important related matters. Choices made along these lines have implications for funding and financing options. For example, sales of extraneous assets can ease debt constraints. This submission is not constrained by those terms of reference.
- 3.5 Many of the Issues Paper’s 49 questions ask for factual information about current arrangements that are best answered by submitters with detailed, on-the-ground daily knowledge of the sector. We leave such submitters to address these questions. This submission focuses on responding to questions that relate directly to matters covered in our published research reports.

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<sup>9</sup> Productivity Commission. “Local Government Funding and Financing – Issues Paper,” op. cit. 2.

<sup>10</sup> Ibid.

Q1

**What other differing circumstances across councils are relevant for understanding local government funding and financing issues?**

- 3.6 The Issues Paper correctly identifies relevant differing *circumstances* across councils. An additional, often forgotten and key point of differences is that different local communities may have different overall *preferences* concerning priorities for their councils. For example, a wealthier community is likely to spend more to treat sewage.
- 3.7 Ideally, each community should enjoy wide freedom to vote for the combination of local public services that best suits its voters' preferences. A concomitant broad choice of funding and financing instruments would improve their ability to fund the preferred spending mix in the most efficient ways.
- 3.8 In this environment, voters are active consumers of public services at a community level – and competition between cities would ensure residents get what they want.
- 3.9 Local residents, therefore, can be viewed as consumer-voters, very much in line with Charles Tiebout's seminal work on local government economics:

Consider for a moment the case of the city resident about to move to the suburbs. What variables will influence his choice of a municipality? If he has children, a high level of expenditures on schools may be important. Another person may prefer a community with a municipal golf course. The availability and quality of such facilities and services as beaches, parks, police protection, roads, and parking facilities will enter into the decision-making process. Of course, non-economic variables will also be considered, but this is of no concern at this point.

“The consumer-voter may be viewed as picking that community which best satisfies his preference pattern for public goods. This is a major difference between central and local provision of public goods. At the central level the preferences of the consumer-voter are given, and the government tries to adjust to the pattern of these preferences, whereas at the local level various governments have their revenue and expenditure patterns more or less set. Given these revenue and expenditure patterns, the consumer-voter moves to that community whose local government best satisfies his set of preferences. The greater the number of communities and the greater the variance among them, the closer the consumer will come to fully realizing his preference position.<sup>11</sup>

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<sup>11</sup> Tiebout, Charles M. “A Pure Theory of Local Expenditures,” *Journal of Political Economy* 64:5 (1956), 416–424.

- 3.10 At present, the financing choices available to local communities are severely constrained. These constraints constitute a drag on the democratic options for local government funding (see our comments on Questions 38 and 41).
- 3.11 In short, the narrowness of the terms of reference for the Issues Paper should not stop decision-makers from taking a broader view of the possibilities for revitalising local communities.

**Q2**

**What explains the difference between the amount that councils account for depreciation and the amount spent on renewing assets? Are changes needed to the methods councils use to estimate depreciation? If so, what changes are needed?**

- 3.12 No specific comment.

**Q3**

**In what ways are population growth and decline affecting funding pressures for local government? How significant are these population trends compared to other funding pressures?**

- 3.13 Differences in population growth and decline across local communities are a significant source of differences in funding pressures. The relative significance of other factors will differ across local authorities, but other submitters will be better placed to assist with details.
- 3.14 Note that differences in population growth and decline can in itself be a symptom rather than a cause.

**Q4**

**What are the implications of demographic changes such as population ageing for the costs faced by local government?**

- 3.15 No specific comment.

**Q5**

**To what extent is tourism growth resulting in funding pressures for local government? Which councils are experiencing the greatest pressure, and how is this manifesting?**

- 3.16 No specific comment, except to note that the Tourism Infrastructure Fund is potentially a useful tool for helping with any such problems.

**Q6**

**Is an expansion of local government responsibilities affecting cost pressures for local government? If so, which additional responsibilities are causing the most significant cost pressures and what is the nature of these increased costs? To what extent do these vary across local authorities?**

3.17 Our research shows that the expansion of local government responsibilities has affected cost pressures for local government.<sup>12</sup>

3.18 For more on these aspects, see our comments on Questions 11 and 37.

**Q7**

**How is the implementation of Treaty of Waitangi settlements, including the establishment of 'co-governance' and 'co-management' arrangements for natural resources, affecting cost pressures for local government? How widespread is this issue?**

3.19 No specific comment.

**Q8**

**How are local authorities factoring in response and adaptation to climate change and other natural hazards (such as earthquakes) to their infrastructure and financial strategies? What are the cost and funding implications of these requirements?**

3.20 Natural hazards constitute a constant challenge for local authorities' infrastructure and financial strategies. For example, the Kapiti Coast District Council case exposed serious weaknesses in their existing capacity to evaluate contingencies.<sup>13</sup> The hired expert decided accretion was too hard to model, so he arbitrarily set future accretion to zero for the long-accreting portion of the coastline.<sup>14</sup> His report presented "predicted" future shorelines that were subsequently revealed to be extremely unlikely, but threatening, projected scenarios.<sup>15</sup> The Council, not realising this, misinformed residents that the report showed "where the shoreline is likely to be" and egregiously annotated around 1,800 residents' LIMS accordingly without any further analysis or giving them any opportunity to comment.<sup>16</sup> The erroneous annotations had to be withdrawn.

3.21 With respect to funding, the fundamental problem was that the Council was not confronted with the potential costs to local landowners of its decisions. Nor did it have

<sup>12</sup> Krupp, Jason and Bryce Wilkinson. "The Local Formula: Myths, Facts and Challenges," op. cit.

<sup>13</sup> Disclosure: One of the authors was an affected property owner in this case.

<sup>14</sup> Roger Shand. "Kapiti Coast Erosion Hazard Assessment, 2012 Update: A Report Prepared for the Kapiti Coast District Council (2012), 16 and 21. Also see Williams J. Interim Judgment in M and V Weir v Kapiti Coast District Council (24 June 2013), [17] and [18].

<sup>15</sup> Interim Judgment. Ibid. [4] and [7].

<sup>16</sup> Kapiti Coast District Council. Letter to affected ratepayers (25 August 2012).

to provide any recognisable benefit-cost justification for its decision, so it did not. Nor did it have to recognise that private property is different from public property. Private owners have a much stronger incentive to determine the best use of their land when informed by a consultant's report than local government bureaucrats do. There are very good reasons private property rights have constitutional protection.

- 3.22 Had the Council been faced with the cost of buying the 1,800 properties at an undiscounted price, annotating their LIMS, and reselling them at a depreciated price, it would surely have acted very differently. The potential cost was major in relation to its balance sheet.
- 3.23 That approach embodies the compensation principle that respects private property rights. If the Council were really acting for the broader public benefit, the public would have been happy to meet the net tax. This is the benefit principle of taxation. To tax a minority for the benefit of a much greater majority is palpably unfair.
- 3.24 If the Council were not acting in the public interest, what is the justification for whatever part of the law made it feel it had to act? It is private parties who incur the cost of investing in private land and bear the risk of complete or partial loss in the event of local flooding. If the Council had been acting in the local landowners' interests, it could have expected them to approve the LIM annotations. The Council's actions made it clear it did not expect them to, and they did not.
- 3.25 Arguably, the most egregious failure in this area currently is the failure to be explicit about likelihoods. To merely tell people that their property is at risk from some natural hazard is to potentially mislead them about the likelihood of it happening.<sup>17</sup> Even if it does not mislead them in this way, it tells them nothing that can usefully inform a decision. Everyone's property is always at risk from one natural hazard or another. Insurance contracts commonly transfer some of those risks, and the premiums are non-zero.
- 3.26 What would be useful for decision-making is a probabilistic statement such as the feared event had a 1 in X chance of occurring in the next year, growing at rate Y per annum across each subsequent year. Insurers will likely already have expert risk assessments of the risks they are insuring. The insurance industry should be consulted before decisions are taken about the probabilities that should be used for decision-making purposes. They have the strongest incentives to get those probabilities right.

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<sup>17</sup> The headline of a recent Local Government New Zealand press release asserted that \$14 billion of Council assets was at risk from sea level rise, without regard to actual likelihoods. Local Government New Zealand (LGNZ). "\$14 billion of council infrastructure at risk from sea level rise," Press release (31 January 2019).

3.27 Without making any claim that this case is the norm, we think the following general principles are pertinent to question 8:

- Local authorities must respect private property rights. The law should not be permitted to trample on private property rights without compensating owners whose property is taken or impaired in the public interest;
- Analyses of natural hazard risks must address the issue of likelihoods. It is an unconscionable fraud on the public for experts or officialdom to present a remote risk to the public as if it is a likely event. Local authorities should not tell land-owners merely that their properties are at risk; they should tell them what they know about the likelihood of the event occurring during relevant time periods;<sup>18</sup>
- Affected private land-owners should be advised of the range of options being considered for responding to a hazard risk, and the likely costs and benefits of each option. This advice must be well in advance of any local authority decision so that those affected can assess the options for themselves. It is their preferences that count.
- Funding option choices are important. For example, if collective action is desired to protect adjacent properties (e.g. an extended sea wall), the option of local authority construction funded by a special rate on the protected properties should be available.
- Local authorities must prepare competent professional analyses that demonstrate to their communities a preferred option has *statistically expected* positive net benefits for those affected (which includes those funding any spending) to a greater extent than any other option. The cost of this assessment should be kept in proportion to the scale of the decision.<sup>19</sup>
- Where the concern is that property owners would fail to insure and pressure the local authority for compensation after the event, the option of conditional resource consents or zoning that explicitly accept *caveat emptor* should be available. A supplementary suggestion is that Councils could make it clear far in advance that they would not maintain public infrastructure servicing particular properties in the event the annual projected costs exceeded \$X per household,

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<sup>18</sup> Better informed ratepayers can make better decisions. Note that insurers already have their own expert risk assessors. The insurance industry should be consulted before making decisions about actual probabilities.

<sup>19</sup> Wilkinson, Bryce. "A Matter of Balance: Regulating Safety" (Wellington: The New Zealand Initiative, 2015); The New Zealand Initiative. "Reducing Unnecessary Regulatory Costs" (Wellington: The New Zealand Initiative, 2015); Crampton, Eric and Linda Meade. "Deadly Heritage" (Wellington: The New Zealand Initiative and Deloitte New Zealand, 2015). The New Zealand Initiative. "Manifesto 2017: What the Next New Zealand Government Should Do" (Wellington: The New Zealand Initiative, 2017), 44.

(or some equivalent provision). In such cases, those affected could be given the option of taking over the maintenance of the services being abandoned.

Q9

**Why is the price of goods and services purchased by local government rising faster than the consumer price index? To what extent is this contributing to cost pressures for local government?**

3.28 No specific comment. We understand that BERL produces relevant statistics.

Q10

**Do the prices of goods and services purchased by local government vary across councils? If so, what are the reasons for these differences?**

3.29 No specific comment.

Q11

**Is local government expenditure shifting away from traditional core business into activities such as economic development, sport and recreation and community development? If so, what is the rationale for this shift, and could these activities be better provided by other parties?**

3.30 Our research notes the expansion of government expenditure away from traditional core business towards other activities since the Local Government Act of 2002. Our report, *The Local Formula*, observed that:

Councils currently provide more services now than they did in the year ended June 2003 during which the Local Government Act 2002 endowed them with the power of general competence, namely community development and economic development. The core functions of local government (roads, potable water and wastewater) still account for some of the highest expenditures, but these essential network services accounted for only 31% of total operating spending in 2014...

The new expenditure areas of community development, economic development and 'other activities' increased faster in percentage terms between 2009 and 2014 than spending on the other activities, with the exception of transportation which increased marginally faster than community development.<sup>20</sup>

3.31 Although these new non-traditional activities such as community and economic development are an important part of a thriving community, the question to be asked is why those activities could not be provided – perhaps with greater efficiency – through voluntary initiatives:

<sup>20</sup> Krupp, Jason and Bryce Wilkinson. "The Local Formula: Myths, Facts and Challenges," op. cit. 18.

Governments do not have a monopoly on good ideas when it comes to delivering social services, and other parties could well take the lead in putting good ideas into action.<sup>21</sup>

- 3.32 When local authorities provide private goods, user charges should be the norm on the grounds of both fairness and efficiency – and where applicable, with clear and transparent costing of subsidies to particular socioeconomic groups.<sup>22</sup>
- 3.33 Property rates collection, on the other hand, should focus on funding the provision of public goods.
- 3.34 As there is a continuum between pure private goods and pure public goods, public expenditure decisions could use a mixture of funding tools: i) provided transparent criteria factors are outlined, discussed and approved at the local level, and ii) the funding tool mix is not mandated by central government.

**Q12**

**Does the scope of activities funded by local government have implications for cost pressures? If so, in what ways?**

- 3.35 The scope of activities funded by local government does have implications for cost pressures. As a general rule, the greater the scope, the larger the funding requirements. Particularly when the scope is dictated from central government and no funding is provided, leading to increasing pressures on the local rating system.
- 3.36 For more on this issue, see our comments to Question 11.

**Q13**

**What other factors are currently generating local government cost pressures? What will be the most significant factors into the future?**

- 3.37 No specific comment.

**Q14**

**How will future trends, for example technological advances and changes in the composition of economic activity, affect local government cost pressures?**

- 3.38 Technological shifts can enhance public service productivity. A Council's rolling long-term plans should, in principle, already take foreseeable changes into account.

<sup>21</sup> Wilkinson, Bryce and Jenesa Jeram. "Investing for Success: Social Impact Bonds and the Future of Public Services" (Wellington: The New Zealand Initiative, 2015).

<sup>22</sup> See Table 1 of the Local Government Business Forum's submission on private/public goods.

**Q15**

**How effective is the Long-term Plan process in addressing cost pressures and keeping council services affordable for residents and businesses?**

3.39 No specific comment, but we have reason to doubt that the process is as effective as it could be.

**Q16**

**How effective are councils' Long-term Plan consultation processes in aligning decisions about capital investments and service levels with the preferences, and willingness and ability to pay, of residents, businesses and other local organisations?**

3.40 No specific comment.

**Q17**

**Is there scope to improve the effectiveness of Long-term Plan processes? If so, what, if any, changes would this require to the current framework for capital expenditure decision making?**

3.41 No specific comment.

**Q18**

**How much scope is there for local government to manage cost pressures by managing assets and delivering services more efficiently?**

3.42 No specific comment. Asset recycling and related partial mechanisms for releasing cash should be on the table.

**Q19**

**What practices and business models do councils use to improve the way they manage their infrastructure assets and the efficiency of their services over time? How effective are these practices and business models in managing cost pressures? Do councils have adequate capacity and skills to use these practices and business models effectively?**

3.43 No specific comment.

**Q20**

**How do councils identify and employ new technologies to manage their infrastructure assets and produce services more efficiently? How effective are councils in using new technologies to manage cost pressures? Please provide specific examples of the use of new technologies to manage cost pressures.**

3.44 No specific comment.

Q21

**What incentives do councils face to improve productivity as a means to deal with cost pressures? How could these incentives be strengthened?**

- 3.45 On the evidence, Councils' incentives are weaker than is desirable.
- 3.46 Too often Councils do not support resource decisions with competent assessments of their net benefits to affected members of the community. Our research identifies analyses that fall short of the standard implicit in section 32(2) of the *Resource Management Act 1991*. It ostensibly requires proper cost-benefit analysis on any major spending item proposed in the district plan.<sup>23</sup>
- 3.47 Nor do current complex consultation processes adequately facilitate community oversight of public expenses.<sup>24</sup>
- 3.48 Current centralist arrangements appear to have weakened incentives to provide value for money by weakening local community involvement on the one hand, and failing to make that deficiency good by effective central government supervision on the other hand.
- 3.49 Under the centralist approach, the authorities should aim to strengthen respect in local government for property rights and to ensure competent assessments are made and published for significant spending and regulatory decisions.
- 3.50 Greater and stronger private-sector involvement in asset management and service provision would help raise productivity, if done well. See also our response to Question 8.
- 3.51 For alternative funding options with greater impact productivity-inducing incentives, see our comments on Questions 38 and 41.

Q22

**What are the most important barriers to local government achieving higher productivity?**

- 3.52 Weak incentives are the biggest barrier (see the answer to Question 8). These arise in turn from deficiencies in central government and local community oversight.

<sup>23</sup> Krupp, Jason. "The Local Manifesto: Restoring Local Government Accountability," op. cit.

<sup>24</sup> Ibid.

**Q23**

**How does local government measure productivity performance? Are these metrics useful? If not, what metrics would be better?**

3.53 No specific comment.

**Q24**

**To what extent and how do councils use measures of productivity performance in their decision-making processes?**

3.54 No specific comment.

**Q25**

**Do councils dedicate sufficient resources and effort toward measuring and improving productivity performance? If not, why not, and how could effort toward measuring and improving productivity performance be increased?**

3.55 No specific comment.

**Q26**

**What measures do councils use to keep services affordable for specific groups, and how effective are they?**

3.56 No specific comment.

**Q27**

**How do councils manage trade-offs between the ability to pay and beneficiary pays principles? What changes might support a better balance?**

3.57 No specific comment.

**Q28**

**Do councils currently distribute costs fairly across different groups of ratepayers? If not, what changes to funding and financing practices would achieve a fairer distribution of costs across ratepayers?**

3.58 No specific comment.

**Q29**

**Do councils currently distribute the costs of long-lived infrastructure investments fairly across present and future generations? If not, what changes to funding and financing practices would achieve a fairer distribution of costs across generations?**

3.59 No specific comment.

**Q30**

**What principles should be used to appraise current and potential new approaches to local government funding and financing, and how should these be applied? What are appropriate trade-offs across these principles?**

3.60 No specific comment.

**Q31**

**How effectively is the existing range of local government funding tools being used?**

3.61 No specific comment. See our comments on Questions 21, 22, 32, 36, 37, 38, 41 and 47.

**Q32**

**Is there a case for greater use of certain funding tools such as targeted rates and user charges? If so, what factors are inhibiting the use of these approaches?**

3.62 As a general rule, user charges and targeted rates improve the transparency and efficient use of resources as opposed to general rating (see comments on Questions 5 and 36).

3.63 One barrier to the greater use of user charges seems to be the (false) idea that in its absence the public service is “free”. A supplementary argument with greater power is that direct billing systems are costly (e.g. the substantial one-off costs of installing water meters for every home). More disciplined benefit-cost assessments of the case for introducing unit charges with adjustment mechanisms for those who might experience hardship could help inform these debates.

3.64 Targeted rates also need to be properly justified and commensurate to the use of specific public services. Otherwise the barrier to their greater use is the fear that they could be used in a predatory manner.

3.65 See also our responses to Questions 21, 47 and 49.

**Q33**

**What is the rationale underlying councils’ approach to levying rates? What are the costs and benefits of shifting from a capital value system to a land value system?**

3.66 No specific comment.

**Q34**

**In addition to restrictions on how targeted rates are applied and the types of services where user charges can be levied, do any other restrictions on existing funding tools unduly limit their uptake or usefulness?**

3.67 No specific comment.

**Q35**

**How does the timing and risk associated with future funding streams influence local authority decision making about long-term investments? What changes to the current funding and financing system (if any) are needed to address these factors?**

3.68 No specific comment.

**Q36**

**What are the pros and cons of a funding system where property rates are the dominant source of funding? Does the local government funding system rely too heavily on rates?**

3.69 Our research shows that using property rates as the main local government funding mechanism fits well with the overall tax structure in New Zealand.<sup>25</sup>

3.70 From a revenue gathering perspective, the pros of property rates are well known: hard to evade, easy to collect, and good for revenue certainty. Additionally, rates are proportional in asset value (vertical equity) and relatively non-distortionary.

3.71 Nonetheless, no tax system is without flaws.

3.72 With property rates revenue approaching, on average, close to 60% of local government operating revenues<sup>26</sup> – which is considerably above the 50% target recommended by the Department of Internal Affairs in its Local Government Rates Inquiry<sup>27</sup> – the current rates-skewed funding system can have counterproductive impacts on local communities.

3.73 First, property rates do not provide a transparent link between tax payments and the specific public services being delivered in return (see our comments on Question 32).

3.74 Second, the system focuses on one aspect of wealth: property. This focus has some unintended distributional consequences as it overlooks all other types of wealth.<sup>28</sup>

<sup>25</sup> Krupp, Jason and Bryce Wilkinson. “The Local Formula: Myths, Facts and Challenges,” op. cit.

<sup>26</sup> Ibid.

<sup>27</sup> Department of Internal Affairs. “Local Government Rates Inquiry – Executive Summary” (Wellington: New Zealand Government, 2007), 2.

<sup>28</sup> Ibid.

- 3.75 Similarly, an over-reliant rates funding system can affect regions with declining populations, particularly in rural districts.<sup>29</sup>
- 3.76 Moreover, the current funding pattern primarily based on property rates presents a real challenge for Councils' incentives to promote economic growth (see our comments on Question 38).
- 3.77 Growth involves change, and change is not necessarily welcome by every taxpayer-voter. The cost burden of new infrastructure is not trivial and is mostly carried through higher general rates payments. This structure fuels Not-in-my-backyard (Nimby) opposition to new developments, and its impact on existing property prices can motivate ratepayers to resist some pro-growth policies.
- 3.78 For further remarks on the adverse effect of property rates overreliance on productivity, see our comments on Questions 21 and 32.

**Q37**

**Under what circumstances (if any) could there be a case for greater central government funding transfers to local government? What are the trade-offs involved?**

- 3.79 Greater accountability for local and central government roles and funding is needed (see our comments on Question 6).
- 3.80 As creatures of statute, councils must comply with the tasks central government assign them. As our research notes: "In theory this should provide for double oversight, but in practice it blurs the lines of accountability between those setting policy and those who bear the costs of it."<sup>30</sup>
- 3.81 This unfunded, forced-upon cost on local governments puts pressure on their budgets – let alone the damage to the democratic process of public spending itself.
- 3.82 Briefly, Parliament is not confronted with the costs to local communities for its (local-level) spending decisions.
- 3.83 This accountability issue has been described in our research:

As a result of these legislative arrangements:

<sup>29</sup> Kerr, Suzi, Andrew Aitken and Arthur Grimes. "Land Taxes and Revenue Needs as Communities Grow and Decline: Evidence from New Zealand," Motu Working Paper 04–01, Report to the Lincoln Institute of Land Policy (Wellington: Motu Economic and Public Policy Research, 2004); Krupp, Jason and Bryce Wilkinson. "The Local Formula: Myths, Facts and Challenges," op. cit.

<sup>30</sup> Krupp, Jason. "The Local Manifesto: Restoring Local Government Accountability," op. cit. 5.

- Central government can pass regulatory tasks to local government without funding. These costs are ultimately borne by communities, who have limited say over the expenditures they are paying for.
- Poor lines of accountability develop between policymakers and tax or ratepayers. Councils can unfairly take the blame for centrally imposed costs, but they can also blame central government for their own poor performance.
- Communities seldom face the costs of their choices, particularly where only property owners pay local taxes directly in the form of rates.<sup>31</sup>

3.84 In 2012, the Productivity Commission also mentioned this lack of clarity regarding who is driving costs, who benefits, and who pays: "... the situation can arise when communities give central government the credit for introducing a new regulation to fix a 'problem', but blame councils for the financial and compliance cost of the regulation. In this case, central government has weak incentives to design the regulation carefully."<sup>32</sup>

3.85 Our general recommendation is to internalise all costs and benefits of spending decisions as much as possible by defining clearer roles for each tier of government and clearer boundaries between those roles.

3.86 With respect to funding, in particular, the costs of national policy should be paid out of central tax revenues, while local communities should bear the costs of the local policies they choose.<sup>33</sup>

**Q38**

**Do local authorities have sufficient financial incentives to accommodate economic and population growth? If not, how could the current funding and financing framework be changed to improve incentives?**

3.87 The issue of local authorities not having the sufficient financial incentives to accommodate economic and population growth has been a central theme in our research.<sup>34</sup>

<sup>31</sup> Ibid. 5.

<sup>32</sup> Productivity Commission. "Towards Better Local Regulation" (Wellington: Productivity Commission, 2013), 68.

<sup>33</sup> Ibid. 18.

<sup>34</sup> Hartwich, Oliver. "A Global Perspective on Localism," op. cit.; Craven, Ben, Jack Goldingham-Newsom and Oliver Hartwich. "#LocalismNZ: Bringing Power to the People," op. cit.; Acharya, Khyati and Eric Crampton. "In the Zone: Creating a Toolbox for Regional Prosperity," op. cit.; Bassett, Michael, Luke Malpass and Jason Krupp. "Free to Build: Restoring New Zealand's Housing Affordability" (Wellington: The New Zealand Initiative,

- 3.88 In fact, not only do councils lack sufficient financial encouragements, but in many instances the existing incentives act against economic growth.
- 3.89 For instance, current local planning funding arrangements have clear enticements to restrain the supply of land zoned suitable for development, e.g. high upfront new infrastructure costs, financial liability for any flaws in building consent, and restrictive property rights.<sup>35</sup>
- 3.90 Greater respect for private property rights could force Councils to resist regulations that depress some land values in order to lift others. (See our comments on Question 8).
- 3.91 In a nutshell, local councils bear most of the new development costs, while tax revenue windfalls flow directly to central government in the form of increased income and GST collections (see our comments on Question 41).
- 3.92 This incentive misalignment against economic growth in local funding is a well-known feature in the New Zealand political structure.
- 3.93 The issue is so acute that the OECD has made it frontline in its own set of recommendations to spur growth in New Zealand. According to the Paris-based multilateral organisation, there are visible limitations on the ability and incentives to fund infrastructure in New Zealand, ultimately restricting housing supply.<sup>36</sup>
- 3.94 As a result, the *OECD 2017 Economic Surveys on New Zealand* expressively states as a key recommendation: “Enhance councils’ incentives [in New Zealand] to accommodate growth, for example by sharing in a tax base linked to local economic activity.”<sup>37</sup>
- 3.95 In particular, with respect to local government funding to accommodate economic and population growth, we recommend that:

Financial incentives should be introduced to encourage councils to ensure local government aligns its activities with central government’s economic strategy.

Possible options include:

- Central government pays bonuses to local politicians that meet agreed-upon performance targets

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2013); Craven, Ben, Jack Goldingham-Newsom and Oliver Hartwich. “#LocalismNZ: Bringing Power to the People,” op. cit.; Krupp, Jason. “The Local Manifesto: Restoring Local Government Accountability,” op. cit.

<sup>35</sup> Krupp, Jason. “The Local Manifesto: Restoring Local Government Accountability,” op. cit.; Krupp, Jason and Bryce Wilkinson. “The Local Formula: Myths, Facts and Challenges,” op. cit.

<sup>36</sup> OECD. “OECD Economic Surveys: New Zealand” (Paris: OECD Publishing, 2017).

<sup>37</sup> Ibid. 13.

- Pay housing encouragement grants to fast-growing local councils for every new house built in the jurisdiction within a minimum time frame, and
- Allow councils to share in the economic growth that occurs in their region via a tax-sharing arrangement should growth exceed central government projections. Population growth projections might be used as an alternative to territorial GDP.<sup>38</sup>

3.96 Additionally, we also recommend the introduction of Special Economic Zones (SEZs) to provide New Zealand’s cities and regions with a flexible policy toolset (including the freedom to test different funding and financing options) to pursue growth.

3.97 Our report *In the Zone* explores this SEZ recommendation to allow local authorities the ability to work out what best suits their needs.<sup>39</sup>

**Q39**

**What funding and financing options would help councils to manage cost pressures associated with population decline? What are the pros and cons of these options?**

3.98 The funding and financing challenges of local councils are even harder in the face of population decline. There is no easy solution, but that does not mean there is no solution.

3.99 Our report *In the Zone* recommends a tax sharing mechanism between central and local governments for communities that perform above mutually agreed targets (see our comments on Question 41).<sup>40</sup> That could help declining communities to rectify the situation. (See also our comments on Questions 3 and 38).

3.100 Although it is not a funding option, allowing greater local community control over the quantity and quality of the local authority spending, along with responsibility for funding that spending could help resolve budgetary problems.

<sup>38</sup> Krupp, Jason. “The Local Manifesto: Restoring Local Government Accountability,” op. cit. 49.

<sup>39</sup> Acharya, Khyaati and Eric Crampton. “In the Zone: Creating a Toolbox for Regional Prosperity,” op. cit.

<sup>40</sup> Ibid.

**Q40**

**Are other options available, such as new delivery models, that could help councils respond to funding pressures associated with a declining population? What conditions or oversight would be required to make these tools most effective?**

3.101 In addition to our comments on Questions 3, 39 and 47, The New Zealand Initiative reiterates that greater local involvement and oversight provide the right incentives for effective and efficient public services.

3.102 Hence, should local authorities be given greater policy flexibility to address funding pressures, an enhanced local participation in such public decisions must be warranted.

3.103 In particular, in our report *The Local Formula*, we recommend local referendums and citizen juries to help dealing with hard trade-off decisions on funding pressures, including those arising from population decline:

[i]f councils are to be allowed more autonomy, they need to show their actions are steered by local democratic preferences. Two excellent mechanisms worth considering are local referendums and citizen juries.<sup>41</sup>

**Q41**

**What are the pros and cons of local income and expenditure taxes?**

3.104 The New Zealand Initiative has long supported more flexible funding to better cater for the unique conditions and realities of each local community, and importantly, to better capture the incentives to adopt growth-enhancing policies.<sup>42</sup>

3.105 Under such a more devolved tax system, one option would be to allow independent local income and expenditure tax settings, although recognising the implementation issues in the current New Zealand tax framework as well as valid concerns with respect to aggregate tax burdens.

3.106 An additional concern with this option would be to deter inefficient migration among neighbouring communities, where residents live in suburban areas to avoid local taxes while benefiting from adjacent local amenities and public services.

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<sup>41</sup> Ibid. 49.

<sup>42</sup> Craven, Ben, Jack Goldingham-Newsom and Oliver Hartwich. “#LocalismNZ: Bringing Power to the People,” op. cit.

- 3.107 Our long-favoured option has been to implement sharing mechanisms between central and local governments, particularly with respect to expenditure taxes.<sup>43</sup> This option would be easier to implement but it would also reduce central government revenue.
- 3.108 Overseas experience indicates that local income and expenditure taxes can fill the incentive gap to promote higher economic growth in accordance to community aspirations and preferences.<sup>44</sup> Two-thirds of OECD countries have elements of personal income taxation at the local government level.<sup>45</sup> See the Box for the leading example – Switzerland.
- 3.109 Councils that receive a share of income tax, GST and company tax remittances from their local areas might “encourage the zoning of appropriate amounts of residential, retail and industrial space and provision of suitable infrastructure”.<sup>46</sup>
- 3.110 There would be administrative challenges with the operation of such a local sharing system of income and expenditure taxes, and the details on an eventual implementation plan are crucial for its success. To allow a local system of income taxes on top of central government taxes would be a major change that would take many years to put in place, and perhaps not even then.
- 3.111 One incremental approach specific to housing would be to let central government pay local councils for every new house completed within a specified period. The payments could be benchmarked on the goods and services tax (GST) charged on residential building (excluding land value), or be a fixed sum.<sup>47</sup>
- 3.112 For instance, “Under the GST model, if each of the 9,400 residential building consents issued in Auckland in 2015 resulted in construction, and each home had a build value of \$200,000, Auckland City Council would have netted \$282 million”.<sup>48</sup>
- 3.113 In short, the Initiative has long argued for better designed revenue sharing arrangements that strengthen incentives to accommodate economic growth. The issue of income and expenditure taxes applied at Council level would be a much more demanding and prolonged reform.

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<sup>43</sup> Acharya, Khyaati and Eric Crampton. “In the Zone: Creating a Toolbox for Regional Prosperity,” op. cit.

<sup>44</sup> Craven, Ben, Jack Goldingham-Newsom and Oliver Hartwich. “#LocalismNZ: Bringing Power to the People,” op. cit.

<sup>45</sup> Hartwich, Oliver. “A Global Perspective on Localism,” op. cit.; Krupp, Jason. “The Local Benchmark: When Smaller Is Better,” op. cit.

<sup>46</sup> Acharya, Khyaati and Eric Crampton. “In the Zone: Creating a Toolbox for Regional Prosperity,” op. cit. 13.

<sup>47</sup> Bassett, Michael, Luke Malpass and Jason Krupp. “Free to Build: Restoring New Zealand’s Housing Affordability,” op. cit. 17.

<sup>48</sup> Krupp, Jason. “The Local Manifesto: Restoring Local Government Accountability,” op. cit. 38–39.

**Box: Switzerland**

Switzerland, which is roughly the same size as the Canterbury region, has 26 cantons (regions) and 2,294 communes, and averages 3,260 people per sub-central unit of government compared to 61,500 people in New Zealand.<sup>49</sup>

In Switzerland, tax is levied on income at the federal, cantonal and municipal levels. Each canton and municipality can charge different tax rates depending on the services they offer, and whether they want to attract more people through low rates.

This sort of taxation system encourages a healthy competition among sub-national authorities to be as efficient and responsive to the community as possible: more local residents mean more local tax revenues.

The Swiss income tax sharing scheme aims to be high enough to offset the costs of development, while maintaining the quality of public services (dispelling the race-to-the-bottom thesis against a flexible local tax system).

Switzerland has managed to maintain affordable housing costs by supplying appropriate land and infrastructure for development as demand peaks.<sup>50</sup> Besides, the country ranks well in international rankings on cost effectiveness of government structures, the quality of public services and relatively low tax-to-GDP ratios compared to other OECD countries (including New Zealand).<sup>51</sup>

**Q42**

**What are the advantages and disadvantages of a local property tax as an alternative to rates?**

- 3.114 A strong intellectual debate on the pros and cons of both local property tax and rates is well and alive, as rightly captured by the Issues Paper.
- 3.115 On this matter, we would like to add two points.
- 3.116 First, despite extensive discussions in policy circles and academia, there is no clear-cut case on which system, property tax vs. property rates, is better. This is because the choice between the two inherently encompasses subjective public preferences and differing political structures.

<sup>49</sup> Craven, Ben, Jack Goldingham-Newsom and Oliver Hartwich. “#LocalismNZ: Bringing Power to the People,” op. cit.

<sup>50</sup> Ibid.

<sup>51</sup> Ibid.

- 3.117 We should recognise that, ultimately, choice is a defining part of the equation, which leads us to the second point.
- 3.118 Through a localist perspective, the choice between local property taxes vs. rates should rest at the level where tax collection and spending are made, i.e. with the local community.
- 3.119 The New Zealand Initiative considers that local communities should have the freedom to choose the tax mix that best suits their preferences and political structure.
- 3.120 An additional reason for allowing choice at the local level is it allows different policy experiments that suit local conditions. Local experiments are easier to revert when not successful (as opposed to reverting a national system) and likely to be copied by other communities if the outcomes are positive.
- 3.121 See our report *In the Zone* for more details on how Special Economic Zones could lead policy experiments at a local level.<sup>52</sup>

**Q43**

**Are there any other changes to the current local government funding and financing framework, such as new funding tools, that would be beneficial?**

- 3.122 See our comments on Question 47 regarding the benefits of bringing greater private sector involvement.

**Q44**

**How can the transition to any new funding models be best managed?**

- 3.123 Different funding models require different transition strategies, so there is not much to add at this point without further information on which new funding model is referred to.
- 3.124 As a general rule, transparency, clear objectives and reasonable public consultation are desirable features in any successful transition.

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<sup>52</sup> Acharya, Khyati and Eric Crampton. "In the Zone: Creating a Toolbox for Regional Prosperity," op. cit.

Q45

**To what extent does the need for particular funding tools vary across local authorities?**

3.125 Each community has its unique set of local challenges and voter preferences, and therefore local choice on funding tools should be the foundation of a democratic and thriving local government environment (see our comments on Question 1).

Q46

**To what extent are financing barriers an impediment to the effective delivery of local infrastructure and services? What changes are needed to address any financing barriers?**

3.126 On top of considerable regulatory barriers,<sup>53</sup> some local councils may face substantial financing barriers on the delivery of local infrastructure and services, either due to debt limits and related financial metrics, political constraints such as public concerns towards increasing local debt, or an inadequate funding system, which is largely based on property rates rather than user-charges (see our comments on Questions 32 and 36).

3.127 On such finance barriers, much can be alleviated – or even neutralised – by a stronger participation of the private sector in delivering local infrastructure and services.

3.128 For instance, local government would benefit from a mechanism that allows infrastructure debt to be financed by publicly issued bonds, which are specifically and solely backed by revenues from targeted rates to be the beneficiaries of new development areas. And most importantly, with *no recourse* to further public liability.

3.129 Infrastructure-related bonds under these arrangements could be paid back if, and only if, the project generates sufficient revenues.

3.130 On Question 47, we present as an option to issue such infrastructure-related bonds under the establishment of *Community Development Districts*, which are “statutory taxing bodies that can privately finance debt to build new infrastructure – fresh and waste water, electricity connections, street lighting, and roads and footpaths – by issuing bonds and charging residents an ad-valorem tax to repay the debt”.<sup>54</sup>

<sup>53</sup> Wilkinson, Bryce. “A Matter of Balance: Regulating Safety,” op. cit.; The New Zealand Initiative. “Reducing Unnecessary Regulatory Costs,” op. cit.; Crompton, Eric and Linda Meade. “Deadly Heritage,” op. cit.

<sup>54</sup> Bassett, Michael, Luke Malpass and Jason Krupp. “Free to Build: Restoring New Zealand’s Housing Affordability,” op. cit. IV.

Q47

**What role could private investors play in financing local government infrastructure and how could this help address financing barriers faced by local governments? What central government policies are needed to support private investment in infrastructure?**

- 3.131 The New Zealand Initiative recognises the importance of free markets and a thriving competitive private sector as the basis for a free, prosperous, fair, and cohesive society.
- 3.132 Under this guidance, we believe private investors could – and should – play a stronger part in financing local government infrastructure.
- 3.133 Successful private companies are obliged by competition to be as efficient as possible and to quickly respond on sound financial fundamentals. A greater participation of private investors in public infrastructure, therefore, would help bring much-needed expertise and rigorous financial practices – as well as financial capital to cash-constrained councils.
- 3.134 There are many ways to spur private sector participation to local government financing, including asset recycling, franchise arrangements and public-private partnerships.
- 3.135 On this matter, The New Zealand Initiative has produced specific research reports on regulatory measures that would increase private sector financing involvement. Two measures would be at the forefront of our recommendations.
- 3.136 First, the *Overseas Investment Act* is unduly hostile to incoming overseas investment. The OECD and the Treasury concur.<sup>55</sup> Major reform is needed.<sup>56</sup>
- 3.137 Our second recommendation regards the introduction of infrastructure-related bonds issued by Community Development Districts. As explained in our *Free to Build* report:

To counteract the high costs charged by monopoly suppliers for infrastructure within new development areas, we recommend a new kind of infrastructural funding option.

Loosely based on Municipal Utility Districts in Texas, Community Development Districts (CDDs) must be created in New Zealand. CDDs are statutory taxing bodies that can privately finance debt to build new infrastructure – fresh and waste water, electricity connections, street lighting, and roads and footpaths – by issuing bonds and charging residents an ad-valorem tax to repay the debt.

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<sup>55</sup> Ibid.

<sup>56</sup> Acharya, Khyaati and Bryce Wilkinson. “Open for Business: Removing the Barriers to Foreign Investment” (Wellington: The New Zealand Initiative, 2014).

Developers or landowners can create a CDD by submitting an application to regional or unitary councils, although Parliament could legislate in case of a council blockage. Regional or unitary councils would identify the areas where CDDs cannot be developed based on long-term environmental, tribal or practical concerns. The size of CDDs would be limited to a total proportion of the district and be subject to appeals to central government. This would compel councils to carefully consider their priorities. There would be an assumed right to develop outside the areas designated by a council for non-development. This way, CDDs would render land zoning irrelevant within the agreed area of coverage, while covenants would protect residents' rights.

The Resource Management Act would apply only to design or infrastructure features that affect properties and areas outside the CDD boundary. CDDs will spur large-scale developments beyond town boundaries aimed at house first-home buyers, with infrastructure costs paid for by residents of the CDDs.<sup>57</sup>

**Q48**

**If New Zealand replaces rates on property with a local property tax, should it also adopt tax increment financing as a way to finance growth-related infrastructure investments? What are the advantages and disadvantages of tax increment financing?**

- 3.138 The New Zealand Initiative supports the beneficiary pays principle, *whenever the benefit to a particular taxpayer is objectively measurable and the tax collection costs are low.*
- 3.139 The thing to avoid is local governments using tax increment financing to indiscriminately raise revenues. That would likely result in long, expensive court challenges.
- 3.140 Another aspect is who should decide? Under a more devolved model, local communities would have a greater opportunity to debate such options and make the choice. (see our comments on Question 42).

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<sup>57</sup> Bassett, Michael, Luke Malpass and Jason Krupp. "Free to Build: Restoring New Zealand's Housing Affordability," op. cit. IV.

Q49

**How effective are the current oversight arrangements for local government funding and financing? Are any changes required, and if so, what is needed and why?**

3.141 Our general assessment is that current oversight arrangements are key to understanding public dissatisfaction towards local authorities.

3.142 Consultation documents, such as the Long-Term Plan and Annual Reports, need to be accessible to the lay taxpayer and provide real opportunities to welcome the views of the community – and therefore, not being treated merely as procedural formalities (see our comments on Question 21).

3.143 As noted in our *The Local Manifesto* report:

A primary duty of local government is to consult with its community, and then to use this information to develop a 10-year plan. This mandated planning process is overly complex and makes many people feel disenfranchised, as was recently noted by the Auditor-General’s office. Central government sought to correct this in 2012 by requiring local authorities to produce consultation documents instead of the draft Long-Term Plan (LTP). The purpose was to start a discussion between local authorities and communities over the proposed long-term objectives in a transparent fashion.

This is a welcome development, but one that has not met its intended purpose. The Auditor-General’s review of the consultation documents found that many local authorities failed to meet the new standard for consultation. Many of the documents were poorly written and failed to explain the significant issues facing a community. Even where the issues were explained, many documents did not spell out different options, the implications and consequences. In one case, an authority was found to have excluded the most important issue facing it from the draft consultation document.

Such shortcomings need to be rectified if residents are to have greater confidence in their local representatives. If the level of local government accountability is to be meaningfully improved, communities need to know what options are available to them, the trade-offs associated with each, and the consequences of their choices. The need for community buy-in is doubly important if local authorities are to convince central government to give them more autonomy and independence.<sup>58</sup>

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<sup>58</sup> Krupp, Jason. “The Local Manifesto: Restoring Local Government Accountability,” op. cit. 45–46.

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