LOCAL GOVERNMENT AND ENVIRONMENT SELECT COMMITTEE
SUBMISSION – JULY 2012

LOCAL GOVERNMENT NEW ZEALAND'S SUBMISSION TO

The Local Government and Environment Select Committee

In the matter of the Local Government Act 2002 Amendment Bill

Local Government New Zealand
te pūtahi matakōkiri

1 Introduction

1.1 *Local Government New Zealand* ("LGNZ") welcomes the opportunity to submit on the Local Government Act 2002 Amendment Bill ("the Bill").

1.2 LGNZ wishes to be heard on this submission.

1.3 LGNZ is a member based organisation representing all 78 local authorities in New Zealand. LGNZ's governance body is the National Council. The members of the National Council are:

- **Lawrence Yule**, President, Mayor, Hastings District Council
- **John Forbes**, Vice-President, Mayor, Opotiki District Council
- **John Bain**, Zone 1, Deputy Chair, Northland Regional Council
- **Richard Northey**, Zone 1, Councillor, Auckland Council
- **Meng Foon**, Zone 2, Mayor, Gisborne District Council
- **Jono Naylor**, Zone 3, Mayor, Palmerston North City Council
- **Adrienne Staples**, Zone 4, Mayor, South Wairarapa District Council
- **Maureen Pugh**, Zone 5, Mayor, Westland District Council
- **Tracy Hicks**, Zone 6, Mayor, Gore District Council
- **Len Brown**, Metro Sector, Mayor, Auckland Council
- **Dave Cull**, Metro Sector, Mayor, Dunedin City Council
- **Stuart Crosby**, Metro Sector, Mayor, Tauranga City Council
- **Brendan Duffy**, Provincial Sector, Mayor, Horowhenua District Council
- **Stephen Woodhead**, Regional Sector, Chair, Otago Regional Council
- **Fran Wilde**, Regional Sector, Chair, Greater Wellington Regional Council.

1.4 This submission has been prepared under the direction of the National Council. Its contents reflect consultation with the sector carried out in conjunction with the Society of Local Government Managers ("SOLGM"). LGNZ's and SOLGM's submissions on the substantive points closely align. Councils may choose to make individual submissions on particular aspects of the Bill reflecting the fact that the Bill's range of topics covers certain matters on which members may hold differing perspectives. The LGNZ submission does not derogate from these individual submissions.

1.5 The final submission was endorsed under delegated authority by Lawrence Yule, President, LGNZ.

1.6 The submission is structured in the following manner:

- First, and to inform the Select Committee, the accountability framework that presently governs local government in New Zealand is described. That framework is founded on the principle of democratic accountability. It is extensive and robust; it is not "broken";
- Second, the submission addresses a number of factual inaccuracies and misconceptions that have been put forward by Government as evidence that a problem (requiring legislative correction) exists with the present purpose statement in the Local Government Act 2002 ("the LGA 2002"); This section is relevant also to consideration of the Bill's provisions relating to the proposed new fiscal responsibility provisions and the proposed new intervention framework;
- Third, the submission addresses, in turn, the six chief components of the Bill, namely:

  i. the proposed change to the purpose of the LGA 2002;
  ii. the proposed power to allow the making of regulations prescribing fiscal parameters or benchmarks;
  iii. the proposed new Part 10 intervention framework;
  iv. the proposed amendments to the existing LGA 2002 reorganisation of local authorities provisions;

v. the provisions concerning the role and powers of mayors; and
vi. the provision concerning a remuneration and employment policy.

1.7 It is LGNZ's view that the Bill proposes a number of changes that, as presently framed, undermine the democratic accountability of elected members to their communities. Some of the proposals also have the potential to introduce significant cost and uncertainty into the local government sector. Additionally, some changes may create incentive effects on councils that could have a chilling impact on the sector's infrastructure investment programme. These latter two outcomes are at odds with the Government's own economic development and infrastructure investment policy objectives.

1.8 Sound regulatory practice requires the development of a robust problem definition that has a solid foundation in fact. The Bill before the Select Committee lacks these characteristics. The Regulatory Impact Statement ("RIS") that accompanying the Bill states (at page 1):

> *"There is limited evidence to inform the development of these proposals, and the timeframes within which the proposals have been developed have restricted the ability to assess multiple options. As a result, the problem analysis and option assessments of specific proposals rely on assumptions that are not, or are only partially tested."*

1.9 The RIS goes on to state (also at page 1):

> *"The short timeframe for formatting and drafting the legislation creates some risk that interventions could be incorrectly aligned, and/or require subsequent amendment to address unforeseen circumstances."*

1.10 Whilst disappointed that there was no substantive consultation with the local government sector prior to the introduction of the Bill, LGNZ believes that local and central government can and should work together in a constructive and productive partnership to meet the myriad needs of New Zealanders.

2 Executive Summary

2.1 LGNZ does not support the proposed amendment to replace the current purpose of local government set out in section 10 of the LGA 2002 ("the well-beings") with a new purpose statement. LGNZ considers:

- There is no evidence that a substantive problem exists that requires legislative change. The examples by the Government to justify the proposed change are not examples of a failure of the well-beings. The examples adduced are either explicable due to the underlying circumstances, for example, holdings in particular business activities which are mandated by the communities affected and deliver an acceptable commercial return or address a community need;
- There is no evidence that councils are finding it difficult to decline requests for funding. Instead the recently completed long-term planning round suggests that the opposite is the case. Councils have been aware of the straightened financial circumstances that the country is in and have been fiscally prudent as a result. The prime driver of rates increases is infrastructure investment; and
- Most significantly, the proposed amendment will likely have significant legal and cost implications. These implications arise for both decision-makers and the community, who are likely to be confused by its intent or application. It is concerning that the legal (and associated cost) consequences of the proposed amendment do not appear to have been considered by the Government. The RIS is silent on this point. The proposed new purpose, and how it changes the proper interpretation of specific obligations under the LGA 2002, is sufficiently unclear as to almost certainly lead to legal challenges of the way local authorities have interpreted their responsibilities. In light of the body of case law under the existing provisions, it would be naïve to think that changing those provisions would not encourage further litigation by well-resourced interest groups who opposed particular local authority decisions. As a result, the proposed change is likely to produce significant costs without any concomitant benefit.

2.2 Given the lack of a problem definition, the lack of any evidence to substantiate the general claims made by Government about the impact of the well-beings, and the unscoped legal risk associated with the change, the proposal to alter the well-beings appears somewhat reckless.

2.3 As a result of this analysis, the members of LGNZ resolved unanimously at its Annual General Meeting on 15 July 2012 that the Government should retain the well-beings.

2.4 LGNZ supports the concept of benchmarking in the local government sector but believes the approach set out in the Bill has shortcomings. LGNZ's preference is for the benchmarking regime to be self-regulatory in nature. LGNZ proposes that it, in consultation with our members and sister organizations such as SOLGM and the Local Government Funding Authority, should be responsible for setting any financial benchmarks. In essence the benchmarks would be developed by these organisations jointly and operated by LGNZ under a less-intrusive "self-regulatory" regime thus avoiding the poor incentive effects that a "soft cap" approach entails.

2.5 LGNZ's chief concern with the Bill's regime, is that the benchmarks are tied to the new Ministerial intervention regime. By linking benchmarks to the intervention regime they become in effect "triggers" for intervention not benchmarks. LGNZ submits that this inter-relationship with the intervention regime will result in "soft caps" being set which may have serious implications for the manner in which local authorities operate. In particular, this could easily lead to councils under-investing in their infrastructure spend in order to stay within thresholds. If so, a risk presents itself that over time an infrastructure deficit for the future will be created – the very thing that the Government's National Infrastructure Plan seeks to avoid.

2.6 If a regulatory approach is pursued then local authorities' primary obligation should be to report against the proposed benchmarks (in their Annual Plans). The reporting process must include the ability for local authorities to explain how or why a particular benchmark has not been achieved, and to allow some flexibility in terms of the consequences of that "failure" to reach a benchmark. If a local authority can reasonably explain why a benchmark has not been achieved, then that "failure" to achieve should not constitute a "problem" worthy of Ministerial intervention.

2.7 Additionally LGNZ believes that the new section 259(3) needs to contain no detail other than giving the Minister a power to prescribe parameters or benchmarks. Providing a list of examples (as the current Bill does) pre-determines that the benchmarks will be drawn from that list. There has been no close examination of the unintended consequences of these examples.

2.8 On balance LGNZ considers that a broader suite of intervention options ought to be available to the Minister in defined circumstances. Intervention should be the exception not the rule. LGNZ does not agree that the Crown Manager option should be retained as this is too draconian a measure with limited constraints on its use by the Minister. The only real test for the appointment of a Crown Manager is that the Minister believes on "reasonable grounds" that a "significant problem" (as defined in new section 254) exists and is such that the local authority is unlikely to effectively address the problem. At a minimum, a greater sense of the possible widespread, long-term, or irreversible effects of the problem should be imported into the test for the appointment of a Crown Manager. In the substantive text, LGNZ suggests amendments to achieve that.

2.9 The submission also contains commentary on the Bill's provisions concerning reorganization, mayoral powers, and remuneration and employment policies.

3. Local Government Accountability Framework

3.1 Councils are accountable to the communities they service. There is an extensive legislative regime that provides the tools to ensure this accountability. As noted earlier the regime is extensive and robust; it is not broken.

Planning

3.2 The first pillar in the accountability regime is the planning requirements imposed on councils under the LGA 2002. The key planning document for any council is its Long Term Plan, which sets out a council's overall direction for the next 10 years. Each council must adopt a Long Term Plan every three years. The LGA 2002 sets out what information must be included in a Long Term Plan, including details about the activities the council expects to undertake, what it will spend on those activities, and how it will raise those funds. In particular, a Long Term Plan must explain a council's financial strategy, which is a description of a community's financial wants and the constraints on those. It includes the council's limits on its rate increases and borrowing.

3.3 In addition to the Long Term Plan, each council must prepare an annual plan. The LGA 2002 sets out the sort of information that must be included in an annual plan. This is primarily detailed financial information about the council's planned expenditure.

3.4 Councils have to publish their draft Long Term Plans and draft annual plans, and formally consult on them. This is the opportunity for members of the public to have their say on what they want their councils to do, and what they consider to be affordable.

3.5 The LGA 2002 requires councils to have both their draft and final Long Term Plans externally audited.

Decision-Making

3.6 The second pillar in the accountability regime is the decision-making requirements that apply to councils, primarily under the LGA 2002. When making any decision, councils have to identify their objective and the reasonably practicable options for achieving that objective. They must analyse the options, and consider the views of any person interested in or affected by the decision. These requirements are strongly worded and have been the main basis for judicial review of council decisions in the past 10 years.

3.7 Councils are guided by the plans set out in their planning and policy documents. If, however, they want to do something that is significantly inconsistent with a plan or policy, they must identify this in their decision-making, explain the inconsistency and what they might do about it. Despite this, some important decisions can be made only if they are already expressly provided for in the council's Long Term Plan – these are decisions to significantly alter a council service, or a decision to transfer ownership or control of a strategic asset.

3.8 There are many statutory provisions, in the LGA 2002 and other legislation, that require councils to consult on particular decisions. For example, councils have to consult before they can establish a council-controlled organisation, and before they adopt a gambling policy or earthquake-prone buildings policy. The LGA 2002 contains consultation principles as well as detailed requirements for the special consultative procedure, which is the mechanism for formal consultation.

3.9 The Local Government Official Information and Meetings Act 1987 requires council meetings to be open to the public, and that agendas and reports have to be made available. That Act gives councils limited grounds to exclude the public from meetings.

Financial Management

3.10 The third pillar in the accountability regime is the financial management requirements under the LGA 2002. Councils must ensure that they balance their budgets. They are also required by the LGA 2002 to manage all their financial dealings prudently and in the interests of their communities.

3.11 Councils have to explain how they will meet these financial obligations in their planning documents. In particular, a council's Long Term Plan must include a revenue and financing policy, which identifies the funding sources for each council activity. In determining what funding sources should be used for each activity, a council must consider the following factors, the:

- Community outcomes that the activity primarily contributes to;
- Distribution of benefits between the community as a whole, any identifiable part of the community, and individuals;
- Period over which those benefits will occur;
- Extent to which particular individuals or groups contribute to the need to undertake the activity; and
- Costs and benefits of funding the activity distinctly from other activities.

3.12 A council must then consider the overall impact of allocating of costs on the community's current and future needs.

3.13 Councils must also adopt liability management and investment policies, which identify the relevant requirements that apply to borrowing and investment.

Reporting

3.14 The fourth pillar of the accountability regime is the reporting requirements imposed on councils under the LGA 2002. Councils must produce annual reports, comparing a council's actual performance against what it said it would do in its Long Term Plan and annual plan. Annual reports have to include audited financial statements, and a host of other information set out in the LGA 2002.

3.15 Importantly, any member of the public can ask for information held by a council at anytime. Under the Local Government Official Information and Meetings Act 1987, councils must provide any information that is requested, unless one of the withholding grounds under that Act applies, e.g. withholding information to protect a person's safety or privacy. Access to official information helps ensure public scrutiny of councils' actions can occur.

External Scrutiny

3.16 External agencies impose further checks and balances on councils' use of power. Councils, like many other public bodies, can be investigated by the Ombudsmen. Under the Ombudsmen Act 1975, investigations can look at any council decision, recommendation and action or omission that affects any person. The Ombudsmen's findings will be reported to the council concerned, and sent directly to the council's Mayor or Chairperson. The Ombudsmen can require a council to make a summary of the report available to the public.

3.17 The Office of the Auditor-General is another agency that can scrutinise councils. Under the Public Audit Act 2001, the Auditor-General can enquire into any matter concerning a council's use of its resources, either on request or at the Auditor-General's own initiative. The Auditor-General can also, at anytime, examine whether a council is carrying out its activities effectively and efficiently, complying with its statutory obligations, enabling waste to occur, or lacking in probity or financial prudence. A report by the Auditor-General must be tabled by the relevant council at a public meeting to ensure members of the public have access to it.

Democracy

3.18 Ultimately, all these tools to ensure accountability come to fruition when electors vote for the people who will represent them as councillors. The mechanisms outlined above mean that electors can be well informed about councils' performance. To supplement this, councils' chief executives must publish pre-election reports in the run up to a local election. A pre-election report summarises a council's performance over the last three years, noting, in particular if the council has kept to its limits on rates increases and borrowing, and briefs electors on the major projects coming up in the next three years.

4 Facts and Statistical Data

4.1 Appendix Three of this submission is a report from NZIER entitled "*Is Local Government Fiscally Irresponsible – NZIER July 2012."* This report clarifies statistical and data issues raised in the debate leading to the Better Local Government reform package.

4.2 The text below is taken from the introduction to that report:

"We find that while revenue and spending have increased, but these by themselves do not present a problem. The increases are contained when compared against measures of wealth like property values and income measures like GDP.

Local Government has an obligation to rate payers to make sure that spending is warranted and provides value for money. Given that Local Government is a community democracy process, while democracy is not fool proof, the rates and expenditure choices should be seen in that political-economy context.

Capital spending is between 3% and 5% of total assets. This is consistent with the level of investment required for long lived asset bases. There is no clear evidence of excessive capital expenditure.

Debt and debt servicing measures are at prudent levels. Debt to assets, a commonly used measure has risen only modestly and interest payments are at a stated prudent level of incomes.

There no consistent evidence that local government as a whole has been fiscally irresponsible in New Zealand over the last two decades. In the face of turbulence following the global financial crisis, there may be other arguments for strengthened fiscal responsibility. But local government's track record over the last two decades does not provide the basis for that argument. "

4.3 Appendix Two of this submission summarises the drivers of cost increases in the local government sector.

Breadth of Activity

4.4 Underpinning much of the recent debate on the breadth of local government activities is the suggestion that the inclusion of the well-beings has created confusion about the proper roles of local government and has resulted in local authorities undertaking a new range of activities that have caused rates to increase at unprecedented levels. LGNZ disputes this.

4.5 Simply put, there is no real evidence that the sector, as a whole, is undertaking functions that it was not undertaking prior to 2002. Indeed three reviews since 2002 have found the opposite position to be the case.

Specifically:

- *"No evidence to date has been produced to suggest that local government, as a whole, is undertaking a wider group of functions than it had prior to 2003. In cases where councils have taken on additional responsibilities these have proved to be quite small in scale and operational in nature."*[1]
- *"The panel does not consider that this empowerment (the LGA 2002) has been a significant driver of increased expenditures. First, the previous legislation contained similar powers, such as the power to promote community welfare. Local government has long been involved in social activities such as public rental housing and construction of major cultural sporting facilities and in commercial operations such as parking buildings and other trading undertakings. There is little that local government is now doing that it has not previously been doing."*[2]
- *"We conclude that the new Act, and particularly the conferring of full capacity, rights and powers on local authorities, has not led to a proliferation of new activities being undertaken by councils."*[3].

4.6 The Government's announcements and the RIS that accompanies this Bill cite several alleged examples of non-core spending. Of these, the comment about NCEA pass rates appears to be a reference to the recently adopted Auckland spatial plan. LGNZ observes that central government designed the spatial plan mechanism with the intent that it be a comprehensive and focused document drawing together central and local government investment intentions and agreement on joint priorities. To the best of LGNZ's knowledge Auckland Council has no intention to engage in front-line delivery of education services as a result of this plan.

4.7 Certain promotional activities such as the Hamilton V8 motor races have received adverse comment from Government. It is LGNZ's view that there are many more examples of successful promotional investments than unsuccessful ones. Indeed the Government has itself partnered very recently with Auckland Council on the V8 race at Pukekohe. Other successful examples include: the 2000 and 2003 Americas Cup; the 2011 Rugby World Cup; World of Wearable Art, and the International Festival of the Arts. Not all business ventures succeed. Those that fail do so for reasons specific to the event and not because of the purpose of the LGA 2002.

Costs

4.8 Rather than the well-beings, the driver increasing local government costs over the past 15 years has been the cost of providing network infrastructure in an environment where resources are becoming increasingly scarce.

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[1] Joint Central/Local Government Funding Project Team (2006), *Local Government Funding Issues – Report of the Joint Officials Group*, page 18. The report subsequently noted that additional spending, where it has occurred typically went to community groups, and as such would have been empowered by section 548 of the Local Government Act 1974

[2] Independent Inquiry into Local Government Rates (2007), *Funding Local Government*, page 78

[3] Local Government Commission (2008), Review of the Local Government Act 2002 and the Local Electoral Act 2001 page 3

4.9 It has been argued that rates are the fastest growing component of the Consumer Price Index ("CPI"). While the percentage increases cited are broadly correct, comparing these without any context is misleading. Most of the measures of prices of goods and services in the CPI are "quality-controlled", as Statistics New Zealand goes through a rigorous process to ensure that only the movements in prices of goods of the same quantity and quality are measured.

4.10 The rates component of the CPI measures both an increase in the rates and an increase in the level of service the user receives. In short, the CPI overstates increases in rates *vis à vis* the other elements of the CPI. This is not comparing *"apples"* with *"apples"*. The CPI measures movements in prices of a basket of goods and services that households consume. The basket of goods that local authorities consume is considerably different. The price of the two baskets of goods need not move in tandem – and while the two did move by about the same rate up until around 1998, that was very much a statistical coincidence. In the 10 years from 2000 the consumer price index moved 37 per cent, the construction cost index moved 67 per cent and the bitumen price index moved 91 per cent.

4.11 In 2009, LGNZ commissioned BERL to construct a Local Government Cost Index ("LGCI") from various local government related statistical indices prepared by Statistics New Zealand (mostly from indices that support its Labour Cost Index, and the Producers Price Index[4]). BERL found that the LGCI had increased by 43 per cent over the period 1999 to 2009. This is a truer reflection of the consumables used by local authorities, and includes engineering parts, bitumen, building materials, concrete and steel[5]. These goods are more expensive than those consumed by households.

Debt

4.12 There are major concerns about the impact of fiscal thresholds on infrastructure investment, concerns reinforced by international research. Attempts to severely limit either rate increases or debt levels, beyond limits identified by the Office of the Auditor-General or rating agencies, will have a potentially serious impact on the state of local infrastructure. Imposed fiscal thresholds have been identified as the primary reason for the major infrastructure deficit facing communities in New South Wales.

4.13 Local authorities have now adopted 2012-22 Long Term Plans, and commentators such as the Auditor-General have noted that the sector is generally planning to reduce debt levels over the intentions in previous plans. Debt is part of investing in the future and supports long term stewardship. From an inter-generational perspective debt funding is more equitable than other alternatives.

4.14 Historically local authorities had very low levels of debt and as a result debt levels today appear high relative to the historical picture.

5 The Purpose of Local Government

5.1 Part 1 of the Bill proposes to replace the current purpose of local government set out in section 10 of the LGA 2002 ("the well-beings") with a new purpose statement.

5.2 LGNZ submits that the well-beings should remain for the reasons set out in the following paragraphs.

[4] Note that these are input prices – that is to say that they measure the cost of goods and services that local authorities consume in producing their own goods and services

[5] BERL LGCI (October 2011)

Lack of a Convincing Problem Definition

5.3 The Bill proposes to amend the purpose of the LGA by removing reference to the four "well-beings", and replacing that with a range of new concepts including "good-quality" infrastructure, services and performance, in a way which is "cost-effective" for businesses and households. Further, references to the well-beings will be removed from specific provisions governing local authority decision-making, and will be replaced with references to "interests". These proposed changes have been promoted notwithstanding that there is significant doubt as to whether it will actually achieve anything. As noted in the RIS (at paragraph 54):

> *"There are limited risks primarily that changing the purpose of local government may not achieve the stated objectives. There is limited evidence that the proposed approach will reduce local government spending or ensure resources are put into core local government services."*

5.4 The RIS goes on to state at paragraph 56 that "the change is likely to have a symbolic effect and should not affect council business as usual."

5.5 The Government has made much of a number of high-profile examples to provide at least some evidence that the well-beings are a problem. Examples adduced by the Government to justify the proposed change are not examples of a failure of the well-beings. These examples are either explicable due to the underlying circumstances, for example, holdings in particular business activities which are mandated by the communities affected, or are examples of poor business cases and oversight, for example the Hamilton V8's. Taking the latter example, it is clear that the activity itself is of no concern to Government as it has just announced a partnership with Auckland Council to run V8 races in Pukekohoe. Bad business decisions occur every day in the commercial and central government sector. Local government's track record is that it successfully runs far more successful business and community activities than not. These activities are an important contributor to economic development and community vibrancy (both aspects of the well-beings), and have been acknowledged as such by Government. The Minister for Economic Development made the point as recently as 18 July 2012 in his address to the EDANZ conference in Queenstown that local government activity is supporting the country's economic growth.

5.6 In summary, there is no evidence that a substantive problem exists that requires legislative change. Ironically, this conclusion seems to be the Government's position also. Since announcing the reforms, the Government has made numerous statements that the proposed change will not affect significantly the activities that councils pursue. If so, why make the change?

5.7 Under the local government accountability framework the elected members are required to account to the electorate for the choices that they make. To depart from the principle of democratic accountability with such a paucity of empirical evidence seems, at best, to be poor public policy and at worst is simply populist legislation.

Ability to Decline Funding Requests

5.8 It has been suggested by Government that a change to the purpose clause will put local authorities in a better position to decline funding requests from the community. This assumes that the present purpose clause makes this difficult.

5.9 However, in the recently completed round of Long Term Plans, local authorities have acknowledged the country's present difficult fiscal circumstances and have been able to decrease the trend in rate increases. Where rate increases are occurring then they are driven primarily by the costs of infrastructure.

5.10 There is no evidence that local authorities are finding it difficult to decline funding requests. Elected members act responsibly and in the broader interests of their community. Again if a particular community disagrees then the appropriate check is the democratic process.

Legal Uncertainty

5.11 One matter that the RIS fails to consider is that amending the purpose of the LGA 2002 in the way proposed will likely have significant legal and cost implications. These implications will impact on both decision-makers and the community, who are likely to be confused by its intent or application. In other words, the proposed change has no identified benefits but is likely to carry significant cost.

5.12 Amending the statutory purpose of an Act is a major step, with significant implications, and one that should therefore be undertaken very carefully. The Interpretation Act 1999 is clear that the meaning of an enactment must be ascertained from its text and in the light of its purpose. In *Commerce Commission* v *Fonterra Co-operative Group Ltd [2007] NZSC 36, [2007] 3 NZLR 767 at [22]* Tipping J stated:

> *It is necessary to bear in mind that s5 of the Interpretation Act 1999 makes text and purpose the key drivers of statutory interpretation. The meaning of an enactment must be ascertained from its text and in the light of its purpose. Even if the meaning of the text may appear plain in isolation of purpose that meaning should always be cross-checked against purpose in order to observe the dual requirements of s5.*

5.13 The purpose provisions of an Act of Parliament are therefore integral to the proper interpretation of all legal requirements under that statute.

5.14 The effect of any amendment to section 10 is wide-reaching, and will not be limited to that section, as the four well-beings permeate throughout the LGA 2002. It will particularly impact on the interpretation of the vires of council action. Another example occurs in the course of the decision-making process under Part 6, section 77 which requires a local authority to identify all practicable options and assess each option in terms of whether it meets the four community well-beings of the district or region. Similarly, in determining whether a decision is "significant", a local authority must assess the impact of the decision on the four well-beings of the district or region. If the local authority considers that the decision will impact or have consequences for the community's well-being, then the local authority must adopt a special consultative procedure.

5.15 Since its introduction over 10 years ago, the purpose of local government, as set out in section 10 of the LGA 2012, is now well understood by local authorities, whose decision-making, planning and activities must always be undertaken in accordance with that purpose. There is also a significant body of case law that provides guidance on how the decision-making provisions in the LGA 2012 should be properly applied.

5.16 While the Bill attempts to offer some guidance around the meaning of "good quality", in absence of a clear assessment or criteria-driven standard by which decision-making and planning can be adequately measured, there will be significant uncertainty for local authorities, and the wider community, in identifying whether or not a particular council has acted in accordance with the Act's new purpose.

5.17 This uncertainty, and the knowledge that a court must assume that Parliament changed the purpose statement for good reason, is likely to lead to increased litigation and costs as local authorities and communities seek further clarification from the courts, by way of judicial review, as to how the new purpose should be interpreted and achieved, and how the consequential changes to other sections should be interpreted.

5.18 The proposed new purpose, and how it changes the proper interpretation of specific obligations under the LGA 2002, is sufficiently unclear as to almost certainly lead to legal challenges of the way local authorities have interpreted their responsibilities. In light of the body of case law under the existing provisions, it would be naïve to think that changing those provisions would not encourage further litigation by well-resourced interest groups who opposed particular local authority decisions.

5.19 Changing the purpose of the LGA 2002 also will create uncertainties (and likely increase the risk of legal challenge) around decisions which are taken in stages over a period of time. For example, in relation to staged capital projects, it is unclear how the amended purpose will affect decisions regarding the subsequent stages of a project which will effectively need to be made within an entirely different decision-making framework (i.e. "good quality" rather than the four well-beings). There is a real risk that subsequent stages of projects could be significantly re-scoped and result in a disconnect between the stages of the project and the level of service provided (if for example, initial stages are built on a "future-proofing" basis, whereas subsequent stages are built on a "cost-effective" basis).

5.20 As noted in the RIS, references to the four well-beings also appear in a range of other acts, including the Civil Defence and Emergency Management Act 2002, the Canterbury Earthquake Recovery Act 2011, the Waitakere Ranges Heritage Area Act 2008, the Waikato-Tainui Raupatu Claims (Waikato River) Settlement Act 2010, Ngāti Tuwharetoa, Raukawa, and Te Arawa River Iwi Waikato River Act 2010, the Nga Wai o Maniapoto (Waipa River) Bill, and in proposed amendments to the Land Transport Management Act 2003. At this stage, there is no intention to amend these provisions.

5.21 We also note the risk of inconsistency and confusion between the Resource Management Act 1991 ("RMA") and LGA 2002, as the sustainable management purpose contained in section 5 of the RMA also requires a consideration of "*social, economic and cultural wellbeing.*" The effect of the amendment to section 10 proposed by the Bill could result in inconsistencies between a local authority's obligations under the LGA 2002, and its decision-making powers under the RMA.

5.22 In summary, the proposed changes to the well-beings:

- Are not founded in fact;
- Lack a cogent problem definition;
- Will introduce significant legal risk and cost where none now exists; and
- Will create misalignment with other pieces of legislation.

6 Proposed Fiscal Parameters or Benchmarks

6.1 Clause 22 of the Bill proposes a new regulation-making power prescribing parameters or benchmarks for assessing whether a local authority is prudently managing its financial dealings.

6.2 As noted in section 3 of this submission, the concept of financial prudence is already firmly established in the LGA 2002. This includes the following:

- an obligation to manage all financial dealings prudently and in the current and future interests of the community – this obligation sits over the top of all other financial management obligations; and
- an obligation to balance the operating budget (unless it can be demonstrated that it is prudent for local authorities to not balance the budget).

6.3 From September 2013 local authorities must provide a report prior to each triennial election that shows whether the local authority has complied with its self-set limits, reports on the outgoing council's financial stewardship and sets out the major spending issue for the next triennium. These reports are not due for 14 months.

6.4 In addition, there already are well established non-statutory benchmarks that can inform a test of financial prudence, especially with regard to debt. The 2006 Report of the Central/Local Government Funding Project Team did not invent the benchmarks it reproduced but built on benchmarks used by international rating agencies as the indicator for "AAA status."

Soft Caps and Self-Regulatory Approach

6.5 Clause 22 of the Bill is related to the proposed new definition of “problem” inserted by clause 21 of the Bill. That definition relates to the new Ministerial intervention regime (new Part 10). The definition of “problem” includes a failure by a local authority to demonstrate prudent management in terms of any parameters or benchmarks prescribed under the new regulatory power.

6.6 By linking benchmarks to the intervention regime they become in effect “triggers” for intervention not benchmarks. LGNZ submits that this inter-relationship with the intervention regime will result in "soft caps" being set which will have serious implications for the manner in which local authorities operate. In particular, they are likely to unduly constrain local authorities, and may in fact prevent them from properly fulfilling their statutory purpose. As such, they need to be carefully considered.

6.7 LGNZ considers that it, in consultation with its members and sister organisations such as SOLGM and the Local Government Funding Authority, should be responsible for setting any financial benchmarks. In essence the benchmarks would be developed by these organisations jointly and operated by LGNZ under a less-intrusive self-regulatory regime. This approach avoids the poor incentive effects that a “soft cap” approach entails.

6.8 Such a regime would be supplemented by retaining the regulatory power to make regulations (as amended in the manner suggested below). In other words if the self-regulatory approach is judged at a later stage not to be fit for purpose then the Minister retains his power to regulate.

Incentive Effects

6.9 Any benchmark for assessing councils performance in respect of income, expenditure and prudent debt levels that are set under a statutory framework will give rise to a public expectation that the benchmarks are levels that local authorities cannot (or at least should not) move beyond. This could easily lead to councils under-investing in their infrastructure spend to stay within thresholds. If so, a risk presents itself that over time an infrastructure deficit for the future will be created – the very thing that the Government’s National Infrastructure Plan seeks to avoid.

6.10 The prices for many of the local government “supplies” are determined in international commodity markets (such as: oil; bitumen; steel; concrete; plastics; and goods that are produced using these as inputs e.g. pipelines). As with the rest of New Zealand, local government is a price-taker for many of these commodities. Local authorities’ only ability to exert any real control over the price of the goods and services they consume comes from competitively tendering capital, maintenance and renewal work (virtually all capital expenditure, and the asset related components of operating expenditure, are “market tested” through competitive tender) or from entering into collaborative arrangements with other local authorities (such as shared services).

6.11 If local authorities can exhibit only limited control over the price of the goods and services they consume, then the mechanism for controlling expenditure must be in controlling the volume of goods they consume. That is, if the price of bitumen increases 10 per cent, but budgets increase by four per cent because of population growth and the CPI, then the local authority must buy less bitumen and construct, seal or reseal fewer roads. That is to say, that a statutory benchmark carries a very real risk of consequences for levels of service.

6.12 Local authorities provide assets that have long service lives – 50, 80, 100 years (some even have perpetual lives if maintained correctly). This means that both present and future ratepayers get to enjoy the benefits that these assets generate. One of the core principles of government finance is the principle of intergenerational equity – that, all things being equal, where future ratepayers enjoy a benefit from a service, they should meet part of the cost of its construction.

6.13 The way local government does this is by borrowing part of the cost of the asset, and spreading the repayments over time, not dissimilar to taking out a long term mortgage. A decision not to borrow, or to borrow “too little”, is also assuming that today’s ratepayers should subsidise the consumption of tomorrow’s ratepayers.

6.14 In the year to June 2010, local authorities invested some $5.4 billion in $92.3 billion dollars worth of fixed assets, and used 5.5 per cent of local authority revenue to pay interest.

6.15 Local authorities have been criticised previously for their reluctance to borrow, for example, in the 2006 Report of the Central/Local Government Funding Project Team, and the 2007 Report of the Independent Inquiry into Local Government Rates.

6.16 At the 2009 Jobs Summit participants not only criticised the sector for its lack of debt (terms such as “lazy balance sheets” were used) but also gave the sector an unambiguous message that councils should be increasing their infrastructural investment to “help communities through the recession.” The Government established the Local Government Funding Agency largely to assist councils with the cost of borrowing.

6.17 It is essential to understand first what local authorities are borrowing to fund, and second their overall ability to service the debt. The key question to be asked is not what the absolute level of debt is, but rather does an individual local authority have the ability to sustainably service an appropriate level of debt? If the answer is yes, then there is no issue.

Necessary Amendments

6.18 However, if Parliament is committed to retaining the power to set benchmarks through regulations, then a reasonable and transparent process around how those benchmarks may (or may not) be achieved is needed.

6.19 Local authorities' primary obligation should be to report against the proposed benchmarks (in their Annual Plans). The reporting process must include the ability for local authorities to explain how or why a particular benchmark has not been achieved, and to allow some flexibility in terms of the consequences of that "failure" to reach a benchmark. If a local authority can reasonably explain why a benchmark has not been achieved, then that "failure" to achieve should not constitute a "problem" worthy of Ministerial intervention. For example, a benchmark might not have been achieved because the local authority's purposes, and therefore the interests of the community it serves, were better advanced by acting in a way which did not achieve the parameter proposed.

6.20 Additionally, LGNZ believes that the new section 259(3) needs to contain no detail other than giving the Minister a power to prescribe parameters or benchmarks. Providing a list of examples (as the current draft does) pre-determines that the benchmarks will be drawn from that list. There has been no close examination of the unintended consequences of these examples and the ratio using the CPI has already been questioned. A simple empowering provision is all that is required thus preserving flexibility.

6.21 Such an approach would be consistent with the current section 259 which provides regulators with the power to prescribe measures of non-financial performance but does not prescribe examples.

6.22 LGNZ submits that the proposed new section 259(4) should be retained.

Transition

6.23 LGNZ understands that the Government may wish to progress the regulations quickly so that they take effect from 1 July 2013.

6.24 In most cases, the level of debt is a "legacy issue", that is to say that debt levels are the results of decisions and actions of previous councils, and councils have taken steps to reduce debt levels in their 2012/22 long-term plans. If regulations came into force on 1 July 2013, a number of local authorities may immediately have a "problem" (for the purposes of the intervention and assistance framework). Other local authorities may have investment and expenditure plans that call for a higher level of rates increase in a particular year, and may need to make amendments to their long-term plans to defer projects to future years, or to abandon projects altogether. Further, by the time regulations are developed and promulgated many local authorities will have substantially completed their main phase of development for their 2013/14 annual plans – some may even have gone out to consultation.

6.25 Accordingly, the Bill should provide that any regulations prescribing prudential benchmarks may not take effect until 1 July 2015. This has the added advantage of allowing a little more time to develop the benchmarks, and minimise the risk of unintended consequences and other forms of policy error.

7 New Part 10 Intervention Framework

7.1 The Government's statement that too much is at stake to let councils fail or mismanage important decisions is concerning as it fails to recognise the fact that councils have been operating successfully for most of the country's history. The RIS states at paragraph 113 that:

> *"The existing framework assumes that councils are autonomous, can generally handle all of their responsibilities, duties and powers, and that government intervention in councils may be required only in exceptional circumstances" (RIS p.22)*

7.2 The balance to be struck lies between providing a better and more flexible range of powers to the Minister without undermining the robust democratic accountability framework that presently is in place.

7.3 On balance LGNZ considers that a broader suite of intervention options ought to be available to the Minister in defined circumstances. But intervention should be the exception not the rule. LGNZ does not agree that the Crown Manager option should be retained as this is too draconian a measure with limited constraints on its use by the Minister.

7.4 LGNZ's chief concerns with the Bill as drafted centre on:

- The financial management trigger linked to the proposed benchmarks (considered in section 6 of this submission); and
- The Crown Manager option and intervention trigger.

Financial Benchmark Trigger

7.5 For the reasons explained in section 6 above, we do not consider it appropriate or wise to link the Minister's intervention power to a financial benchmark regime. Aside from the adverse incentive effects on councils operations, the Minister is likely to attract significant and constant lobbying from disaffected persons in communities to intervene if a benchmark is breached. Such lobbying is not conducive to supporting the democratic accountability of elected members. This risk is referred to at paragraphs 128 and 129 of the RIS.

Crown Manager

7.6 LGNZ does not believe that the Crown Manager option is a necessary step in the graduated intervention process. A Crown Review Team or Crown Observer prior to the appointment of a Commission is sufficient.

7.7 LGNZ has significant concerns with the way in which a Crown Manager can be appointed (new section 258B). The appointment of a Crown Manager is arguably unlimited and gives the Crown wide powers. For example, the Minister does not have to first appoint a Crown Review team or Crown Observer before appointment of a Crown Manager (new section 258B(2)). A Crown Manager can also be appointed simply on the recommendation of a Crown Review Team or Crown Observer, with no limits on that recommendation (new section 258B(1)(a)).

7.8 The only real test for the appointment of a Crown Manager is that the Minister believes on "reasonable grounds" that a "significant problem" (as defined in new section 254) exists and is such that the local authority is unlikely to effectively address the problem. The local authority must comply with any directions the Crown Manager makes.

7.9 While the concept of what is "reasonable grounds" is fairly well understood in law and requires there to be reasonable evidence to support the decision to act, the appointment of a Crown Manager is such an invasive procedure, it needs a high threshold to justify its use. The appointment of a Crown Manager effectively subverts local democratic processes by overriding the ability of a democratically elected and accountable body to act, and should therefore be very carefully controlled.

7.10 At a minimum, a greater sense of the possible widespread, long-term, or irreversible effects of the problem should be imported into the test for the appointment of a Crown Manager. This would make clear that it is only a significant problem whose effects are irreversible that triggers the consideration of appointment. Otherwise, the appropriate response would be to wait until the next election, when residents and ratepayers can determine how the "problem" should be fixed, in accordance with the democratic accountability that underpins the LGA 2002.

7.11 If legislative amendment to introduce the role of Crown Manager proceeds, LGNZ recommend that new section 258B (1) be amended to read as follows:

“258B Minister may appoint Crown Manager

“(1) The Minister may appoint a Crown Manager to a local authority if—

(a) “the Minister believes, on reasonable grounds, that a significant problem relating to the local authority exists which is likely to disrupt social, environmental, or economic interests of residents and ratepayers within the district or region and the effects of the disruption are likely to be widespread, long-term, or irreversible, and the nature or extent of the problem is such that the local authority is unlikely to effectively address the problem without the appointment of a Crown Manager; or

(b) the Minister has received a written request from the local authority to do so.

(1A) When making a decision under subsection (1), the Minister may have regard to:

(a) the recommendations of a Crown Review Team or a Crown Observer appointed to the local authority; and

(b) whether, for no good reason, the local authority has not adequately implemented a recommendation of a Crown Review Team or Crown Observer in relation to the problem.”

7.12 This will ensure the test to appoint a Crown Manager is sufficiently robust.

7.13 LGNZ reiterates its view that the local democratic process is generally sufficient to address problems that arise in councils. Ministerial intervention should only exist as a means of last resort.

8 Reorganisation

8.1 The membership of LGNZ has differing perspectives on this aspect of the Bill. This reflects the nature of differing political approaches to reorganisation in particular areas of the country.

8.2 Accordingly, LGNZ confines its comments to certain high-level observations.

Forced Amalgamation not Supported

8.3 LGNZ supports the democratic right of communities to choose the nature of the political structure that governs their locality. As such, LGNZ does not support the enforced amalgamation of local authorities.

8.4 Population and technological change inevitably means that over time administrative boundaries get out of step with community boundaries. Therefore an effective process to reorganise local authorities to respond to that change is necessary. A reorganisation process must balance efficient and effective service delivery with responsiveness to community concerns and issues.

Consultation on a Proposal

8.5 The Local Government Commission is not obligated to consult with residents, though it may do so. LGNZ believes that the Commission should be required to consult. While it is important to consult with stakeholder organisations, individual citizens have the right to be heard when it comes to the subject of changing their local representation arrangements. Given an assessment of significant community support need only involve gathering a view from the whole community, consultation may be the only opportunity for the whole community to make their views known.

Polls

8.6 The new provisions do not require a poll of the affected area. Many, but not all, of LGNZ's members believe a poll should be required.

Ministerial Expectations

8.7 The Bill places a new section 31A into the body of the Act that gives the Minister the power to "specify measures and expectations relating to the Commission's performance of its powers and duties." The Bill specifically mentions timeframes within which the Commission must progress certain matters, and which applications are to have the highest priority."

8.8 This provision appears to permit a future Minister to direct the Commission to progress some applications at the expense of others. This potentially would insert a political dimension that is inconsistent with the overall framework which is designed, through the Commission, to put the reorganisation process at arm's length from central government's political considerations.

9 Role and Powers of Mayors

9.1 The proposed new section 41A inserts provisions relating to the role and powers of Mayors. As the Bill's Explanatory Note states, these provisions are based on section 9 of the Local Government (Auckland Council) Act 2009 which sets out the role and powers of the Mayor of Auckland. In the Auckland model, funding is provided to the Office of the Mayor. Such a provision is not present in the Bill. Moreover for the majority of

LGNZ's members the equivalent percentage sum provided to the Mayor of Auckland would be insignificant as they lack the financial scale of Auckland Council. Looking forward this operational difference will need to be kept in mind.

9.2 Nonetheless LGNZ agrees with the Bill's provisions provided they remain enabling rather mandatory in nature. The overwhelming majority of LGNZ's elected members work well and constructively as a team.

10 Remuneration and Employment Policy

10.1 The proposed new section 36A empowers a local authority to adopt policies relating to employee staffing levels and remuneration. As a matter of general principle LGNZ supports the underlying intent of these provisions and agrees that the power should be enabling rather than mandatory. In practice the policies may add little as the elected members of local authorities already set limits on spending in their long-term and annual plans.

10.2 LGNZ would not support amendments to the Bill's clause that result in a blurring of the respective roles of governance and management. LGNZ notes that this type of risk is identified in the RIS.

10.3 The wording of the Bill may misapply the Government's policy intent. LGNZ understands that the Government had intended that an employment and remuneration policy would specify overall staff numbers and constrain the overall remuneration cost. The proposed new section 36A empowers local authorities to adopt a policy that sets out the policies of the local authority in relation to employee staffing levels and the remuneration of employees. This phraseology appears to allow a local authority to adopt policies that sit below the whole of council level. If so, this could result in an inappropriate level of intrusion into management decisions. This would be poor governance practice. The Bill needs to balance effective governance oversight by elected members against inappropriate interference in management decisions.

11 Other Electoral Matters

11.1 LGNZ had understood that the Government intended to fold the amendments promoted in the Local Electoral Amendment Bill into this legislation in time to take effect for the 2013 local body elections. This has not occurred.

11.2 LGNZ requests that the Select Committee use its report on this Bill to remind Parliament that "the clock is ticking" on the Local Electoral Amendment Bill.

12 Conclusion

12.1 This submission has covered a number of matters set out in the Bill. However, the overriding theme of the submission is that many of the proposals contained in the Bill have suffered from a severe lack of analysis and sound problem definition. Some of the proposals if carried forward unamended, carry serious consequences for the future operation of local government.

12.2 Most of these issues could and should have been raised with the local government sector in a substantive consultation process. The Government chose not to do so. The opportunity now exists for the Select Committee to carefully consider the points that have been raised in this submission and to make appropriate and considered amendments to the Bill. This should not be an opportunity for political point scoring. The local government sector is too important to New Zealand and its democratic institutions to make hasty ill-considered changes that will benefit no one.

12.3 LGNZ looks forward to presenting its oral submission to the Select Committee.

APPENDIX 1

Local Government New Zealand Policy Principles

In developing a view on the provisions in the Bill we have drawn on the following high level principles that have been endorsed by the National Council of *Local Government New Zealand.* We would like the Local Government and Environment Select Committee to take these into account when reading this submission.

- **Local autonomy and decision-making:** communities should be free to make the decisions directly affecting them, and councils should have autonomy to respond to community needs.
- **Accountability to local communities:** councils should be accountable to communities, and not to Government, for the decisions they make on the behalf of communities.
- **Local difference = local solutions:** avoid one-size-fits-all solutions, which are over-engineered to meet all circumstances and create unnecessary costs for many councils. Local diversity reflects differing local needs and priorities.
- **Equity:** regulatory requirements should be applied fairly and equitably across communities and regions. All councils face common costs and have their costs increased by Government, and government funding should apply, to some extent, to all councils. Systemic, not targeted funding solutions.
- **Reduced compliance costs:** legislation and regulation should be designed to minimise cost and compliance effort for councils, consistent with local autonomy and accountability. More recognition needs to be given by Government to the cumulative impacts of regulation on the role, functions and funding of local government.
- **Cost-sharing for national benefit:** where local activities produce benefits at the national level, these benefits should be recognised through contributions of national revenues.

APPENDIX 2

LOCAL GOVERNMENT COSTS – DRIVERS OF COST INCREASES

- Movements in international energy prices have both first and second order impact on local authority costs. The most direct impact is on the cost of running vehicle fleets, pumping on local authority reticulated networks and operating and maintaining facilities. Energy prices (especially oil) are determined in international markets and in the case of oil are driven by increasing global demand and a tapering off in global supply once the Hubbert peak is reached.
- Shortages of key skills in local government – especially civil engineers, experienced planners, and building inspectors have caused some "bidding up" of salaries for recruitment and retention.
- The occupational breakdown within local government is more senior, more tertiary (or trade) qualified, and deals with a higher degree of skill specialisation and non-transferability than other parts of the economy.
- Population growth (and change) creates additional demand for infrastructure. This includes network infrastructure such as roads and water supplies and community infrastructure such as recreation centres.
- Population change (such as the aging population) creates demands for a different portfolio of services – an aging population may carry less demand for roading, more demand for passenger transport, and demands for different types of recreational assets.
- Economic growth and transformation create their own demands and similar to population growth, the impact of economic growth and transformation differs from local authority to local authority.
- Dairy conversions in rural Southland have seen regional incomes move at a faster rate than the national average – but the greater frequency of heavy traffic creates accelerated depreciation on the network, demand for road widening and smoothing for safety reasons.
- The 2010 and 2011 Canterbury earthquakes have, and will have, a financial impact for the sector as a whole - increases in insurance costs – the main insurer of underground assets had to increase the premiums 400 per cent to restore depleted funds. As the recovery work moves from demolition and removal to reconstruction, the capacity of the civil construction industry will be stretched, this will manifest itself in tender prices.
- Increases in tender prices and a general trend to increasing land values increases the replacement cost of infrastructure. When coupled with a requirement to manage assets and finances prudently and balance operating budgets, this means local authorities have to fund the loss of service potential. Since the introduction of the balanced budget requirement depreciation has increased to the point where it now accounts for 21 per cent of the operating budget.

APPENDIX 3

Is Local Government Fiscally Responsible?

NZIER report to Local Government New Zealand

25 July 2012

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About NZIER

NZIER is a specialist consulting firm that uses applied economic research and analysis to provide a wide range of strategic advice to clients in the public and private sectors, throughout New Zealand and Australia, and further afield.

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Our aim is to be the premier centre of applied economic research in New Zealand. We pride ourselves on our reputation for independence and delivering quality analysis in the right form, and at the right time, for our clients. We ensure quality through teamwork on individual projects, critical review at internal seminars, and by peer review at various stages through a project by a senior staff member otherwise not involved in the project.

Each year NZIER devotes resources to undertake and make freely available economic research and thinking aimed at promoting a better understanding of New Zealand's important economic challenges.

NZIER was established in 1958.

Authorship

This paper was prepared at NZIER by Peter Nicholls & Derek Gill

It was quality approved by Jean-Pierre de Raad and Shamubeel Eaqub

The assistance of Sarah Spring is gratefully acknowledged.

Key points

"'My other piece of advice, Copperfield, you know. Annual income twenty pounds, annual expenditure nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds nought and six, result misery."

Mr Micawber from David Copperfield. Charles Dickens. (1850)

This report addresses the question 'is local government fiscally irresponsible?' In brief it concludes that it is not clear that rates revenue or expenditure is too high. The result according to Mr Micawber should be 'happiness'.

Better Local Government, the government discussion document and relative documents back-grounding the first and second local government reform bills, argued that rates revenues have increased relative to the CPI. Further, that labour costs, capital spending and debt have grown too much.

This report focuses on the key measures of revenue, expenses, debt and debt servicing at the aggregate level. The analysis is simple due to time restrictions. More time and detailed analysis would answer a broader array of issues.

We find that while revenue and spending have increased, but these by themselves do not present a problem. The increases are contained when compared against measures of wealth like property values and income measures like GDP.

Local Government has an obligation to rate payers to make sure that spending is warranted and provides value for money. Given that Local Government is a community democracy process, while democracy is not fool proof, the rates and expenditure choices should be seen in that political-economy context.

Capital spending is between 3% and 5% of total assets. This is consistent with the level of investment required for long lived asset bases. There is no clear evidence of excessive capital expenditure.

Debt and debt servicing measures are at prudent levels. Debt to assets, a commonly used measure has risen only modestly and interest payments are at a stated prudent level of incomes.

There no consistent evidence that local government as a whole has been fiscally irresponsible in New Zealand over the last two decades. In the face of turbulence following the global financial crisis, there may be other arguments for strengthened fiscal responsibility. But local government's track record over the last two decades does not provide the basis for that argument.

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3 The Issue

Local Government New Zealand (LGNZ) has commissioned NZIER to provide an independent review of recent trends in Local Government statistics.

Our report provides an independent review of the trends reported and the conclusions drawn in three papers:

- the Better Local Government discussion document (NZ Govt. March 2012)
- the Cabinet paper
- the accompanying Regulatory Impact Statement for Better Local Government (dated 16 March 2012).

These three papers conclude that the local government sector has been fiscally irresponsible since the local government reforms of 2002. This is based on five main issues:

- Rates have increased much faster than general inflation
- Local government labour costs have risen rapidly
- Local government expenditure has risen as a proportion of the economy
- Local government capital expenditure has risen rapidly
- Local government debt has quadrupled over the past decade and is projected to rise further.

We summarise the key issues, the metrics used, the appropriate metrics and the interpretations in Table 1. We agree with some of the trends identified, but we do not find these evidence of fiscal irresponsibility.

In particular, while rates have risen, they remain contained relative to the rating base – the value of property – and some measures of income. Capital expenditure, debt and interest cover are all at prudent levels.

The Better Local Government reform programme should be based on robust statistical evidence, using the appropriate metric and in the appropriate context to answer the question posed.

Table 1 Five key issues

#	Issue	Measure used	Proper measure	Rationale	Conclusion
1	Rates have increased at double the rate of inflation	1) Average annual increase in CPI (2003-2010) 2) Annual % change: 1993-2011	1) Real rates revenue per household 2) Rates revenue as a share of property values and an income measure (such as GDP)	1) Rates are charged per household 2) The value of properties is the local authority's rateable base 3) The income measure signals affordability and demand for services	Rates have increased, but are contained relative to property values and incomes
2	Significant increases in LG labour costs	Labour Cost index comparing LG with core state sector	1) Index of LG real wages compared to central government and overall economy 2) LG sector employment growth compared to core state sector and overall economy	1) Indicate if LG wages are growing faster than other sectors 2) Identify if the growing wage spending is a function of LG simply employing more people	LG wages have by and large grown in line with economy-wide measures
3	Total LG expenditure has increased as a proportion of GDP	Ratio of LG expenditure to GDP grew from 3.1% (2002) to 4% (2011)	Comparison of spending/GDP ratio with central government	See if local government spending has increased in general and relatively more than the central government sector	Spending has increased in recent years, but not clear this is an issue in context of a weak economy
4	Capital expenditure has increased by 154%	Quotes numbers and graph, but no data source given	1) Ratio of capital expenditure to assets (LG and CG)	Reveals how much LG and central government are investing in capital	Capex is lumpy, but not clear whether deficient or excessive relative to the asset base
5	LG debt has quadrupled over the past decade & is expected to continue to grow	Debt ($m) from Local Authority Financial Statistics and analysis of 2009 LTCCP The RIS uses total debt (historical and forecast) from the DIA paper	1) Real debt per household 2) Debt/asset ratio of LG and central government 3) Interest paid on LG debt to LG revenue ratio 4) Debt/GDP ratio of LG and central government	1) How much real debt is LG holding when you take into account the number of households 2) Indicates the % of LG assets that are provided via debt, and compares it with central government 3) Indicates cost of debt servicing 4) Indicates level of indebtedness, comparing it with central government	Debt and gearing is low, and interest costs are at a prudent level relative to incomes and quoted benchmarks

Source: NZIER

4 Rates Revenues

Local Government in New Zealand is funded through a variety of means. These include:

- Rates on property values (the primary source of revenue)
- The national road tax (in the case of road construction and maintenance)
- Development contributions (capital spending forecast to be increasingly funded by this).

In this section we compare trends over time in local authority rates with the number of households and property values. We also consider the local government operating balance.

4.1.1.1.1 The key issue

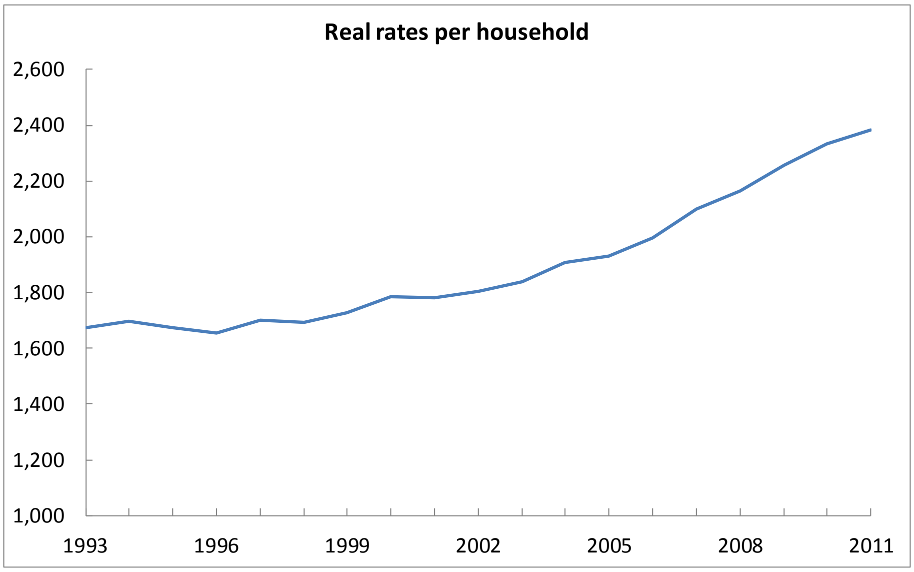
The RIS and the Discussion document compared the Consumer Price Index (CPI) with the rates component of the CPI. This showed that rates had relatively increased; since 2003, rates had increased 6.8% compared to a 3% increase in the overall CPI.

Rates have increased, but by itself it is not clear that this is a problem. Increases in rates (and expenditure) may be the choice of local communities, and should be considered relative to measures of income and wealth.

4.1.1.1.2 Real rates per household

The data show rates have increased in real terms and on a per household level.

Figure 1 Real rates per household[6]



Source: Statistics New Zealand

4.1.1.1.3 Rates relative to property values

Relative to property values, which is a measure of wealth and the rateable base, rates have been contained.

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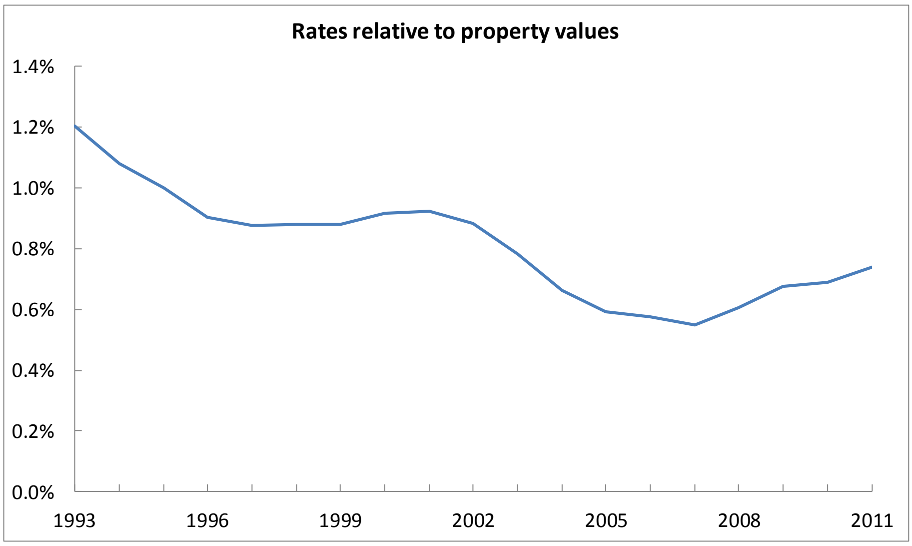
6 Real rates calculated by deflating rates revenues by annual averages of the CPI index. The number of households is taken from Statistics New Zealand's population data.

Figure 2 Rates contained relative to rateable base

Rates revenue divided by total housing stock value



Source: RBNZ, Statistics New Zealand

Why use rates relative to property values?

The revenue stream for local government is underpinned by property values, which is a measure of wealth (and therefore affordability).

What does it show?

Figure 2 shows that rates have fallen, and then remained contained relative to property-based wealth since 1993.

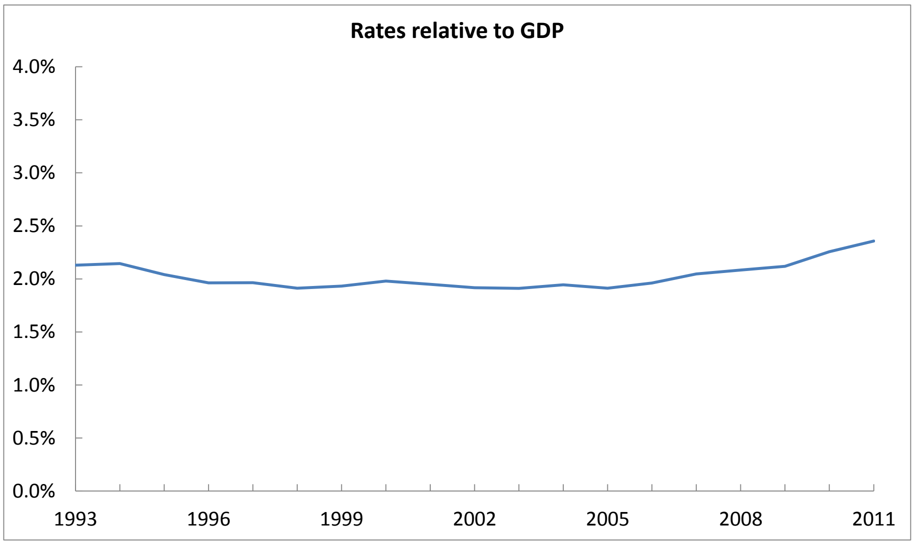
This trend only reversed as property prices flattened after 2007.

4.1.1.1.4 Rates as a proportion of GDP

Figure 3 shows that rates have risen modestly relative to GDP.

Figure 3 Rates conatined relative to GDP

Rates revenue divided by GDP



Source: Statistics New Zealand

Why use rates to GDP ratio?

The ratio is an economy-wide measure of affordability. GDP also captures the change in the demand for services.

What does it show?

Rates have risen modestly relative to GDP. There is not clear evidence on this measure, by itself, that rates are too high.

5 Labour Costs

In this section we compare trends over time in local and central government median wages and employment numbers.

5.1.1.1.1 The key issue

The Regulatory Impact Statement suggested that labour costs in the local government sector have increased beyond both the private sector and the public service. This used percentage changes in the Labour Cost Index (LCI) for 2005 to 2008, and 2008 to 2011.

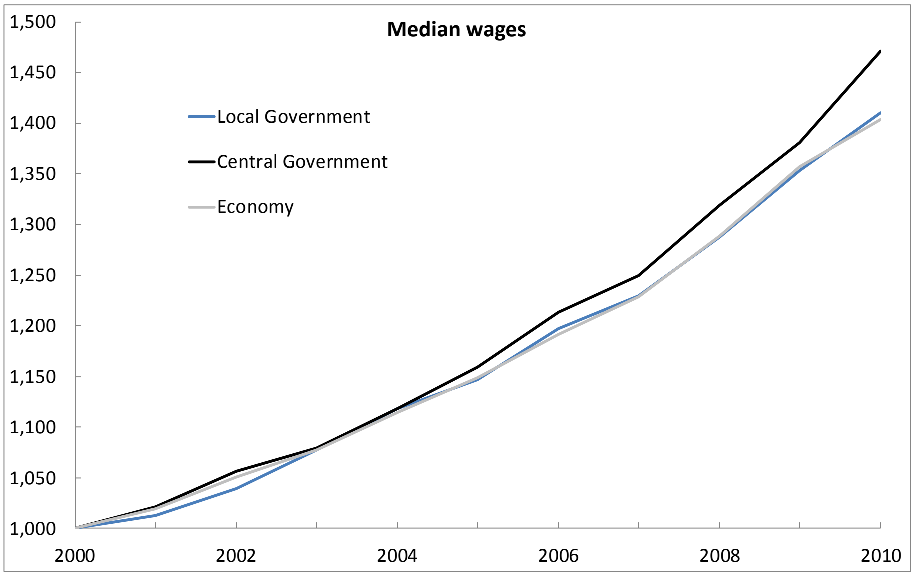
This is a reasonable measure, but we can see a longer history using median wage and employment numbers from the Linked Employer-Employee Dataset (LEED).

5.1.1.1.2 Longer history

Figure 4 shows an index of the level of median wages in local government, central government and the wider economy.

Figure 4 Median wages in line with economy

Index, base=year 2000



Source: Statistics New Zealand

Why use a longer history of wages?

The 2005-2008 period saw a very tight labour market and high wage inflation. There was some catch-up of wages in sectors that had grown by less or more in earlier periods. Because labour market adjustments take time, a longer timeframe gives a more accurate picture of wage pressures.

What does it show?

The longer history of wage data shows that over the decade to 2010 Local Government wages moved largely in line with the broader economy.

6 Spending to GDP

In this section we compare trends over time in local and central government expenditure relative to GDP.

6.1.1.1.1 The key issue

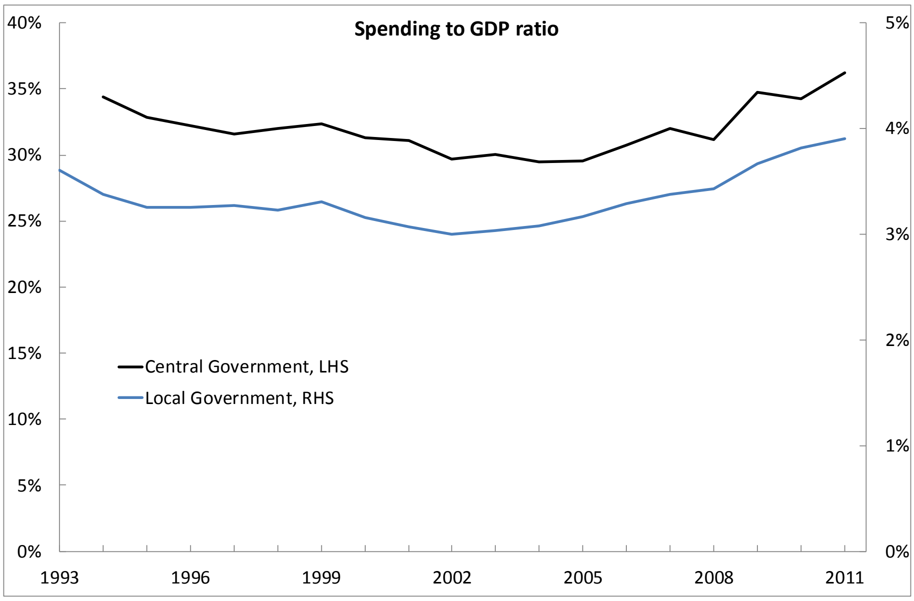
The Better Local Government report and the Cabinet paper both suggested that local government expenditure as a percentage of GDP increased since the passing of the Local Government Act in 2002. The ratio grew from 3.1% of GDP (in 2002) to 4% (in 2011).

6.1.1.1.2 Spending to GDP

LG spending to GDP ratio has increased (as has central Government spending). By itself it is not clear that this is a problem. Note that spending on government services tends to be less cyclical than GDP. The recession and subsequent weak economic growth since 2007 partly explains the rising spending to GDP ratio.

Figure 5 Similar trends in spending to GDP ratio

Operating expenditure to nominal GDP



Source: Statistics New Zealand

What does it show?

- Local government has increase from 3% in 2002 to 3.9% in 2011 – this is an average annual percentage change of 2.7%
- Central government has increased from 29.7% in 2002 to 36.2% in 2011 – this is an average annual percentage change of 1.6%.

7 Capital Spending

An examination of local government spending reveals that it is dominated by roading, and the three waters (water supply, waste water and storm water) – in particular, spending on infrastructure maintenance and depreciation.

In this section we compare trends over time in local authority capital spending.

7.1.1.1.1 The key issue

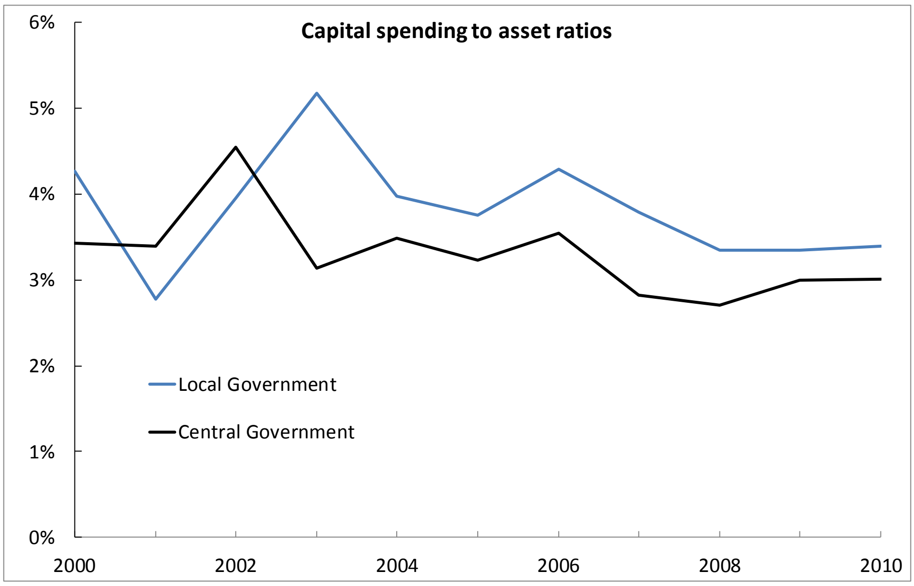
The Regulatory Impact Statement suggested that local government capital expenditure had increased by 154% between 2002 and 2012. The RIS notes that the major drivers of the capital expenditure included constructing new and maintaining existing infrastructure, and building new facilities and amenities. It was suggested that the large increase in capital expenditure was a key factor behind the increase in local government debt.

7.1.1.1.2 Capital spending to total assets

Figure 6 shows the ratio of capital spending to total asset ratios for both the central and local government.

Figure 6 Capital spending similar to central government

Capital expenditure to total assets



Source: Statistics New Zealand, Treasury

Why the capital spending to asset ratio?

This indicates how much investment is being made relative to the asset base.

What does it show?

The local government is investing between 3-5% of its total asset base. This is slightly higher but in the same vicinity as the central government.

With long term infrastructure assets with 20 year, 30 year or longer lives, a 3-5% investment rate is consistent with a natural depreciation rate.

8 Debt

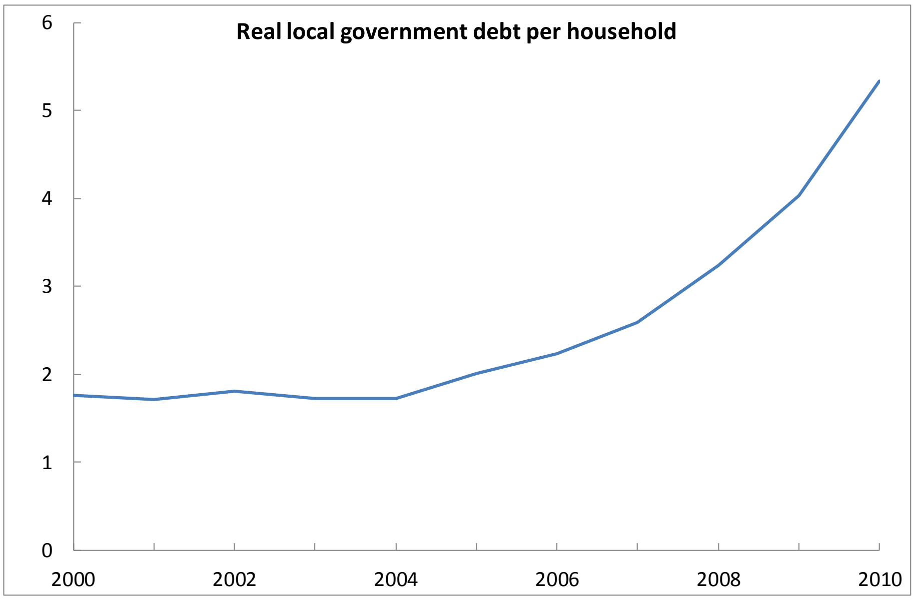
Local government is generally obliged to balance their budget so debt is not used to fund operational expenditure. This is underpinned by the 'Golden Rule' of fiscal policy. The Golden Rule suggests that Government should only borrow to invest and not to fund current spending. This is consistent with intergenerational equity in that any debt inherited by future generations is matched by assets passed on. Debt can be used by local government to spread the cost of capital across generations.

The 2007 Rates Inquiry indicated that local government could make increased use of debt. In part this is because debt can used to enable projects to be undertaken earlier than they could be if they were to be funded from general revenue.

As a result of the sharp increase in capital spending since the mid-2000s, the sector is making more use of debt. This is shown in Figure 7. The level of real local government debt per household has increased, particularly since 2004.

Figure 7 Local government debt increasing[7]

Dollars



Source: Statistics New Zealand

8.1.1.1.1 The key issue

The Regulatory Impact Statement, the Better Local Government paper and the Cabinet paper all flag the increase in local government debt as a concern. Local government debt is said to have quadrupled over the past decade and is expected to continue growing. It is also pointed out that the local government sector has not pulled back on increased debt in response to the global debt crisis.

The level of debt is not the problem though. The problem is whether or not the local government sector can deal with the amount of debt it has. To get an understanding for that, two measures can be used:

- the Gearing ratio – comparing debt to total assets
- the Interest Cover ratio – comparing the interest being paid on debt with the revenue stream.

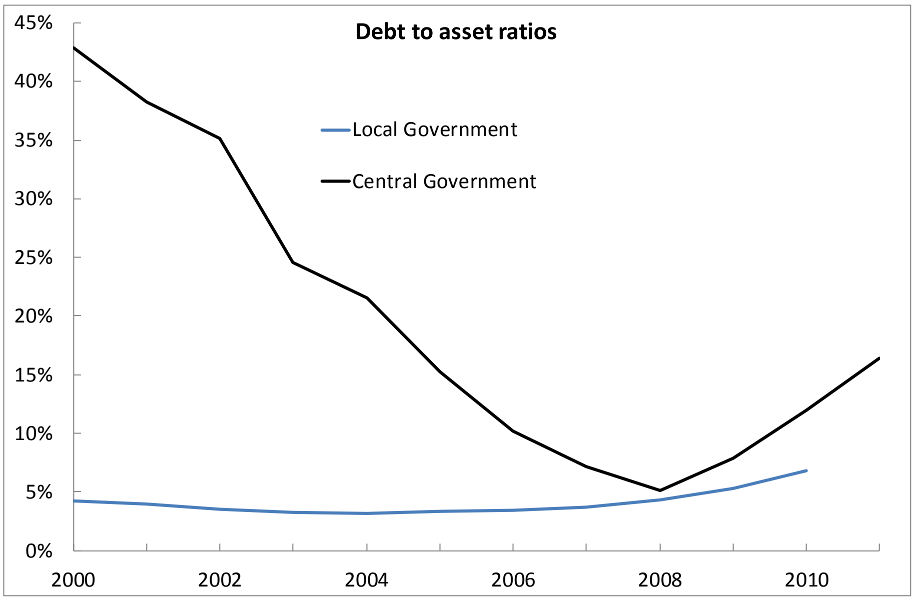
8.1.1.1.2 Debt to asset ratio

Figure 8 shows the gearing ratio for central and local government.

[7] Local government debt stock is deflated by the CPI to transform it to real debt. The number of households comes from Statistics New Zealand's population data.

Figure 8 Gearing ratio rising but still modest

Debt to total assets



Source: Statistics New Zealand

Why use the gearing ratio?

The ratio indicates the percentage of local government assets that are provided via debt, and enables comparison with the central government. As the ratio increases so does the level of risk, as it reflects a greater level of financing by debt.

What does it show?

The gearing ratio has trended slowly upwards since 2000. As of 2010, the local government gearing ratio is at 6.8%. This compares to 12% for central government. The level of local government financed by debt does not appear worryingly high from this data.

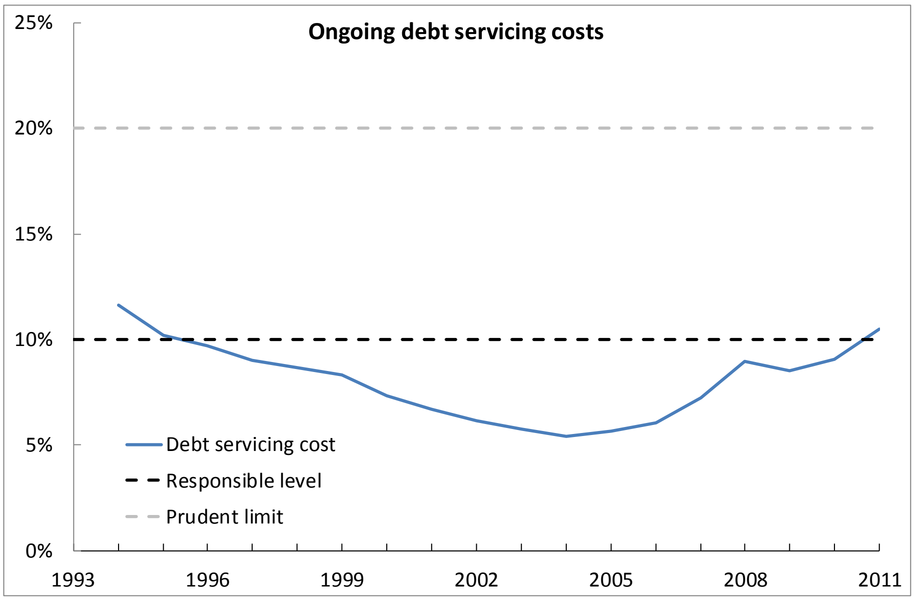
Such a gearing ratio also does not look high compared to, say, the NZX-listed property sector (also carrying long term physical assets), which typically have a gearing ratio of around 30%.

8.1.1.1.3 Ongoing debt servicing

Using debt to fund quality capital spending is consistent with the golden rule of fiscal policy discussed above. However the local authority has to be able to service the debt over time. Figure 9 summarises the debt servicing costs since 1993.

Figure 9 Debt servicing costs responsible[8]

Interest paid on debt relative to rates revenue



Source: Statistics New Zealand

Why use the debt servicing costs ratio?

This is the cost of servicing debt as a proportion of the local government's revenues. This indicates how much of the revenue stream is going towards servicing the debt each year.

What does it show?

The ratio of revenue being spent on debt servicing is at 10.5% in 2011. Is this level prudent?

Different benchmarks exist for what constitutes a prudent level of debt servicing. According to Reid (2012), the internationally prudent benchmark is that debt servicing should be below 10% of revenue. The DIA (2011) in their paper on local government debt suggested that "20% was generally seen as being the prudent limit".[9]

The level of local government debt servicing is well within the prudent levels suggested by Reid and the DIA.

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8 Debt servicing costs are the ratio between interest payments on local government debt and rates revenues.

9 Quote from DIA (2011 p65): "the forecast increases in debt are generated by a much larger increase in fixed assets. As a sector, the forecast peak interest costs/rates ratio is 12% in 2016, well under the average 20% ratio generally seen as being the prudent limit. While Auckland councils are forecasting a peak interest costs/rates ratio of 17%, many local authorities still have very low levels of debt relative to assets and income"

9 A Wider Range of Functions

A final discussion point arising from the Regulatory Impact Statement, the Cabinet paper and the Better Local Government paper is the range of functions being provided by Local Government.

9.1.1.1.1 The key issue

The Regulatory Impact Statement proposes that "there is no clear quantitative evidence to suggest that the LGA02 has resulted in a proliferation of new activities, or that local government is undertaking a wider group of functions." This was drawing on findings from a joint 2006 Central Government and Local Authority Funding Project team.

9.1.1.1.2 A lack of data

The claim in the RIS goes beyond what the data can inform. There is no local government activity spending data before 2002, so it is impossible to make comparison and see if the LGA02 has had any effect. Since 2003, data has been collected on activity but not at the level of disaggregation that is required to make an informed decision on whether or not local government are spending resources on a wider range of functions.

Appendix A References

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