



Advisory

# Local government reform

↳ An opportunity for the future



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- Over the next two years, the government's Future for Local Government Review will examine roles and functions of local government; representation and governance; and funding and financing.
- The review is broad enough to cover not just how local government can be fit for the future, but also where the line between local and central should be drawn.
- The rationale for reform includes the changing mandate of local government; local capability and economies of scale; funding challenges; and ongoing reviews of other geographically-based parts of the economy like water and health.
- It would be a weak outcome if the reforms simply focused on amalgamation. The review offers an opportunity to better align communities of interest; resolve funding and financing issues; improve asset management; and encourage more formal shared services or centres of excellence.

## A rationale for reform

In the last 32 years, New Zealand has had two major local government reforms. In 1989, around 700 local authorities reduced to 86 local authorities. Then in 2010, Auckland's eight constituent councils merged to form a new unitary authority, leaving the 67 territorial authorities and 11 regional councils people currently serving five million people.

But the scale of the population served ranges from under 800 on the Chatham Islands to a little over 4,000 in Kaikoura District, and over 1.7 million in Auckland. The largest unitary/**regional** council has a population 53 times larger than the smallest regional council.

Then there's the simple fact of passing time and changing technologies. This has made New Zealand a different place to what it was in 1989. Are current governance structures right for the New Zealand of today and the future?

**“There are at least four reasons to consider a rejigging of local government – changing roles and mandates, local capability, funding, and other national reforms.”**

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## Changing local mandates

The first of these is the changing role of local authorities. In much the same way the New Zealand Fire Service took on the role of attending car accidents as first responders because it saw a need, local authorities have taken on additional roles, especially within social services.

Councils have seen unmet needs in their communities, and have begun working to tackle them, often without extra central government funding. This includes initiatives to change the public's behaviour to meet climate change targets; homelessness strategies; affordable housing policies; or skills and trades training.

Current structures and funding do not allow councils to meet the needs of this informal mandate. This can lead to loss of trust among the public, who see local government as the face of government in their area.

For the Fire Service, reform came in 2017 with the establishment of Fire and Emergency New Zealand, and with it, a boost in funding. In the same way, in considering the growing scope of responsibilities taken on by local authorities, we will need to ask:

- Should these new roles be the responsibility of local authorities?
- If not, how will central government fill the gap?
- If yes, where will the funding, capability and capacity to provide these localised services come from? And how will this be reflected in a formal mandate?

## Local capability and economies of scale

On average, New Zealand's 67 territorial authorities serve just 75,000 people - this varies by a factor of 2,200 between the least and the most populous.

Many will argue that there are too many local authorities to ensure each territory is adequately served by the technical skills needed in water, transport, procurement, asset management, or policy making. In addition, can New Zealand secure enough senior management staff to run this many local authorities? Some would argue no.

As we discuss later, this does not necessarily mean amalgamation into a smaller number of councils is the silver bullet. But there is almost certainly scope for more a formal, back office sharing of skills across technical areas, from environmental monitoring to business functions such as procurement.

## Local capacity and funding

A third reason for reviewing local government is linked inextricably to the others - local capacity and funding. As local government's role has changed, funding has not fallen behind. Equally, as technology, public service expectations and populations have grown, capacity to deliver has not always kept up.

While demand for housing surges in many parts of the country, local authorities are challenged by high debt that stops them from borrowing more to meet

their infrastructure shortfall without a credit downgrade. Do they need new funding, new funding tools or additional clear mandates from central government to help their jurisdictions succeed?

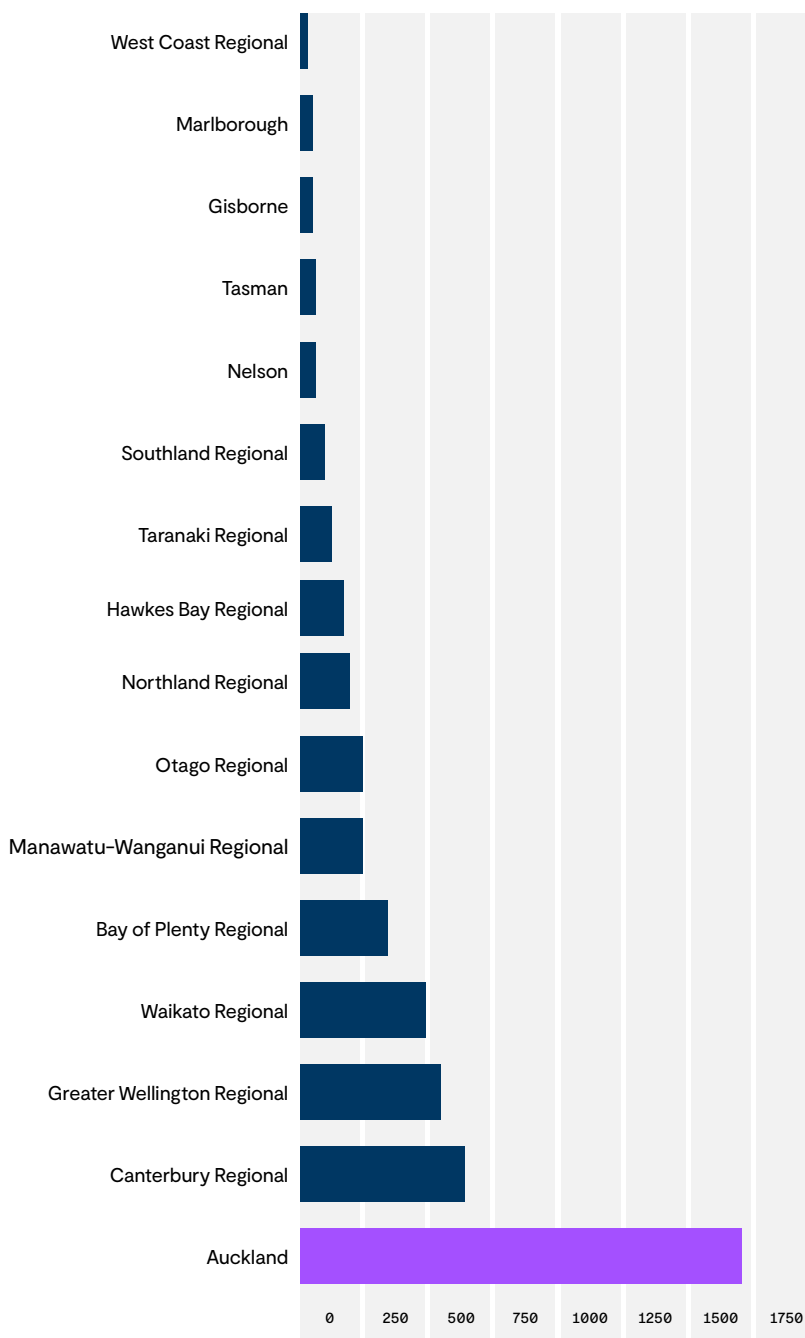
## Links to other reviews

Finally, a raft of other national reforms is currently in play. These include the Resource Management Act, one of the most important pieces of legislation for regional and unitary authorities. Changes will require authorities to re-balance urban development with environmental management.

Water reforms aim to improve water quality, build infrastructure resilience and adequately fund water infrastructure. But the proposed changes will likely see water services grouped across existing local and regional boundaries. This restructure should inform any potential local government reform.

## Population by Local Government Region, thousands, 2020

Source: GHD, Statistics New Zealand



Similarly, the recently announced health reforms will eliminate district health boards in favour of one national system with four geographic regions. Better alignment between lifelines (water and transport for instance) and health catchments makes sense.

# What could reform look like?

An economist would ask, “Which structure will deliver maximum benefit to New Zealanders for minimum cost?” In other words, how do we get better social (e.g. housing, health), environmental, financial and cultural outcomes in a way that minimises administrative and tax costs.

Secondary economic questions include “who pays, and who benefits?” The goal is for those who get the benefits to broadly be the ones who pay (the ‘beneficiary pays’ principle), but with some allowance for those who can afford more to fund a bit more than their share (the ‘ability to pay’ principle).

There are a number of approaches the reforms could look to combine.

## Amalgamation

One way the reform could play out is through amalgamation. At the extreme, we could see amalgamation into just a handful of jurisdictions across New Zealand. Less extreme would be amalgamation largely along current regional council boundaries, with perhaps 15–20 council areas, or along natural community of interest boundaries.

New Zealand is a largely rural country with a few much more densely populated urban areas. More rural areas have lower levels of services generally seen as ‘urban’ – reticulated water, and social infrastructure like parks, or community centres. But this does not necessarily mean lower rates in rural areas. Many large geographic areas with small populations have relatively high rates burdens precisely because they have few ratepayers across whom to spread the costs of running local services.

The implication for amalgamation is two-fold. First, to be at all affordable, service level expectations must be managed across any new amalgamated area. It will be unrealistic to assume that a rural area merged with a more urban area should have access to the same levels of service (e.g. footpaths along roads). Second, any service improvements in the less populated areas will almost certainly imply a subsidy from urban areas.

Neither of these outcomes are implicitly bad, but the trade-offs must be made explicitly, and the questions of what appropriate levels of service are, and at what cost, must be answered clearly.

## Funding and financing

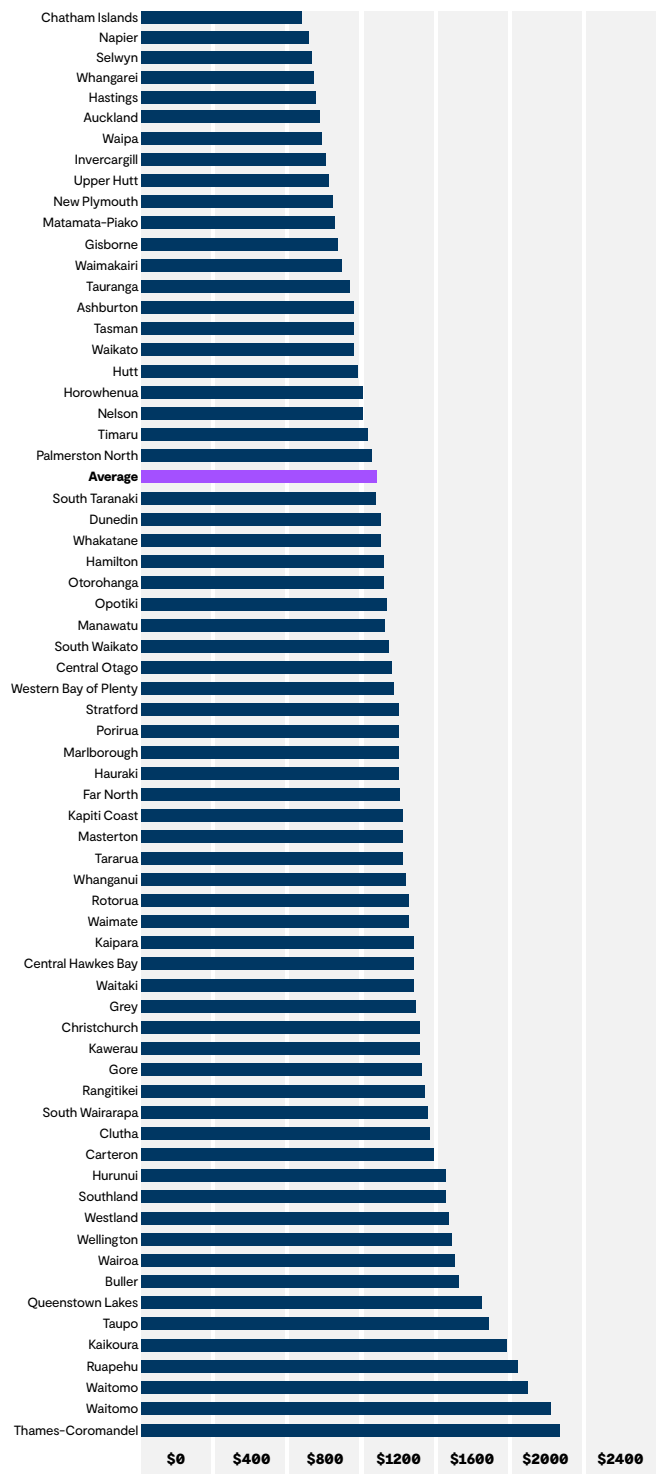
One of the most pressing issues for local government at present is infrastructure maintenance and funding. Around 93% of tax revenues accrue to central government, with rates to local authorities accounting for just 7%. Yet local authorities are on the front line in the provision of vital lifelines across water and transport.

COVID-19 stretched councils further. New Zealand’s most populous council area, Auckland, was left with an unexpected

hole in its budget of around \$1 billion. Councils are up against, and in some cases temporarily breaching, their borrowing limits beyond which they will receive a credit downgrade. This would make borrowing more expensive and reduce the pool of willing lenders.

# Which structure will deliver maximum benefit to New Zealanders for minimum cost?

Estimated rates per resident, 2020  
Source: GHD, Statistics New Zealand



## Existing local government tools

There are already tools available to local authorities to charge new development for infrastructure, primarily development contributions and targeted rates. Historically, these have been set lower than the true cost of new infrastructure, but some councils are bravely looking to raise these charges to reflect the actual costs of infrastructure.

They face political challenges from those who don't want to pay for their infrastructure. At times, councils hold the belief that charging the full cost of infrastructure pushes up house prices. Yet, evidence has shown that charging correctly for new development infrastructure pushes raw land prices down, reflecting their true value absent of infrastructure.

## Central government's role in funding

Even if councils charge the full price of development infrastructure, the funding shortfall would not disappear. This is because central government is also a major infrastructure funder. This is perhaps most obvious in the transport sector, where Waka Kotahi funds all highways and a large portion of the cost of local roads and public transport.

But it's not limited to transport. Central government funds schools, hospitals and police stations. It has to make sure those facilities are in place in time to meet community need. That requires an immense amount of joined up thinking between local and central government on development timing and location.

This interdependence means any reform in local government should consider how it will allow better coordination between central and local government. The review will also need to answer whether the mix of funding is right. If there is an amalgamation, partly based on the argument that skills and capability will be improved in a smaller number of larger jurisdictions, then there will be a stronger case for devolving more of the funding decisions to the local level. This could help align decisions on lifelines and other infrastructure more closely.

## New funding tools and vehicles

A further question is whether extra funding tools are needed for local or central government. The recent Infrastructure Funding and Financing Act provides the ability to ring-fence an additional levy, separate from the council's balance sheet, to provide a further funding source, not unlike a targeted rate. By paying for infrastructure via a well-signalled levy, buyers will begin to incorporate the levy cost into purchasing decisions, and the cost of infrastructure will begin to flow back up the chain to lower raw land prices.

The review will want to consider how local authorities can make greater use of this funding vehicle. It will also want to create clarity about the role of targeted levies or rates versus 'general taxes' being used to fund large-scale infrastructure projects usually funded by central government.

One argument is that central government spending on infrastructure across New Zealand should all be funded by general taxes, and that using a targeted levy could be 'double dipping'. A counter argument is that government investment in infrastructure like schools, roads or healthcare directly lifts land values, and those who benefit could reasonably be expected to contribute.



**Charging correctly for new development infrastructure does not push house prices up. It pushes raw land prices down to reflect their true value absent infrastructure.**

## Asset management standards

Asset management, approaches to depreciation costs, historical levels of investment, and population growth among other things are dramatically different across council areas. This has led to large differences in the state and adequacy of infrastructure. A generalisation would be that transport, water and social infrastructure are all in need of massive investment.

Another component of local government reform could be the introduction of standards for asset management across all local authorities. This would require standardised approaches toward defining assets, evaluating the state of assets, covering depreciation, and better optimising renewals or upgrades.



## Formal shared services

Ad hoc shared services arrangements already exist across some parts of New Zealand, but there is no formalised mechanism nationally available for sharing skills. Obvious examples include a national consenting system that would allow sharing of consent processing skills, or a procurement centre of excellence that would allow access to specialist skills for smaller councils with fewer large-scale procurements.

This could be a centrally managed service, through the development of centres of excellence, or by simply providing tools to enable local authorities to build shared service models easily and affordably.