WELLINGTON CHAMBER OF COMMERCE

SUBMISSION TO THE GREATER WELLINGTON REGIONAL COUNCIL ON THE REVENUE AND FINANCING POLICY

April 2018

Introduction

The Wellington Chamber of Commerce (the Chamber) welcomes the opportunity to make a submission to the Greater Wellington Regional Council (GWRC) on its Revenue and Funding Policy. This submission is also supported in principle by the Kapiti Chamber of Commerce.

The Chamber of Commerce has been the voice of business in the Wellington region for 161 years, since 1856, and advocates policies that reflect the interests of the business community in both the city and region and assist the development of the region's economy as a whole. The Chamber advocates for the views of its members and obtains their views through regular member surveys.

For the purposes of this submission, it is important to note that Wellington region businesses contribute significantly to the city and region's rate-take. Businesses pay 46 per cent of the total rates collected by Wellington City Council while making up only 21 per cent of the total rateable property. Regionally, businesses pay around one-third of the region's rates collected by Greater Wellington Regional Council. Further, Wellington businesses pay the highest proportion of rates of any town, city, or region in New Zealand, nearly 50 per cent higher than Auckland and nearly 100 per cent more than in Hamilton. Therefore as the largest contributor to Wellington City's and the Wellington region's rate-take, and paying the highest proportion in the country, businesses have a real stake in what happens with that money.

The Chamber notes the GWRC is seeking feedback on the Revenue and Financing Policy's proposals regarding the use of rates to fund public transport and flood protection.

For ease of reference, this submission is in three sections. Section 1 provides a brief context for local government, Section 2 comments on the proposed revenue and financing policy changes relating to flood protection and Section 3 comments on the proposed public transport funding changes.

The Chamber would welcome the opportunity to discuss our submission with the GWRC and requests to be heard orally.

The Chamber has also made a separate submission on the GWRC's Long Term Plan 2018-2028 Consultation Document.

Discussion

The size of local government demands that it is financially responsible, transparent, and accountable to ratepayers. Local government has a vital role to play in advancing the overall well-being of New Zealanders but that role is not all-encompassing. The role of local government must be established on a principled basis and its activities properly circumscribed.

In the Chamber's view it is desirable for local government to focus on the provision of local public goods, since in all likelihood, their provision will otherwise be inadequate. There is little incentive for the private sector to provide goods and services where the return on investment is likely to be low or in the worst case, non-existent.

Wellington's business sector pays just under half the city's rates bill and regionally, around a third of the region's rates bill, with the level of rates paid often entirely disproportionate to the level of services received. The situation is exacerbated by the generally wide use of business/commercial rating differentials despite strong evidence supporting their removal. Where councils have agreed to reduce such differentials, they have often been tardy in doing so, tending towards incremental change due to "expenditure pressures".

While rates will likely be the 'cornerstone' of local government for some time, they will need to be complemented, and possibly eventually displaced, by other revenue sources. This will ensure they better reflect the needs and costs of communities, the more so as pricing mechanisms are improving by the day, as is the availability of real-time data. Moreover, rating mechanisms are often a poor measure of costs imposed by (or benefits received from) goods and services provided by local government.

Section 3: Flood Protection Proposals

The GWRC is seeking feedback on proposals to change the way flood protection is funded given that around 90 percent of the flood protection network is concentrated in three areas – the Hutt Valley, Wairarapa and Kapiti. It is estimated the GWRC will spend more than $200 million over the next 10 years on flood protection work.

The proposal is to fund 70 percent of the cost of flood protection work through a targeted rate on properties in the area where the work is taking place. The remaining 30 percent would be funded by a targeted rate on all properties in the region. The intention is to reflect better the benefits each ratepayer group receives from the work rather than the current approach where around 50 percent is funded through general rates.

The proposed approach would see residents in Kapiti, Wairarapa and the Hutt Valley pay more for flood protection, while residents of Wellington City and Porirua would pay less.

The detailed information provided in the GWRC's revenue and financing policy is not further referred to in our submission. Suffice it to say the Chamber supports the thrust of the GWRC proposal (Option 1), that is, to better align costs with those who will benefit. It is outrageous that Wellington City ratepayers currently fund around 32% of the total cost of flood protection in the Wellington region, yet is responsible for around 1% of total regional expenditure.

Notwithstanding the Chamber's general support for the proposal and acknowledging flood protection can have some positive externalities for other properties within a region and even marginal benefits beyond it, the Chamber would suggest there is a strong case for an even higher percentage of the targeted rate to be funded by the work's principal beneficiaries. The reason: many schemes have very localised costs and benefits.

While it is accepted trade-offs must be made between a very detailed analysis of costs and benefits and the need for their relatively simple and efficient allocation, the GWRC should consider whether a tiered approach can be taken to reflect the localised costs and benefits of taking action, or of inaction, as the case might be. For example, the beneficiaries of seawalls might be highly localised residents. There is little rationale for requiring those outside the immediate area to pay a disproportionate share of the costs associated with an upgrade when the value of sea-walls might be substantial – but only to a small number of residents along their coastal area.

Householders need to take greater responsibility for identifying and managing the risks associated with land use; such risks should not be spread across all ratepayers or, in some cases, carried by central government. This would allow for increased housing development and in time should result in increased housing affordability.

As a general principle, individuals and companies should bear the full costs associated with their behaviour (i.e. costs should be internalised); individuals will over-consume resources if they can shift costs on to third parties. Management of land use risk is no different. If individuals are to make rational decisions about risk, they should ideally bear the associated costs (just as they enjoy the benefits).

However, it is important to understand there is an optimal amount of resource which should be used to reduce risk, just as there is an optimal amount of resource that should be spent on crime prevention, health interventions etc. The crucial and undeniable fact is that resources are limited and risk cannot be completely eliminated or if it can, not without great cost. While it might be possible to reduce risk, beyond a certain point, the marginal cost of taking action becomes progressively higher while the potential returns reduce. Therefore while individuals and companies should invest in risk minimisation strategies, they, like councils, should do so only to the point where the marginal cost equals the marginal benefit.

Section 3: <u>Public Transport Proposals</u>

Feedback is also requested on proposed changes to public transport which the GWRC considers will spread public transport rates more evenly across the region. While initially sounding convincing, the proposals then state that a weighting (rating differential) will be introduced to reflect the so–called benefits for each group of ratepayers. Proposed differentials, as outlined in the consultation document, vary but a differential of 8.0 is proposed for Wellington CBD businesses (with the next highest being 1.5 for other businesses, excluding in the Wairarapa). This proposal in respect to Wellington CBD businesses is quite simply, appalling!

Before commenting specifically on the differential, the Chamber would point out that goods and services of a largely private good nature (such as public transport) should ideally be principally paid for by users. On the other hand, goods that clearly meet the definition of public goods are generally best funded by ratepayers, if they benefit a region, or by central government (taxpayers), where they constitute a national public good (e.g. national defence systems).

The distinctive features of public goods are first, non-payers cannot easily be excluded from receiving the benefit others pay for (that is, public goods are susceptible to free riding) and second, one person's consumption does not reduce others' consumption opportunities. These are known as the non-excludability and non-rivalry characteristics of public goods.

Public transport, by contrast, is still largely in the nature of a private good, where users can be charged for using it.

While the beneficiaries of subsidised public transport will principally be the users of such services, it is accepted there are others who will also benefit, for example, from potentially fewer private vehicles on the road, possibly reducing congestion and improved travel times.

Similarly, there will perhaps be some minor benefits for businesses in the CBD in that an effective and efficient transport sector could provide certainty (although past experiences with public transport make this debatable) for their employees and other individuals travelling to and from the central city. However, as stated earlier, the principal beneficiary is the user of such services and hence, as a largely private good, it is they who should pay the majority of the costs associated with public transport use.

It should be noted that businesses already face considerable financial demands from local government, including a greater differential for general rates charges, targeted commercial-sector rating charges, down-town levies, etc, disproportionate to the benefits they receive. This proposal by the GWRC is simply another inappropriate cost imposition on CBD businesses.

Differential and targeted rating, as proposed for the Wellington CBD, should be permitted only where a clearly identified community (such as a remote rural area, or in the case of flood protection) is provided with a distinctly different level of public goods from that of other ratepayers and the differential or targeted tax reflects the difference in the level of services. There should be an objective test in respect to 'benefits received' to ensure a consistency of approach. However, in general, rates differentials, if used at all, should be used sparingly and not, as some councils have done, as a general revenue raising device, on unprincipled and unsubstantiated grounds.

Sometimes business sector differential rating is used on the unsubstantiated ground that the sector benefits proportionally more from council services. A number of reports have found such thinking to be groundless, yet councils continue to apply significant differentials simply because they can and not on any principled economic basis. Where councils have agreed to reduce such differentials, the reduction has generally occurred at a snail's pace, councils being mindful of not upsetting residential ratepayers who enjoy the advantages of a lower rates' burden courtesy of the business sector. Or conversely, other rating charges that fall on the business sector have been introduced or increased, with no or little reduction overall.

In the past, and indeed to a certain extent still today, a number of people have argued businesses are advantaged relative to residential ratepayers because they can deduct rates for income tax purposes and claim a credit for GST paid on rates. Reputable economists have discredited these claims for the following reasons. First, a firm can only claim a tax deduction for rates because its income is subject to tax. Nobody could seriously argue it is an advantage to be subject to income tax. Second, a GST registered person or firm can claim a credit for GST paid on inputs because supplies (outputs) are subject to GST. The net GST collected is paid to Inland Revenue so there is no advantage for businesses.

The Chamber would urge the GWRC to go back to the drawing board and start afresh, acknowledging the principal beneficiaries of public transport to be public transport users. Services should be priced accordingly. Proposing a differential of any magnitude, let alone 8.0 for Wellington CBD businesses, is seriously flawed and calls into question the objectiveness of the GWRC's thinking.

The Chamber would urge the GWRC to reconsider its funding model for public transport in light of the comments made in this submission placing much greater emphasis on the use of user charges and reducing, if not eliminating, any rating differentials.

The Chamber considers the GWRC should arguably receive better guidance on the use of available funding tools to ensure greater consistency, underpinned by an economically principled approach to funding council activities. There should also be greater clarity in distinguishing among the following:

Appropriate pricing and user charges for local authority services. Charging for the use of private goods and services would bring greater efficiencies. For example, while some councils charge for water and waste on a user-pays basis, many still fund such activities out of general rates, sending strictly limited signals to consumers as to the real costs associated with their behaviour.

Taxes imposed on a subset of a local authority's ratepayers to fund local public goods of clear benefit to subset members. There may be isolated cases where levying additional rates (taxes) on a particular class of ratepayers is appropriate, for example, where specific local public goods benefit a clearly defined subset of ratepayers such as schemes to control floods.

An appropriate tax to fund local public goods of benefit to all residents. The administrative costs of council operations could fall into this category, along with other public goods such as footpaths and street lighting.

Charges justified as internalising external costs imposed on people or firms. For example, these could include emission charges.