

11 POSSIBLE NEW SOURCES OF FUNDING FOR LOCAL GOVERNMENT

Because rates are under pressure the contribution of new revenue instruments to replace, reduce, or hold rates requires examination. This chapter examines a range of possible new sources of funding for local government. These are assessed against generally accepted criteria for assessment of taxes. In large measure the Panel's work has involved going over, but in greater depth, ground that has been well tilled in the past. We were able to draw from earlier reports; one prepared for the Local Authority Funding Project and another by McKinlay Douglas Limited for Local Government New Zealand and a consortium of councils. However, the Panel also commissioned some work from the New Zealand Institute of Economic Research to provide an independent appraisal of the options. The Panel is aware that possible new instruments require detailed and careful analysis. The objective was to determine which new sources could be recommended, which deserve further consideration, and which should be rejected.

SUMMARY OF KEY POINTS

11.1 The existing rating system and any possible new sources of taxation revenue for local government must be seen as part of New Zealand's total taxation system. Within New Zealand's broader tax system, property is comparatively lightly taxed, with property taxes (rates) accounting for some 6% of the total national tax take, compared with income tax 66%, and GST 28%.¹²⁹

11.2 Rates also have some strong features as a source of funding for local government, and the Panel sees them remaining central to local government revenue, although being reduced as a percentage of operating revenue to around 50%. Some of the pressure on ratepayers could be alleviated if suitable additional revenues can be found and these revenues are not used to further increase expenditures.

11.3 The Panel considers it important to state that there is no "pot of gold" available either from existing central government revenues or from new taxes to provide additional funding to local government. All these options involve somebody paying and each has its own impact on equity and on the economy.

11.4 The Panel considered a range of potential new taxes and other financial instruments. These included

- citizens or poll tax

¹²⁹ For year ended June 2006. Statistics New Zealand Local Authority Statistics and Treasury website (<http://www.treasury.govt.nz>) accessed 31 July 2007.

- payroll tax, including the “versement” transport tax
- local income tax
- local consumption tax
- industry and commodity taxes, including a bed tax and a regional petroleum tax
- environmental or “eco” taxes, such as a waste levy and road congestion pricing
- general revenue sharing, including the possibility of existing GST from rates being distributed to councils.

The Panel does not support any of these as a new source of revenue for local government.

11.5 The Panel’s main conclusion is that there is no better alternative to rates as a principal source of local government revenue. The Panel also concludes that there is no strong case for any major new broadly based tax (income or goods and services) for local government. There are, nonetheless, some instruments that could be further developed for the use of local government that would help raise additional revenue and address particular funding problems.

11.6 One of the specific problems is the high cost, for some local authorities, in providing infrastructure and other services for very high numbers of visitors. An “international visitor environmental levy” is a national instrument that could be used as a source of funds.

11.7 The adequacy of transport infrastructure is a major challenge for many local authorities. In the course of the inquiry, the Government took a decision in the 2007 Budget to support a new regional petroleum tax to fund major regional projects. This is a means of addressing some of the major transport problems in Auckland and Wellington and may assist councils in other regions with priority projects.

11.8 The Panel recommends increasing the existing local authority petroleum tax (LAPT), which has not changed since its introduction in 1971, by 2 cents a litre on petrol and with a commensurate change in diesel prices. This would raise around \$90 million annually and be a useful source of additional funding consistent with greater user charging for roads. Although councils should continue to be free to use this money for general purposes, the Panel notes that it would enable councils to reduce the amount of road funding presently provided from rates.

11.9 Infrastructure for the three waters is another area where there is a significant funding challenge for many local authorities, particularly for those with a small ratepayer base, high deprivation levels, and numbers of small communities. The Panel recommends the establishment of an “Infrastructure Equalisation Fund” to provide greater Government assistance for this infrastructure with funding of around \$100 million per year, using an earmarked portion of GST. New institutional arrangements for this fund would need to be developed.

Criteria for assessing funding mechanisms

11.10 A discussion of taxes and taxation principles is contained in Chapter 5. Different instruments apply to the same people and entities. Changes in the tax system may redistribute the burden but will still be constrained by taxpayers’ ability to pay and the opportunities they have to shift taxable activity (like labour or investment) to locations with lower tax burden. The criteria we

use here are drawn from previous papers¹³⁰ and are commonly used as the basis for assessing funding mechanisms. They are grouped under four headings:

- ✦ appropriateness for local government use, covering issues of accountability, autonomy, consistency with central government objectives, and nationwide applicability
- ✦ efficiency, covering issues of behavioural incentive effects and resource allocation, administration costs, and compliance costs
- ✦ equity, covering issues of horizontal equity, vertical equity, and intergenerational equity
- ✦ sustainability, covering issues of revenue potential and predictability over time.

Assessment of the options

11.11 Table 11-1 provides a summary of the assessment of different taxes against these criteria undertaken for the Panel by NZIER. In the section that follows the Panel comments on the different options and draws its own conclusions.

11.12 Taxes with broad bases such as property, income, and goods and services taxes have some inherent advantages over more narrowly defined taxes because they spread the source of tax, limit distortions, and achieve efficiencies in administration. In New Zealand central government commands the broad-based taxes on income and on goods and services, with local government having access to property taxes.

Property taxes (rates)

11.13 Rates are the only form of property tax in New Zealand. The characteristics of rates are described in detail in Chapter 5. In brief, rates as taxes are

- ✦ highly visible, which improves council accountability but may exacerbate ratepayer dissatisfaction
- ✦ minimally distorting because of the relative immobility of the tax base
- ✦ relatively buoyant in the long term to the extent that property value increases in line with income from property
- ✦ difficult to evade and have high collection rates and low collection costs
- ✦ relatively inelastic in yield in the short term because the tax base does not increase regularly over time
- ✦ a very autonomous source of funding for local government.

11.14 In New Zealand property taxes (rates) form some 6% of New Zealand's total tax take and need to be considered in the context of the overall tax system. Local property taxes complement the other tax bases used by central government. Care is needed to ensure that the generally regressive impacts of rates are well understood and compensated for elsewhere in the tax or welfare systems.

11.15 In terms of economic impact, it can be noted that rates currently account for around 2.16% of the Consumers Price Index (CPI) calculation. Although, in theory, rate increases should be discounted by any service quality improvements in calculating CPI movements, in practice this has not proved possible to do. In principle rates also have a relatively low "deadweight" cost compared

130 The Local Authority Funding Project; Clough, Peter and Patrick Nolan, *Alternatives to Rates: Review of Revenue Mechanisms to Supplement Local Authority Rates*, NZIER, Wellington, 2007.

Table 11-1 Different taxes assessed against criteria of appropriateness, efficiency, equity, and sustainability

	Appropriateness			Efficiency			Equity		Sustainability			
	Accountability	Local autonomy	Consistency with central government objectives	Nationwide application	Allocative incentives	Administrative costs	Compliance costs	Horizontal	Vertical	Inter-generational	Revenue potential	Predictability
Local property tax	High visibility attracts public scrutiny	High in setting rates and choosing base (LV, VC, AR, UAC etc)	Complements central govt tax bases	Yes - but variable impacts due to different bases	Low distortion	Low cost, high effective recovery	Low cost	Equal treatment of similar entities, in absence of differentials, targeted rates etc	Proportional but not progressive; UAC can be regressive	Some cost shifting between early payers and later beneficiaries	Buoyant (elastic) in long term but inelastic in short term	Predictable in aggregate - potentially volatile for individual ratepayers
Citizens or poll tax	High visibility attracts scrutiny	High if rate set locally		Could be	Highly distorting at border with different rates	High due to tracking problem	Low	High - equal payment per head	Not progressive at all	n.a.	Buoyant	Variable due to unforeseen relocations
Payroll tax	Low visibility in PAYE; source not residency based	High unless rate set or restrained by central govt	Possible conflict in tapping the same base	Could be	Some incentive for capital/labour substitution	Low marginal cost on PAYE	Low if returns based in situ	High - like treatment of like earners	Usually flat rate with no progressivity	n.a.	Buoyant	Predictable, but time lag between expectation and realisation
Local income tax	Low visibility if attached to PAYE; but higher than payroll tax if based on residency	High unless rate set or restrained by central govt	Possible conflict in tapping the same base	Could be	Broad base, but disincentive for work	Low marginal cost on PAYE; moderate on enforcement against evasion	Low to moderate if corporates need to "localise" their PAYE returns	High - like treatment of like earners in locality	Progressivity possible	n.a.	Buoyant	Predictable, but time lag between expectation and realisation
Local consumption tax	Low visibility and weak link to LG expenditures	High unless rate set or restrained by central govt	Possible conflict in tapping the same base	Could be	Potential for border hopping with different local rates	Low marginal cost on GST return etc	Low marginal cost on GST return etc	High - broad base like treatment of all sales	Regressive on basic goods	n.a.	Buoyant	Predictable

Table 11-1
continued

	Appropriateness			Efficiency			Equity			Sustainability		
	Accountability	Local autonomy	Consistency with central government objectives	Nationwide application	Allocative incentives	Administrative costs	Compliance costs	Horizontal	Vertical	Inter-generational	Revenue potential	Predictability
Industry & commodity taxes <i>Tourist bed tax</i>	High visibility attracts scrutiny	High if rate set locally	Unlikely to seriously conflict with CG	Yes but not equally useful in all districts	Narrowly based but not distorting at low rate	High due to new return system	High due to new return system	Equal treatment of large lodgings; small may not be cost effective to include	Neutral	n.a.	Buoyant with tourism industry fortunes	Predictability vulnerable to bad weather, exchange rates etc.
Local petrol taxes	High visibility attracts scrutiny	High if rate set locally	Possible conflict with wider road pricing policy	Yes	Narrowly based; highly distorting at the border; cost shifting by multi-region suppliers	Low marginal cost on LAPT returns	Low marginal cost on LAPT returns	Variable treatment according to border proximity; prone to tax exporting	Neutral - vaguely progressive against gas guzzlers	n.a.	Buoyant with general income and travel demand	Predictability subject to general income and industry response
Green taxes Waste taxes	High visibility attracts scrutiny	High if rate set locally	Unlikely to seriously conflict with CG	Yes - for districts with taxable waste facilities	Narrowly based and intentionally distorting	High due to new return system required	High due to new return system required	Equal treatment of facilities	Neutral	Current facility operators face falling returns or stranded assets	Revenue declines with falling waste volume	Dependent on price response in waste disposal

Table 11-1 continued

	Appropriateness		Efficiency			Equity		Sustainability				
	Accountability	Local autonomy	Consistency with central government objectives	Nationwide application	Allocative incentives	Administrative costs	Compliance costs	Horizontal	Vertical	Inter-generational	Revenue potential	Predictability
Road/congestion taxes												
Congestion charge	High visibility attracts scrutiny	High if rate set locally	Possible conflict with wider road pricing policy	Yes but only feasible in some cities	Narrowly based and intentionally distorting	High due to new monitoring & return system required	High due to new return system required	Equal treatment of drivers; rights shift for properties in zone	Regressive for those on low incomes and with no substitutes	n.a.	Buoyant with general income and travel demand	Predictability subject to driver price response
Infrastructure tolls (Norwegian model)	High visibility attracts scrutiny	High if rate set locally	Possible conflict with wider transport policy	Yes but only feasible in some cities	Narrowly based but low rate	High due to new monitoring & return system required	High due to new return system required	Equal treatment of drivers crossing cordon	Regressive for those on low incomes and with no substitutes	Current drivers pay more to accelerate new infrastructure	Buoyant with general income and travel demand	Predictability subject to driver price response
24/7 road charging	High visibility attracts scrutiny	High if rate set locally, but probably nationally set	Possible conflict with wider transport policy	Yes and ultimately applied nationwide	Broad base so all drivers face full costs of road use	High due to new monitoring & return system required	High due to new return system required	Equal treatment of all drivers	Regressive for those on low incomes and with no substitutes	n.a.	Buoyant with general income and travel demand	Predictability subject to driver price response
Revenue sharing	Low visibility	Low as rate probably set by central govt	No conflict as central govt controls revenue	Yes	Broad tax bases so low distortion	Low once CG & LG reach agreement	Low	Redistribution across districts likely	May be progressive through variable assistance rates to localities	n.a.	Buoyant	Predictability subject to CG/LG agreement

with other taxes. Deadweight cost measures the extent to which taxes distort the incentives across the economy to work, save, and invest.¹³¹

Citizens or poll tax

11.16 A citizens or poll tax is a fixed charge per resident over a certain age rate. This was 18 years of age in the case of the 1990 British poll tax. Citizen taxes are often advocated because they address the criticism that not all residents pay rates and therefore do not contribute to the cost of local government services. They are, however, regressive in that their impact falls more heavily on those with lower incomes.

11.17 This form of tax can support local autonomy and if set locally, would promote local accountability. A citizens tax at a standard rate and set centrally would be more efficient than a variable and locally set tax, but this approach would reduce local autonomy and accountability.

11.18 The compliance and administration costs would be high because of the difficulties in keeping track of people and ensuring that the tax was paid.

11.19 The inherent problems with citizens/poll taxes led to the quick demise of the poll tax or “community services charge” introduced in Britain in 1990.¹³²

11.20 Based on national rates revenue of \$2.779 million, a poll tax of \$690 per head of population would be needed to replace rates as a source of revenue.¹³³ A poll tax at \$70 a head would contribute about 10% of national rates revenue.

11.21 The Panel does not advocate the use of citizen taxes as source of local government revenue.

Payroll tax

11.22 A payroll tax is levied on the number of employees of a business in a district. Unlike income tax, which covers all forms of income, a payroll tax is paid only on wages and salaries – at a percentage amount on payrolls.

11.23 Payroll taxes can piggyback on existing PAYE systems and hence have low administrative and compliance costs. A payroll tax would be buoyant in times of economic growth when employment tends to increase, but revenue would tend to drop if economic activity declines. Thus the impacts of the economic cycle would more directly affect local government revenue.

11.24 Payroll taxes increase the cost of hiring labour and create an incentive to employ more capital and less labour. Labour-intensive industries such as retailing and hospitality would face a higher burden than capital-intensive industries such as manufacturing.

11.25 A payroll tax based on territorial authorities would create an incentive for industries to relocate where the tax was lower. A regional, or particularly a national, payroll tax would mitigate this effect but would require some mechanism for redistribution and would significantly reduce local autonomy.

11.26 A particular variant of a local payroll tax is the “Versement Transport”, which is the principal source of funding for local public transport in France. This instrument is discussed in the McKinlay

131 Clough, Peter and Patrick Nolan, *Alternatives to Rates: Review of Revenue Mechanisms to Supplement Local Authority Rates*, NZIER, Wellington, 2007.

132 The community services charge (or poll tax) was introduced in April 1990 to replace general rates and was replaced itself, in 1993, by the Council Tax.

133 NZIER report on alternatives to rates, Appendix B, p. 41.

Douglas report¹³⁴ and is supported, as a regional payroll tax.¹³⁵ It was not considered in the work undertaken for the Local Authority Funding Project.

11.27 This is a tax on all employers with nine or more employees, at a rate between 1% and 2.5%. The rationale for the levy is that it is journeys to or from work that create the major demands for public transport expenditures, especially during peak periods.

11.28 The tax is apparently regarded as useful in France where there are extensive public transport services. It has been argued that such a payroll tax would support the Government objective of increasing productivity by changing the relative price of labour and encouraging capital substitution; and that by linking the revenues to public transport demand it justifies imposition of the tax on a narrow base.

11.29 NZIER¹³⁶ argues that neither of these arguments is compelling: “Applying a selective tax to encourage capital substitution is a convoluted way of raising productivity, and public transport expenditures would be better funded by instruments that are more closely related to peak traffic flows (e.g. road charges).”

11.30 The Panel agrees with this conclusion and does not support the introduction of either a more general payroll tax or the “versement” variation.

Local income tax

11.31 Local personal income taxes are used in a number of countries, usually as a surtax “piggybacking” on the national income tax. In this model the tax is set and administered locally, collected centrally, and then distributed to local authorities. It may apply only to income tax paid by individuals rather than businesses, given that some authorities’ areas contain many more businesses than others and it can be difficult to fairly distribute the tax paid by businesses with multiple locations. If set centrally, the tax becomes a form of general revenue sharing by local government, not a local tax, and would reduce local autonomy. The option of general revenue sharing is discussed separately below.

11.32 An alternative approach would have the income tax set and administered locally. The administrative costs for individual territorial authorities would be prohibitively high, but a regionally set and administered tax may have lower administrative costs.

11.33 A local income tax would have the buoyancy and revenue base associated with national income tax. This revenue base would be wider than a payroll tax because it includes income on interest, dividends, and rent. However, issues of avoidance and evasion associated with national income tax would apply. Work by NZIER suggests it would also have significantly higher deadweight costs than rates and might reduce economic activity by around \$500 million per year if used as a total replacement for rates.

11.34 Income taxes are progressive with people on higher incomes paying higher taxes, reflecting ability to pay.

11.35 Replacing rates by a local income tax would require an increase in total income tax receipts of 9% or 13% of personal income tax receipts. To achieve a 10% rise in local authority revenue, a 1% rise in income tax would be necessary.

134 McKinlay, P. *Local Government Funding: A Report Prepared for Local Government New Zealand and a Consortium of Councils*, McKinlay Douglas Limited, Tauranga, 2006 (available at http://www.mdl.co.nz/library/lib_gov_rating_inquiry.htm).

135 Submission S541 from a group of local authorities and stakeholder interests.

136 NZIER report on alternatives to rates, p. 23.

11.36 The Panel does not support a local income tax.

Local consumption tax

11.37 The most common forms of consumption tax are the straight sales tax (without reclaim of tax on inputs) and the value added tax or VAT (which enables reclaim of VAT on inputs). New Zealand's GST, which is a broad-based tax on the consumption of goods and services, is an example of VAT.

11.38 A local GST could be set and administered locally with individual transactions becoming liable for the tax based on the location where the good or service was purchased. This approach is likely to have very high administrative and compliance costs; less so if a regional approach were taken. It could also lead to "trade distortions" across the boundary of different territorial authorities or regions. A local GST coupled to the national GST would require little additional administration.

11.39 NZIER advised that replacing rates with GST would require an increase in GST receipts of 26%. Assuming no reduction in spending this would be the equivalent to raising the rate from 12.5% to 15.75%. However, using assumptions about elasticity of demand it could require an increase to around 17%. To achieve a 10% increase in local authority revenue, an increase in GST of 1% would be needed.

11.40 NZIER work also suggests that the deadweight costs of replacing rates with an equivalent amount of GST would be a reduction in economic activity of around \$390 million per year.

11.41 The Panel does not support a local GST.

General revenue sharing

11.42 Another possible source of additional funding for local authorities would be for central government to allocate a share of its existing taxes to individual local authorities on a formula basis, to be used as part of the council's general revenue and used for purposes determined by it. The Panel received a number of suggestions that a share of GST or other taxes should be allocated to local government. This would mean central government either increasing the rates of the nominated source of tax or reducing its expenditures in other areas.

11.43 The Porirua Steering Group,¹³⁷ for instance, advocated the introduction of general revenue sharing as a defined proportion of income tax or GST. It argued that general revenue sharing would reflect the shift in the role of local government from its traditional focus on providing services to property to the much wider role that it currently has in promoting the social, economic, cultural, and environmental well-being of communities.

11.44 General revenue sharing is applied in Australia where states receive, by way of financial assistance grants, a share of the federal GST tax pool, for transfer to local government. Local authorities are then allocated these funds through formulae applied by a grants commission established by each state. The funding is generally intended to assist local authorities provide a level of services not lower than the average for the state. The formulae attempt to take account of relative costs of providing an equivalent level of services, after allowing for such factors as differing costs and local revenue capacities.

11.45 A number of submissions suggested allowing GST on rates, which amounted to around \$400 million in 2005/06, to be kept by local authorities for their own use. This would amount to a form of general revenue sharing in proportion to the amount of rates levied.

137 Submission from Porirua Steering Group [S225].

Table 11-2 Potential revenues from a regional petrol tax

	Rate/litre	Annual revenue	Debt capacity	% local revenues
		\$ million	\$ million	
Auckland	\$0.10	120	1,500	2.4%
Wellington	\$0.10	35	430	0.7%

Source: NZIER.

11.46 The major disadvantage of general revenue sharing is its conflict with the principle of local accountability; that is, that local authorities should as far as possible be accountable for the taxes or charges they levy. For this reason the Panel does not support general revenue sharing, but the Australian objective of using revenue sharing to improve “horizontal equity” within local government is discussed later in this chapter in terms of the proposed “infrastructure equalisation fund”.

Industry- and commodity-specific taxes

11.47 Industry and commodity taxes are narrowly based taxes levied on particular products and services. Examples at the national level are the excise duty on alcohol and the local authority petroleum tax (LAPT). A “bed tax” is an example that could be applied locally.

11.48 The contribution of these taxes to local government autonomy depends on whether they are set locally or nationally and whether they are used for specific purposes or as sources of general revenue.

11.49 Taxing specific commodities or industries for general revenue purposes can be inefficient because such taxes can distort the pattern of production and consumption. Taxing specific commodities or industries can, however, be efficient when the objective is to address externalities.

11.50 The amount of revenue generated by any industry or commodity tax would depend on a number of factors including the size of the industry, the amount of the tax, and the elasticity of demand for the commodity. These taxes tend to generate only moderate amounts of revenue if set at a low rate.

11.51 Two commodity taxes have the potential to contribute to two specific issues that create problems for local authority funding. These are petroleum and tourist accommodation taxes, which can relate to transport and tourist-related expenditures. These possibilities are discussed separately in the sections below.

Regional and local petroleum taxes

11.52 In Budget 2007 the Government announced it was granting powers to local or regional authorities to levy a regional petroleum tax to raise revenue for specific roading and other capital transport projects that might not otherwise be funded within the timetable wanted by the region. The maximum rate would be 10 cents per litre. The regional council or other body representing the region would need to approach the Government to gain approval for such a tax for specific new capital projects. The proposals need to come from a body representing the region (assumed to be, but not necessarily, regional councils) but would be put together with the involvement of territorial authorities.

11.53 An illustration of the revenues such a tax at maximum rate is expected to generate in Auckland and Wellington is presented in Table 11-2. This shows the potential annual revenues, the level of debt that such revenues could support, and the share of those revenues in total local government revenues across the country. Although the data is from only two regions, the yield appears relatively high compared with other possible new instruments.

11.54 The extent to which this new tax will be applied within regions is still to be established. It is likely to be more relevant to the large metropolitan centres such as Auckland and Wellington facing major investment in urban transport projects than the provincial regions where the costs of maintaining and improving extensive rural roading networks is a key issue. The Government has also announced its intention to permanently direct all revenue generated from fuel excise duty to the National Land Transport Fund for land transport expenditure, including public transport.

11.55 Territorial authorities have had access since 1971 to a local petrol tax in the form of the Local Authority Petroleum Tax (LAPT) at the rate of 0.66 cents per litre petrol and 0.33 cents per litre of diesel. LAPT funds are currently collected within district tax areas and distributed to councils in proportion to their previous year's rates revenue. LAPT funds do not pass through the National Land Transport Fund. The LAPT has remained at the same rate since its introduction in February 1971 and currently yields around \$30 million a year.

11.56 NZIER advised the Panel that an LAPT with the same purchasing power today as it had in 1971 would be 7.6 cents per litre, and its revenue yield if applied to both petrol and diesel would be \$492 million. This would raise its contribution to local authority revenues from about 1% at present to about 10%.

11.57 The Panel does not suggest that the LAPT should be raised by this amount. To do so would have a significant effect on petrol prices and on other revenues collected from the fuel taxes. However, the Panel sees an increase of 2 cents per litre, which would yield around \$90 million per year as a useful source of new funding for local authorities, consistent with greater user charging for roads. Although councils should continue to be free to use this money for general purposes, the Panel notes that it would enable councils to reduce the amount of road funding presently provided from rates.

Recommendation

34 That the current Local Authority Petroleum Tax (LAPT) be increased by 2 cents a litre on petrol with a commensurate increase on diesel, to be distributed to councils for general purposes based on a revised formula that incorporates equalisation principles.

Visitor bed tax

11.58 A visitor bed tax is an option to help meet the costs of council services such as drinking water, waste-water treatment, and waste disposal associated with high (and often seasonally high) number of visitors, which are discussed in Chapter 8 (drivers of expenditure). Such taxes were supported in several submissions from councils and individuals but strongly opposed in submissions from the tourism and accommodation industry, and also opposed by Local Government New Zealand. A visitor bed tax could be levied as a uniform tax per person night or as a percentage of the room charge. It could either be levied by central government and distributed to councils on some formula basis or be levied locally at the discretion of individual councils. In either case a decision is needed on the tax base (for example, whether to include camping grounds, bed and breakfast establishments, and so on).

Table 11-3 Gross annual revenues from percentage visitor bed tax at different tax levels

	Spending \$ million	Per head 1% \$ million	Per head 3% \$ million	Per head 5% \$ million	Per head 8% \$ million
Total accommodation spending	1,546	15.5	46.4	77.3	123.7
Share of local government funding		0.3%	0.9%	1.5%	2.5%

Source: NZIER.

Table 11-4 Projected revenues from an international visitor tax

Year ended June 2007	Number millions	Per head \$10.00 \$ million	Per head \$25.00 \$ million
Short-term overseas visitor departures	2.453	24.5	61.3
Share of local government operating revenue (2007 estimate)		0.4%	1.0%

Source: Statistics New Zealand, External Migration June 2007. Local Authority Funding Project data.

11.59 An illustration of the revenues possible from this source is provided in Table 11-3.

11.60 The Local Authority Funding Project report in December 2006 suggested that, at current visitor levels, a centrally collected visitor bed tax of \$1 per person night could yield over \$30 million a year. Distribution of revenue in proportion to bed nights would see 12% allocated to Auckland City, 10% in Christchurch City, 9% in Queenstown-Lakes District, 6% each in Wellington City and Rotorua District, 4% in Far North District, and no more than 2% in any other district.

11.61 The Panel considers that the distribution of funds from a visitor bed tax would be complicated because there are efficiency and equity considerations. It recognises that in 2002 the Government rejected a proposal from the parliamentary select committee on the Local Government (Rating) Act 2002 to allow for such a tax, apparently on the grounds that such a tax was too “industry specific” and might create a threat to the tourist industry.

11.62 The Panel notes that there are already options for councils to assist in meeting the additional costs imposed by visitors. These include targeted rates on the business or tourism sector. For example, Marlborough District Council levies a targeted rate on hotels and motels, and Queenstown-Lakes District Council levies a separate rate on commercial properties, most of which service the tourist industry.

11.63 The Panel does not support the use of a visitor bed tax.

International visitor environmental levy

11.64 Departure taxes are commonly levied at airports to collect revenues to fund improvements in airport facilities. They are also sometimes used to collect revenues for wider use on tourism developments. A few submissions supported taxing foreign visitors on arrival in or departure from New Zealand and using the revenues for tourism-related expenditures. Auckland Regional Council, for example,¹³⁸ stated that all seven Auckland territorial authorities and the regional council supported the use of a departure tax, which would apply to international visitors.

138 Submission from Auckland Regional Council [S580], p. 13.

11.65 With around 2.4 million international visitors each year, expected to increase to three million by 2010, an international visitor levy has potential to raise substantial volumes of revenue, as illustrated in Table 11-4.

11.66 A levy at \$25 or even \$10 per head could raise an appreciable sum to assist in meeting environmental costs imposed by international visitors. As indicated in Table 11-4, a \$25 levy would raise around \$108 million per year and a \$10 levy some \$43 million. A hypothecation and distribution system for the tax would need to be established.

11.67 Maintaining high environmental standards is an important influence on visitor experience, and an international visitor tax would recognise their environmental impact. The funds from the levy could be channelled to local authorities through the Tourism Demand Subsidy Scheme administered by the Ministry of Tourism. This scheme was established in 2004 to assist small communities fund water and waste-water infrastructure to sustain tourism.

11.68 This form of tax is usually levied as a flat rate “departure tax” and charged at the time of departure. The Panel considers an alternative approach is to see it as a “visitors tax” that would be incorporated into the visitor’s ticket price. The Panel recommends the further consideration of this funding option.

Recommendation

35 That consideration be given to a “international visitors environmental levy” on overseas visitors as an option for funding local authority environmental costs associated with high levels of visitors. Further, that this funding be paid into the Tourism Demand Subsidy Scheme, which should in due course be subsumed into the proposed Infrastructure Equalisation Fund.

Environmental or “eco” taxes

11.69 These taxes are directed at changing behaviour so as to improve the environment. Although they clearly also raise revenue, if they successfully change behaviour this may result in less revenue being collected.

11.70 Various forms of environmental or eco-taxes have been suggested. The efficiency of each depends on the breadth of the base being taxed, the ease of levying a tax on the particular activity, the ability to set a rate that reflects the environmental damage or concern, and the ease with which those affected can change to less environmentally damaging activities. Such taxes are more readily applied when there is a uniform adverse impact, in which case the tax is most appropriately levied at a uniform rate across the country by central government. To be efficient, local eco-taxes should reflect local externalities, but they may result in variation across districts and provide incentives for “border hopping”. The recommended increase in the LAPT petrol tax can be seen as having elements of an environmental tax.

11.71 The 2001 tax review¹³⁹ considered environmental taxes would be appropriate at a national level only if several conditions were met, but may have more promise at a local level. This reflected the reasonable assumption that the externalities associated with activities were local rather than national, and “national” environmental taxes would tend to be inefficient because they would assume that externalities everywhere are the same. This would be true for greenhouse gas emissions but not for most other pollution. However, the institutional arrangements for such taxes have yet to be established nationally.

139 Tax Review 2001, Final Report, October 2001, The Treasury, Wellington, Chapter 4, page 47

Table 11-5 Revenue from a waste levy

	Tonnes/year millions	Per tonne \$10.00 \$ million	Per tonne \$20.00 \$ million	Per tonne \$30.00 \$ million
Gross waste tax revenues	3.2	32.0	64.0	96.0
Share of local government funding		0.6%	1.3%	1.9%

Source: NZIER.

Waste tax

11.72 A waste tax is one example of an environmental tax that could be used at a local level to support waste minimisation and management activities. A proposal for a waste tax to be collected at landfills and transfer stations is in the Waste Minimisation (Solids) Bill, currently being considered by the Local Government and Environment Committee, and due for report back on 31 October 2007.¹⁴⁰

11.73 Table 11-5 indicates the revenue stream that a waste levy could produce at different level per tonne of waste.

Other road user charges

11.74 Another variant of environmental taxation is other road user charges, which may have a mix of objectives including reducing congestion by changing user behaviour, reducing emissions, and raising revenue.

11.75 A congestion charge is a toll primarily intended to curb traffic and encourage people to switch to other modes of transport during peak period but will also generate revenues that can be tied to transport improvements. A congestion charge has been used successfully in London.

11.76 Congestion charges were considered in the Auckland Road Pricing Evaluation Study.¹⁴¹ Five schemes with varying results on revenue raised and congestion reduced were considered. Two of these were "cordon" schemes, under which lines are drawn around the city and a charge levied on vehicles that cross the lines. Others were a flat charge on a defined area associated with high levels of congestion, a scheme where charges apply at specific points of congestion, and a parking charge where a fixed rate would be charged for any vehicle parked in a designated parking zone.

11.77 Congestion charging schemes have high implementation costs and there are inherent problems in introducing them into a large widely dispersed city like Auckland with its limited public transport infrastructure. Congestion charges also tend to be regressive.

11.78 Standard road tolls, which are charges to recover cost of a new road, are direct user charges and also aimed at revenue raising as well as demand management. The Land Transport Management Act 2003 provides the statutory basis for the use of toll roads in New Zealand.

11.79 Road charging on a real time basis (24/7 road charging) involves electronic monitoring of all vehicles, probably via a satellite, so that they can be charged precisely for the use they make of roads. Charging can be varied by location and by time of day. The technical feasibility of such schemes means that their use in New Zealand may be an option for the future. However, there are important privacy implications to be addressed.

¹⁴⁰ www.parliament.nz, Select Committee details, Local Government and Environment Select Committee, June 2007.

¹⁴¹ *Tackling Congestion in Auckland, Auckland Road Pricing Evaluation Study*, Ministry of Transport, March 2006.

11.80 Environmental taxes offer potential both as instruments for revenue gathering and for achieving environmental objectives. The Panel supports further consideration of the use of this form of tax.

11.81 Chapter 10 recommends the general use of user charges for water supply, and waste water and solid waste collection and disposal. These can be regarded as a form of environmental taxation, designed to reduce the environmental impact of water and solid waste disposal and in all three cases reduce demands so the infrastructure spending can also be reduced.

Meeting water infrastructure funding needs: an Infrastructure Equalisation Fund

11.82 Chapter 8 considers the extent to which capital expenditure on water supply and waste water is impacting on local government, and discussion underlines the significant investment that is yet to be made on the three waters – drinking water, waste water, and stormwater. Chapter 10 suggests there are strong reasons for central government to provide additional funding for construction and maintenance of these three important water infrastructures. This is based on the principle that much of this expenditure is incurred to meet national standards and has national benefits. In addition, some councils or communities have inadequate financial capacity to meet these expenditures, reflecting the diversity in local government – in population size and composition, income levels and rateable base, different cost levels in different geographical areas, and the different condition of water infrastructure reflecting past expenditure patterns. Chapter 10 also notes the heavy bias towards transport expenditures in the existing pattern of transfers from local government. It considers that the present land transport funding arrangements work well, reflecting a partnership between central and local government that could be replicated for water infrastructure. It notes that equalisation principles apply in the funding of roads, with the distribution formula taking account of differences between councils in cost levels and rateable base.

11.83 Equity in the provision of water infrastructure services has already been recognised as an issue. The Sanitary Works Subsidy Scheme introduced in July 2003 recognises the problems that some communities have in addressing a specific infrastructure need. Eligibility for this scheme includes the level of social deprivation. Likewise the Drinking Water Assistance Programme is focused on small communities with limited resources. These schemes, along with the Tourism Demand Subsidy Scheme, should be subsumed into the new arrangements discussed below.

11.84 The funding available under each of these schemes is relatively small and is already largely committed. Although the costs involved in upgrading water infrastructure are not fully known, the LTCCPs indicate total capital expenditures of nearly \$9 billion up to 2016. This will be beyond the financial capacity of many councils. For example, Local Government New Zealand now estimates the cost to local authorities of meeting the proposed new drinking water standards as being some \$950 million, although this figure appears to be disputed by the Ministry of Health.

11.85 To address these issues, the Panel recommends the establishment of a contestable “Infrastructure Equalisation Fund” (IEF). The main purpose of the fund would be to support targeted councils or communities to develop and maintain adequate standards of water infrastructure.

11.86 The establishment of the IEF would recognise the partnership that exists between central and local government as well as the national interest in ensuring that all councils can maintain an adequate level of water infrastructure that is broadly the same for all New Zealanders. What is considered “adequate” would be established in the funding rules of the IEF, which would cover such matters as the eligibility for funding support, the proportion of funding support (which would vary with different circumstances), the terms and duration of any funding, the balance between funding of capital and operating expenses, and the accountability expected for such funding. An appropriate

basis for equalisation would need to be worked out. Considerable work would be required in the design of the IEF and this should be done with full consultation with local government.

11.87 The Panel suggests that the functions proposed would be best suited to a Crown entity form, with a board able to decide on funding applications against criteria agreed between central and local government. It is desirable that there be an arms-length relationship between Ministers and those making financial decisions so that there is confidence in the processes being used. The Panel can see clear advantages in a small agency with limited staff numbers, but with a focus on being able to interact with local government at a senior level. The Department of Internal Affairs would seem to be the logical administering department.

11.88 The IEF would clearly be a new institution but it would absorb some existing funding mechanisms that sit comfortably with its purpose, such as the Sanitary Works Subsidy Scheme, the Drinking Water Assistance Programme, and the Tourism Demand Subsidy Scheme. Although the Panel considers the funding of water services infrastructure to be a core role for the IEF, a wider role, consistent with the equalisation principle, may be justified for some other activities that have clear national benefits such as improvements in air quality to meet national standards. The separate funding arrangements for roading and other transport infrastructure are already well established, as discussed elsewhere in this report, and would remain.

11.89 The IEF would require a dedicated and buoyant source of funding. The use of a hypothecated share of the GST take is the Panel's preferred funding source. It is difficult to determine the likely annual funding requirements, but the Panel considers they could be in the range of \$100 million per year, equivalent to less than 1% of GST.

Recommendation

- 36 That a contestable Infrastructure Equalisation Fund (IEF) be established, funded by a share of GST, to provide financial assistance to councils and communities in the development and maintenance of the "three waters" infrastructure – water supply, waste water, and stormwater.**