Income and Wealth Redistribution

SHOULD IT BE A ROLE OF LOCAL GOVERNMENT?

LOCAL GOVERNMENT
FORUM

The Local Government Forum comprises organisations that have a vital interest in the activities of local government. Its members include Business New Zealand, Electricity Networks Association, Federated Farmers of New Zealand, New Zealand Business Roundtable, New Zealand Chambers of Commerce and New Zealand Retailers' Association. The Forum was established in 1994 to promote greater efficiency in local government and to contribute to debate on policy issues affecting it.

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OVERVIEW

> [L]ocal government should recognise that it is inherently involved in income redistribution, along with central government.[1]

> The term "distributive justice" is not a neutral one. … [W]e are not in the position of children who have been given portions of pie by someone who now makes last minute adjustments to rectify careless cutting. There is no central distribution, no person or group entitled to control all the resources, jointly deciding how they are to be doled out. What each person gets, he gets from others who give to him in exchange for something, or as a gift. In a free society, diverse persons control different resources, and new holdings arise out of the voluntary exchanges and actions of persons. There is no more a distributing or distribution of shares than there is a distributing of mates in a society in which persons choose whom they shall marry. The total result is the product of many individual decisions which the different individuals involved are entitled to make.[2]

Almost all actions taken by government affect the distribution of income and wealth among individuals. This is illustrated below in relation to local government:

- A council may provide goods and services that benefit one group of citizens but are funded (in whole or in part) by another group. Subsidised housing for the elderly is an example.
- A council may expand its activities and employ additional personnel whose incomes may increase. Some existing staff may also benefit through higher pay for increased responsibilities. On the other hand, current or future ratepayers who are required to fund such activities may face lower incomes and less wealth than otherwise.
- A council may buy goods and services from a new supplier. The incomes of the new supplier and its staff will tend to increase while those of the former supplier and its staff will tend to decline. Similarly, a council may contract for the supply of goods and services. This may boost the income of successful contractors and their staff while diminishing that of council employees.
- A council may remit rates, for instance on grounds of hardship.
- A council may introduce a new regulation or amend an existing regulation. This may increase the income and wealth of individuals who benefit while decreasing those of individuals who are adversely affected. A council might, for example, confer a wealth

1 Shand, David, Horsley, Graeme and Cheyne, Christine (2007), *Funding Local Government: Report of the Local Government Rates Inquiry*, Department of Internal Affairs, Wellington, p 3. This report is referred to below as the Shand Inquiry.

2 Nozick, Robert (1974), *Anarchy, State, and Utopia*, Basic Books, New York, pp 149–150.

gain on existing owners of urban land by not allowing the supply of land available for development to increase commensurately with an increase in demand.

Many distributional effects that arise from government decisions are incidental to the undertaking of its two main functions of maintaining order and facilitating the provision of public goods and services.[3] Others may arise because it is inappropriate or infeasible to charge users directly for public goods and services. Certain distributional effects of council activities reflect the normal operation of markets. Firms, for instance, are not generally compensated if they lose business to their competitors. Some distributional effects may be small and of little significance from a public policy perspective.

Some government programmes are, however, unambiguously designed to provide money, goods or services to individuals or firms that give nothing in exchange. Similarly, some taxing arrangements are designed to impose a disproportionate burden on particular individuals, groups or firms. Regulatory policies may also be primarily intended to confer benefits on individuals, groups or firms that do not provide anything in return. The explicit purpose of those programmes, taxes and regulations is to redistribute income and wealth among citizens and taxpayers.[4] This report focuses on policies at the local government level that explicitly aim to redistribute income and wealth.

As the Shand Inquiry observed, both central and local government undertake programmes and impose taxes that are explicitly aimed at redistributing income and wealth.[5] Central government, however, has prime responsibility for income and wealth redistribution in New Zealand. Its policy initiatives include large income transfer programmes, spending on health, education and housing, and progressive income taxes.

Local government has traditionally played a minor role in explicit income and wealth redistribution. Most of its redistributive programmes, such as housing for the elderly, are, or were previously, subsidised by central government. Similarly, explicit redistribution of income and wealth via differential rates was prohibited until 1969 for counties (rural areas) and until 1975 for boroughs and cities (urban areas).

According to the Local Government Act 2002 (LGA 2002), one purpose of councils is to advance the social well-being of their communities. Council spending on social activities may involve explicit income and wealth redistribution. Such spending is small relative to that on roading, the 'three waters' (potable water, waste water and storm water) and refuse collection and disposal. Collectively, the LGA 2002, central government and social trends appear to have encouraged some councils to extend their social activities.

The issue of whether explicit income and wealth redistribution should be a role of local government is the question addressed in this report.

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3 The role of government is discussed in section 3.1 of Local Government Forum (2007), *Democracy and Performance: A Manifesto for Local Government*, Christchurch.

4 An unanticipated increase in the level of rates imposed on one category of ratepayers could be expected to reduce the affected ratepayers' incomes in the first instance. The increase could also be expected to reduce the market value of the affected properties. Both income and wealth are likely to be affected. Over time, the initial incidence of the increase in rates may be shifted.

5 Shand, Horsley and Cheyne (2007), *op cit*, pp 3, 124 and 184.

While the redistribution of income and wealth may help some people, the only way to raise average material living standards over time is through income growth. The top priority, therefore, should be to boost national output and incomes. Any distributional concerns that arise should then be addressed.

There are good reasons why local government should not engage in explicit income redistribution, apart from the delivery of central government programmes and remission of rates and charges on hardship grounds. They include the following:

- Aside from matters relating to procedural fairness, local authorities are generally poorly placed to judge equity issues on an informed and objective basis.
- Redistribution by individual councils may not advance the overall redistribution goals of the government.
- Council redistributive programmes may impose costs on ratepayers that would otherwise fall on taxpayers.
- Councils generally lack expertise in the area of income and wealth distribution, and it is unlikely to be efficient for councils to acquire the information and skilled resources that would be required.

The balance of this report is presented in three sections. The next section (section 2) examines social services provided by local government. The purpose of local government and the social activities of councils are noted.

Explicit income and wealth redistribution is examined in section 3. The role of the government, what constitutes social goals and the advancement of social goals are discussed. The redistributive policies of councils are summarised. The question of whether explicit redistribution is an appropriate role for local government is addressed. Rates rebate scheme changes are also discussed.

The conclusions are presented in section 4.

2
SOCIAL SERVICES

2.1 The purpose of local government

The Labour government led by prime minister David Lange announced a review of local government in 1987. A 1988 officials' discussion paper suggested that the key role for local government should be to provide public goods that could not be more efficiently supplied by firms, voluntary arrangements or central government. Officials acknowledged that local government engaged in the delivery of certain social services, often on behalf of central government, particularly in relation to housing and community development. They proposed that the explicit redistribution of income and wealth should remain the responsibility of central government.[6]

The local government sector strenuously opposed the role of local government suggested by officials. Their concerns focused on the restriction of local government to the provision of public goods rather than the issue of whether local government should engage in the redistribution of income and wealth. In response, the then government did not constrain local government to a public goods role.

The very first statutory definition of the purpose of local government, which was adopted in 1989 following the review, did not contain any reference to the redistribution of income and wealth by local government. Nor did it confer a social purpose on local government. Social activities often involve the explicit redistribution of income and wealth.

The statutory purpose of local government was to provide, at the appropriate levels of local government, for the following:

- recognition of the existence of different communities;
- recognition of the identities and values of those communities;
- definition and enforcement of appropriate rights within communities;
- scope for communities to make choices between different kinds of local public facilities and services;
- operation of commercial activities by local authorities on a competitively neutral basis;[7]
- delivery of facilities and services on behalf of central government;

6 Officials' Co-ordinating Committee on Local Government (1988), *Reform of Local and Regional Government: Discussion Document*, Government Printer, Wellington.

7 The terms local authority (or authorities) and council (or councils) have the same meaning in this report.

- recognition of communities of interest;
- efficient and effective exercise of the functions, duties and powers of the components of local government; and
- effective participation of local people in local government.[8]

The Labour-led government elected in 1999 undertook to review local government legislation. The review resulted in a significant change to the statutory purpose of local government as enacted in the new principal act, the Local Government Act 2002. It defines the purpose of local government in the following terms:

- to enable democratic local decision making and action by, and on behalf of, communities; and
- to promote the social, economic, environmental and cultural well-being of communities, in the present and for the future.

Councils have wide discretion on what activities they undertake to promote the social, economic, environmental and cultural well-being of their communities.

The Labour-led government encouraged territorial local authorities and regional councils to work in partnership with central government in what was called a whole-of-government collaboration to advance the concept of sustainable development. The four key pillars of sustainable development – social, economic, environmental and cultural well-being in the present and the future – are reflected in the purpose of local government.[9]

For the purpose of performing its role, a local authority has "full capacity to carry on or undertake any activity or business, do any act, or enter into any transaction" and "full rights, powers and privileges", subject to other enactments and the general law.[10] A territorial local authority is required to exercise its power of general competence "wholly or principally" for the benefit of its district. Similarly, a regional council is required to exercise its power of general competence "wholly or principally" for the benefit of its region.[11]

The requirement to focus on the overall benefits of proposals to residents of the relevant district or region does not seem to apply to the promotion of the social, economic environmental and cultural well-being of communities. The LGA 2002 recognises that a district or region may comprise more than one community. It states that councils should take account of the diversity of communities (including future communities) and the interests of communities in taking decisions.[12] Thus, the social, economic, environmental and cultural interests of one community within a district or region might be promoted at the expense of similar interests in another community or in the district or region as a whole.

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8 Local Government Amendment Act (No 2) 1989, s 5.

9 Clark, Helen (2004), 'PM Speech: Local Government New Zealand', http://www.scoop.co.nz/mason/stories/PA0407/S00406.htm (last accessed 26 July 2004).

10 LGA 2002, s 12.

11 LGA 2002, ss 12(4) and 12(5).

12 LGA 2002, s 14.

It seems impossible to envisage an activity, whether undertaken by local government or otherwise, that is not intended to advance the social, economic, environmental or cultural well-being of some individual or group. Some activities may advance the well-being of one individual, group or community at the expense of one or more other individuals, groups or communities. Similarly, the well-being of an individual, group or community may be advanced to the detriment of society as a whole. Political patronage and criminal and other antisocial activities are examples of actions that may benefit particular individuals or groups at the expense of the overall interests of society.

2.2 Council social activities

The LGA 2002 does not define what constitutes a social purpose. Moreover, there is no generally accepted distinction between activities that may be deemed to have a social purpose and those that have another purpose. Some activities may be undertaken to advance more than one purpose.

Councils have traditionally engaged in certain activities that might be said to have a predominantly social purpose. Such activities may be primarily intended to redistribute income and wealth. Council social spending may include the following:

- Subsidised rental housing for the retired and other low-income groups. The acquisition of pensioner housing by local government was subsidised by central government until 1991. Some councils, such as Auckland City, have exited from the ownership of rental accommodation. Few councils have increased their stock of rental housing in recent years.[13]
- Day care and early educational facilities for children under five years of age and after-school and holiday programmes for children of school age. Such programmes are subsidised by central government. Councils do not otherwise supply childcare or formal education services. Similarly, their responsibilities for health services are limited.[14]
- A wide range of recreational facilities, including parks and reserves, sports fields and playgrounds, swimming pools, halls, community centres and other venues, and facilities for youth.
- Grants for many community activities, including information services (for example, citizens advice bureaux), advocacy bodies, and non-government social service providers. Some community grants are funded by central government but administered by local government.

13 According to the 2006 Census, private dwellings that were owned by local authorities fell by 25 percent from 14,781 in 1996 to 11,004 in 2006. In 2006, councils owned less than 1 percent of all private dwellings. See Statistics New Zealand (2007), 'QuickStats About Housing', http://www.stats.govt.nz (last accessed 2 July 2008).

14 Certain programmes provided by public libraries, for example story time for children, are possible exceptions. Local authorities have some responsibilities for public health, for example contagious diseases, the licensing and inspection of food premises and aspects of sanitation.

- Regulatory and other services to address public nuisances or promote public health and safety (such as the licensing of food premises, liquor outlets, certain gambling venues and brothels and public lighting) ensure graffiti removal, control of dogs and noise, and fencing of swimming pools and promote liaison with police and social agencies.
- The promotion of safety through a range of transport activities.
- The provision of employment and training schemes for the unemployed.

The provision of subsidised housing and, possibly, early childcare and education are the only significant social services provided by councils that might be said to be designed explicitly to redistribute income and wealth.

Although the variety of social activities (very broadly interpreted) is considerable, council resources devoted to these activities are modest, as noted, compared with those applied to roading, the 'three waters' (potable water, storm water and waste water), refuse collection and disposal, libraries, museums and regulatory activities, such as those related to the Resource Management Act 1991 and the Building Act 2004.[15] This is illustrated by reference to Manukau City (see Box 1).

Box 1: Social spending by Manukau City

Manukau City is the fourth fastest growing district. It has a relatively young and culturally diverse population and faces significant social problems with relatively high rates of unemployment, single parent families and crime.

In 2008/09 Manukau City plans to spend 5 percent of its total operating spending on community services. This category includes community development (such as advisory services, support for its diverse communities and health advocacy), housing for the elderly, Manukau Memorial Gardens (a cemetery and a crematorium) and community halls.

If spending on leisure and recreation (other than libraries and arts (18 percent)) and safe-city activities (other than emergency management (3 percent)) were included, social spending would account for 26 percent of total operating spending. Safe-city activities include licensing and its enforcement and crime prevention initiatives.

In contrast, 40 percent of total operating spending is to be spent on storm water, transport and solid waste collection and disposal.

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15 Councils do not generally identify spending on social services separately in their annual plans. A further breakdown may be available from councils, but the activities classified as social activities may differ from council to council.

Box 2: Expanded social mandate for Christchurch City

A 2002 report prepared by the Christchurch City Council concluded as follows:

> Not only has the range of issues confronting local governments increased but also the issues have become more complex as communities face seemingly intractable problems and disparities in health, welfare and employment.
>
> In response, the Christchurch City Council has moved beyond being a provider of basic services to provide a wider range of social and community services, including employment initiatives, leisure programmes and community development activities. It has become an active advocate for its communities both regarding traditional areas of concern and a broader array of matters impacting on the wellbeing and welfare of its residents. The Council is developing new concepts of community leadership and mechanisms for increasing participation by citizens in decision making and implementation. It is working co-operatively with a range of voluntary, private and public organisations.

Source: Christchurch City Council (2002), *Summary of Social Trends and Council Social Policy*, Christchurch City Council, Christchurch, p 84.

The promotion of the social well-being of the community, together with community concerns about adverse social trends over recent decades, appear to be encouraging some councils to expand their social activities.[16] Christchurch City illustrates this trend (see Box 2). It seems, however, that the explicit redistribution of income and wealth is not the focus of an expanded commitment to social activities.

The smaller councils, such as Opotiki District Council, that have continued to focus on the traditional activities of local authorities undertake very few social activities. As the mayor of Opotiki commented in the *Opotiki District Community Plan 2006–2016*, the primary solution to social problems is beyond the responsibilities and capacity of councils:

> Over the last decade Opotiki has consistently ranked as the 'most deprived' district in the country as measured by Statistics NZ ... The work of the various social service providers is important to address these issues. Long term solutions, however, lie in the creation of sustainable jobs and opportunities.[17]

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16 The funding or delivery, or both, of most health services is the responsibility of district health boards. They are defined as local authorities for some purposes but are not territorial local authorities or regional councils, which are the focus of the discussion in this report.

17 Forbes, John (2006), 'Message from the Mayor', *Opotiki District Community Plan 2006–2016*, http://www.odc.govt.nz (last accessed 26 October 2008).

3
INCOME AND WEALTH REDISTRIBUTION

3.1 Role of government

There is a widely shared view that government should assist the poor and weak in society.[18] This gives rise to a redistributive role for the government.[19]

There is debate about the nature and extent of this role. Some people, such as Robert Nozick, argue that the government has no role in redistributing income and wealth.[20] Others believe that the government's redistributive role should be limited to the avoidance of hardship where personal, family and voluntary resources are insufficient. Some other people think that the government should provide more extensive assistance such as to people with modest incomes or levels of wealth who do not face hardship. Still others believe that incomes and wealth should be distributed equally or close to equally.[21]

This issue can only be resolved through the political process although that process is far from perfect. Economic and other analysis can inform such decisions. The social goals discussed below point to a limited redistributive role for the government that could be undertaken by central government or local government, or both.

3.2 Social goals

Efficiency and freedom are important social goals.[22] Inefficiency, in a sense, entails waste. If someone can be made better off by adopting a policy proposal while other people are made no worse off (the definition of Pareto optimality), in what sense could the policy be said to be unfair?[23] In a less strict application of Pareto optimality, the overall surplus

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18 The retention of large government transfer programmes over time is an indicator of public support for a redistributive role for government.

19 For a discussion of the role of local government see Local Government Forum (2007), *op cit*, pp 5–13.

20 Nozick (1974), *op cit*.

21 Philosopher John Rawls argues that departures from an equal distribution of what he calls primary goods – "things which a rational man wants whatever else he wants" – are justified only to the extent that they improve the lot of those who are worst off under that distribution in comparison with the previous equal distribution. See Rawls, John (1971), *A Theory of Justice*, Harvard University Press, Cambridge, p 92. Nozick responded to Rawls in Nozick (1974), *op cit*.

22 The discussion that follows draws on Buchanan, Cathy and Hartley, Peter (2000), *Equity as a Social Goal*, New Zealand Business Roundtable, Wellington. Also see Epstein, Richard (2005), *Fairness in a Liberal Society*, New Zealand Business Roundtable, Wellington.

23 Efficiency is the most important goal for utilitarians. In contrast, Rawls emphasises equality. An efficient policy would be inequitable in his view if it did not assist those who were worst off in society. See Rawls (1971), *op cit*.

generated by an efficient policy is at least sufficient to compensate those people who would otherwise be adversely affected.

A concern for liberty is often compatible with institutional rules or policies that maximise efficiency. People who are free to engage in voluntary exchanges could be expected to trade until all potential gains are exploited. All parties to voluntary exchanges expect to be better off from being involved in the trading. Voluntary exchanges that are in the interests of the parties involved are often also in the interests of society as a whole.[24]

Fairness or equity is also an important social goal. It is, in part, concerned with the distribution of the net benefits from economic activity whereas efficiency focuses on the allocation of resources to obtain the highest possible levels of output regardless of who benefits. Many policies enhance both efficiency and equity. In other circumstances, there may be a trade-off between them.

The concept of fairness needs to be defined carefully. Its meaning varies according to different people. Equity defined as fair treatment (such as equality before the law, including procedural fairness), equal treatment of equally situated people (horizontal equity) or a compassionate concern for those genuinely in need are worthy social goals.

However, if equity is defined as equality of outcome, wealth or income, it should be rejected because it cannot be achieved, and an attempt to do so is likely to do more harm than good.[25] The objective of achieving an equal distribution of income or wealth, for instance, would blunt the incentive to work, invest and innovate and would thus reduce the overall well-being of society. The income of each person would be unrelated to his or her work effort. The policy would restrict individual autonomy.

The related objective of achieving a more equal distribution of income or wealth implies that more redistribution is desirable without specifying when income or wealth would be equitably distributed. Taken to its limit, this objective implies an absolutely equal distribution of income and wealth.

Equality of opportunity is often proposed as an equity goal. As no two people are the same in all respects, even if they have the same opportunities to succeed in life, it is unlikely that they will end up in the same circumstances. It is difficult to achieve equality of opportunity. It requires that people have more information, much of which may be unobtainable, to ensure they have equal opportunity throughout their lives.[26]

The government's redistributive role may crowd out voluntary support provided by family, friends and charities. These people and voluntary agencies might be better placed to encourage behavioural changes where personal choices, such as drug and alcohol abuse, are contributing to the difficulties faced by people needing support. If

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24 Exceptions may arise when benefits and costs from the overall perspective of society are not fully reflected in the benefits and costs for the parties directly involved and when action to better align social and private costs and benefits is warranted. This is the problem of externality that is discussed in Local Government Forum (2007), *op cit*, section 3.1.

25 Buchanan and Hartley (2000), *op cit*, pp 4–9.

26 *Ibid*, p 6.

government assistance is poorly targeted and open-ended, people may be trapped in a cycle of dependency that results in adverse social outcomes for the very people, and their children, that the government wishes to help.

Government redistribution of income must generally be funded from taxation (including rates). All feasible taxes distort the choices that people face. They may discourage work effort, saving, and investment, and bias a host of other decisions that people and firms make. Capital value rates, for instance, discourage investment in new residences and commercial buildings. The disincentive effects of taxes reduce national output and incomes. The immediate benefit of income transfers to recipients may be offset over the longer term by lower aggregate incomes.

While the redistribution of income and wealth may help some people, the only way to raise average material living standards over time is through income growth. This requires institutions and sound policies that encourage productive activities. As the former president of the United States Bill Clinton observed:

> Open markets … are the best engine we know of to lift living standards … and build shared prosperity.[27]

3.3 Advancement of social goals

Councils often state that their policies and proposals are fair. The criteria that are applied in judging fairness and the reason why a particular policy or proposal is deemed to be fair may not be stated or discussed. The assertion that a policy is fair may also be made to dress up a politically expedient policy.

Councils pay close attention to issues of procedural fairness. Significant breaches may lead the courts to scrutinise their decisions. However, councils do not always apply the principle of horizontal equity. Rating policies may, for example, breach that principle.[28]

Councils usually cite the benefit, 'exacerbater pays' and intergenerational equity principles. The Local Government Act 1974 required these principles to be applied in financing council spending. They were included in the LGA 2002 but in a more general form.[29] Efficiency was also included as a criterion in both acts, but it is generally given insufficient weight by councils.

Councils may ignore or underestimate inefficiency that may arise from pursuing equity goals. The revenue required to fund cash transfers imposes output and income losses (deadweight costs) on the community. In-kind transfers may be inefficient relative to cash transfers, as noted below. Both cash and in-kind transfers involve compliance and administration costs, and they give rise to inefficiency associated with lobbying.

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27 Clinton, W J (2000), 'Remarks by the President at World Economic Forum', Davos, Switzerland, 29 January 2000, http://www.usembassy.it/file2000_01/alia/a0013102.htm (last accessed 7 January 2009).

28 Uniform annual general charges and differential rates are inconsistent with the principle of horizontal equity.

29 See Local Government Act 1974, s 122F and LGA 2002, s 101. Section 122F was inserted into the former act by s 3 of the Local Government Amendment (No 3) Act 1996.

Programmes that are designed to advance equity goals of councils may not do so, or may do so to a more limited extent than intended, because the overall output and income of society in the longer term is lower than otherwise.

Councils commonly cite the 'ability to pay' as a criterion for their rating policies. Its application is usually superficial because councils generally hold little information on the financial circumstances of ratepayers. They tend to examine broad groups of ratepayers (for example, residential and commercial categories) rather than particular individuals, households or firms. Moreover, councils tend to focus on the initial incidence of rates and overlook the fact that markets adjust over time, shifting the incidence of rates to immobile factors of production, such as certain classes of employees. Furthermore, the ability-to-pay criterion provides little guidance as to the relative rating burden to be applied to people who are in different circumstances.

The Shand Inquiry reported:

> A fundamental principle of taxation is fairness (or equity). Fairness of the rating system is achieved where the distribution of rates does not impose unsustainable financial pressures on individuals or groups, and where those who have particular needs as a result of their low income receive assistance.[30]

This criterion takes no account of the benefits that ratepayers receive and offers no guidance on how the rating burden should be distributed from an equity perspective, aside from avoiding unsustainable pressure on ratepayers and advocating assistance for those on low incomes. Many questions would arise in attempting to apply it.

3.4 Redistributive policies

Social policies often focus on direct income or wealth redistribution rather than the provision of services. The main aim of such policies is to transfer resources from one individual or group to other individuals or groups. This is often achieved via the provision of cash transfers. Welfare benefits, the Accommodation Allowance and Working for Families Tax Credits are important income transfer programmes provided by central government.

The provision of goods and services on a subsidised basis, such as the provision of housing for the elderly, may also be primarily aimed at transferring resources from one group to another.[31] In this case, the transfer is in kind rather than in cash.

The direct economic effect of in-kind transfers is the same as that of cash transfers when they boost the income of recipients without causing them to substitute the goods and services provided for other goods and services. However, in-kind transfers may induce recipients to substitute one provided good or service for another. In this event in-kind transfers may be inefficient (see Box 3).

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30 Shand, Horsley and Cheyne (2007), *op cit*, p 184.

31 Public goods may be supplied free of charge where it is infeasible or inappropriate to charge for them. Public goods include street lighting, measures to control contagious diseases and the democratic activities of elected representatives. See Local Government Forum (2007), *op cit*, section 3.1.

Box 3: In-kind assistance

Suppose a person spends $50 a week on food. The government provides a food voucher worth $20 a week that can be exchanged for food at a range of stores. The voucher is an in-kind transfer that would not distort the recipient's consumption pattern. The person can use it to buy $20 worth of food that would otherwise be paid for from their income.

The person is likely to spend more than $50 on food and more than otherwise on other goods and services as the voucher increases their income (budget constraint). From an economic perspective the voucher is broadly equivalent to a cash transfer of $20. It increases the person's income but does not induce them to substitute food for other goods and services.

Now consider the case where the person receives a food voucher of $70 a week. The recipient is induced to consume more food than otherwise (because it is free of charge to the consumer up to $70 a week) and to spend less on other goods and services than would be the case if a cash transfer of $70 a week were provided instead. In this situation, the in-kind assistance leads to the substitution of one product or service for another. The person's overall welfare is reduced relative to the level that would have been possible with an equivalent cash transfer. In this case, in-kind assistance is inefficient relative to a cash transfer.

Assistance might be delivered via an in-kind transfer if the donor's preferences are deemed to be more important than those of the recipient. Thus, a drug addict might be supplied with a food voucher and free or subsidised accommodation rather than a cash transfer so as to reduce the risk that the support provided would be used to buy drugs.

In-kind transfers may be more costly to administer than cash transfers.

Councils do not generally have the power to transfer income to address perceived social concerns (or for other reasons) although they may provide in-kind transfers.[32] Many activities undertaken by local government may, however, affect the distribution of income and wealth among citizens and ratepayers. Some policies may be intended to alter the distribution of income or wealth while others may do so as an unintended consequence of advancing other goals.

The following illustrate council policies that affect the distribution of income and wealth among citizens and ratepayers:

- A council may alter the distribution of income through the patterns of its spending and investing on the one hand, and rates, user charges, borrowing and asset sales on the other:[33]

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32 Similarly, councils cannot distribute the proceeds from the sale of assets directly to ratepayers or citizens.

33 The Tax Review 2001 noted that the pattern of expenditure at the central government level was more important in relation to redistribution than the tax system. The welfare system and spending on education and health are relatively more important in relation to income redistribution at the central government level than any comparable assistance provided at the local government level. The Local Government Forum is unaware of any comparable studies that focus on local government. See McLeod, Robert, Chatterjee, Srikanta, Jones, Shirley, Patterson, David and Sieper, Edward (2001), *Tax Review 2001: Final Report*, The Treasury, Wellington.

- One group of ratepayers may benefit from goods and services that are funded by another group. Most of the benefits from the provision of libraries, art galleries, museums, recreation facilities, roads and public transport accrue to residents and non-residents who use them, but all ratepayers, including those who do not use them or use them rarely, contribute to their cost.[34] Preferential rights to use council services and assets free of charge or on a subsidised basis redistribute income to those citizens who benefit. Bus lanes and subsidised housing for the elderly and other low-income earners are examples.
- Rating policies may impose a more than proportionate burden on certain groups of ratepayers. The rating base (land value, capital value or annual value) and the form of rate applied (a general rate, a targeted rate or a uniform annual general charge) may be poor indicators of the level of services used by particular ratepayers. The value of some rateable land, such as farm land, relative to the aggregate value of rateable land in the region or district may be disproportionate to the level of services supplied to the ratepayer. A uniform annual general charge for refuse collection may be imposed on property owners who do not use the service.

  Councils generally confirm their forecasts of expenditure for the coming year and then decide how their spending is to be funded. Their spending plans often imply a politically unpopular increase in the level of the general rate. In that circumstance, councils may apply a differential or targeted rate or an annual general charge to particular ratepayer groups that bears little or no relationship to the level of services provided. Such rates and charges are often imposed on groups that are less than proportionately represented at the ballot box. This is largely intended to moderate the general rate burden on residential ratepayers who hold most votes rather than impose the cost of spending programmes on those who benefit. This contrasts with central government where the same rate of goods and services tax is applied to all consumers and where income and other tax rates are generally changed occasionally rather than annually.
- Development contributions that exceed the true economic costs of providing services for new developments impose excessive costs on the buyers of newly developed property, discourage investment and impose income losses on future generations. The users of other council services are subsidised.
- Regulations may impose a non-transparent tax on certain ratepayers. Those that restrict the development of land for housing, other than for valid public policy purposes, impose a wealth loss on prospective homeowners and confer a wealth gain on existing landowners. Similar wealth transfers may occur in relation to land for business purposes.

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[34] It may be argued that such activities also benefit the wider community (external benefits). While some benefit may accrue to non-users, it is implausible that most or a large proportion of the benefit accrues to the wider community. For a further discussion, see Local Government Forum (2008), *Local Government and the Provision of Public Goods*, Local Government Forum, Christchurch, pp 11–12.

– Investment in low yielding commercial activities transfers income from current ratepayers to customers of council-controlled trading organisations and their employees and suppliers. While councils often focus on intergenerational equity in deciding the level of borrowings, they seem to pay little attention to the adequacy of the expected yield from their commercial investments. Such investments, for instance ports, commonly yield an inadequate return. This deprives current and future ratepayers of income that should be earned on the resources committed. Overall community income may be reduced in these situations because the resources could be used more productively.

– Council policies on the remission and postponement of rates may redistribute income among ratepayers. Councils are required to adopt a policy on the remission and postponement of rates on Maori freehold land. Councils may also adopt policies on rates remission or rates postponement, or both, for all land or for all land other than Maori freehold land. Rates remissions and postponements can be permitted on any property, to any extent and for any reason, provided the local authority has adopted its policies following consultation with its community. Any such policies must state the objectives to be achieved and the conditions and criteria for the remission or postponement of rates.[35]

  Under the Rating Powers Act 1988, which preceded the Local Government (Rating) Act 2002, uniform rates remission and postponement provisions applied to all councils. Rates on residential land could generally be remitted in the case of "extreme hardship" or postponed on grounds of "hardship". Rates could also be remitted or postponed on certain categories of land (for example, land owned by trusts and certain other not-for-profit entities and land used for religious, community or conservation purposes) or following a natural calamity. Some categories of land (for example, certain reserve land) were eligible for a mandatory 50 percent reduction in rates. Special provisions applied to the postponement of rates on farm land. Relief through special valuations was also available in some other circumstances, such as where residential properties were located in a commercial or industrial area or vice versa.[36]

  Some councils now remit rates, in whole or part, to encourage activities that are perceived to be meritorious (for example, land voluntarily put into conservation, land subject to protection for natural, historical, cultural or conservation purposes and land used for charitable or community purposes). A council may also use its remission policy to soften the impact of its rates policy in particular circumstances, for instance where part of the land is outside the council's district. While some councils allow the postponement of residential rates on the grounds of hardship alone, other councils allow residential ratepayers to elect to postpone their rates. Such policies may be used to defer rates payable by an elderly homeowner until the death of the ratepayer, when the postponed

35 Local Government (Rating) Act 2002, ss 102 and 108–110.

36 Rating Powers Act 1988, parts X–XII.

rates are recovered from the ratepayer's estate. Unless a market rate of interest is charged, affected ratepayers are subsidised by other ratepayers.

- Central government introduced a rates rebate scheme in 1973. It is administered through local government. The scheme has been substantially expanded in the recent past and is forecast to cost almost $77 million in 2008/09. (The 2007/08 budget of $70.7 million was underspent by $21.8 million. There were an estimated 120,000 claims for assistance.) The maximum rebate is $530.00 at present. The maximum allowable income for a full rates rebate is generally $21,180 plus $500 for each dependant (child or welfare beneficiary but not a spouse or equivalent) who usually resides at the rateable property.[37] Policy recommendations on the rates rebate scheme are discussed below.

- A new or amended council regulation may increase the income or wealth of those who benefit while decreasing that of individuals who are adversely affected. Regulations imposed under the Resource Management Act 1991, such as district plans, have the capacity to generate large wealth transfers among ratepayers and residents. An unanticipated extension of a metropolitan urban limit may, for example, confer a wealth gain on owners whose property can be developed more intensively than previously. A new regulation limiting the height of buildings in a locality or restricting the property owner's right to redevelop the property may impose a wealth loss on landowners if compensation is not paid, which is the usual situation. Likewise, regulations that restrict the removal of houses or their renovation, other than to make changes that are in accordance with the existing character of an area, impose a tax on existing property owners and confer a subsidy on those who value the preservation of streetscapes but do not bear the cost.
- If a council buys goods and services from a new supplier, the income and employment of the supplier will tend to rise while those of the former supplier will tend to fall.
- If a council increases its expenditure, its staff will tend to expand while that of the private sector will tend to be lower than otherwise. Over time, senior council officers may receive higher pay than otherwise because their responsibilities increase.

Income and wealth redistribution may arise, in part, because it is infeasible or inappropriate, or both, to charge users directly for public goods. Councils may limit such transfers by seeking to balance the level of such goods and services provided to particular groups. Spending on the renewal and upgrade of footpaths, for instance, may be allocated among communities within a district rather than allocated where the spending might be most effective for the district as a whole.

[37] For further information on the rates rebate scheme, see http://www.ratesrebates.govt.nz (last accessed 17 February 2009).

Councils commonly apply the benefit principle (along with other principles) in funding their activities.[38] Under certain strict conditions, the economic effect of a benefit tax might be similar to user charges, but there are considerable difficulties in applying it rigorously. The rate burden payable by each ratepayer must coincide with the level of benefits received by that ratepayer, otherwise redistribution arises. This is difficult, if not impossible, to achieve for the following reasons:

- The benefits derived by ratepayers from goods and services are subjective. They reflect the different preferences of individual ratepayers. One person may highly value the services provided by the local public library whereas another may not use them at all.
- Ratepayers are discouraged from revealing their true preferences when goods and services are exchanged other than on a voluntary basis. People lobby for council services knowing that the cost will be imposed on all ratepayers.
- The benefit principle cannot be applied if avoidable harm is regarded as a benefit. Traffic lights may, for instance, reduce deaths, injuries and property damage that arise from motor vehicle accidents. The reduction in harm is not taken into account in funding council spending since it is only the capital and operating cost of the traffic lights (net of any central government subsidies) that are reflected in rates.
- The exacerbater-pays principle rather than the benefit principle is often applied to funding activities that address pollution and other nuisances.[39] In the absence of transaction costs and with perfect information, the choice between these principles would make no difference. However, these conditions do not apply, and the choice of principle affects incentives and the distribution of benefits and costs.

Some distributional effects noted above are likely to be small and of little significance from a public policy perspective. The general presumption is that minor or incidental changes in income distribution or wealth, which are difficult to identify and measure, tend to balance out over time, and they are usually ignored.[40]

The effect of the normal operation of markets on the distribution of income does not generally give rise to policy concerns. Firms are not compensated if they lose income to their competitors. Such a policy would deprive society of the massive benefits that arise from competition.

On the other hand, some council policies are explicitly designed to redistribute income or wealth and are not trivial. They may relate to the following:

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38 The LGA 2002 states that the funding needs of a council must be met from those sources that the council deems to be appropriate following consideration of "the distribution of benefits between the community as a whole, any identifiable part of the community, and individuals" and other principles (LGA 2002, s 101(3)(a)(ii)).

39 Councils are required to consider, among other principles, "the extent to which the action or inaction of particular individuals or a group contribute to the need to undertake an activity" (LGA 2002, s 101(3)(a)(iv)).

40 This is the standard presumption in partial equilibrium analysis. Also see the discussion of local or micro-justice in Buchanan and Hartley (2000), *op cit*, pp 8–9.

- Private goods and services may be provided to particular groups (for instance, subsidised housing, employment schemes and public transport) but be funded by ratepayers generally.
- Rates may be allocated among different ratepayer groups on the basis of their perceived ability to pay or other equity criteria. Policies on differential rates, targeted rates, uniform annual general charges and rates remissions affect the allocation of rates among ratepayer groups.

Market prices can be expected to adjust to council spending, investment, rating, borrowing and regulatory policies. As a consequence, the distributional outcomes of council policies can be expected to differ from their initial impact. A landowner is liable to pay rates, but over time firms will seek to pass such rates forward to their customers and backwards to suppliers of intermediate inputs and their employees. As businesses that are exposed to international trade are unable to influence world prices, rates payable by them will tend to be passed backwards to suppliers of immobile inputs, such as those employees whose wages are not set in the international market.

The shifting of the incidence of rates is often overlooked or ignored in council analyses. The ultimate incidence of distributional policies of councils (and of central government) is almost certainly impossible to determine with confidence.[41]

3.5 Should councils engage in explicit redistribution?

The central issue is whether councils should engage in explicit income and wealth distribution, that is, whether they should adopt policies and programmes that aim to take income or wealth from one individual, group or firm and give it to another. Such policies and programmes can be distinguished from those that implicitly redistribute income because it is infeasible or inappropriate to charge for public goods.

The Shand Inquiry reported:

> Although, historically, central government in New Zealand has assumed primary responsibility for income redistribution, overall responsibility for well-being has been shared between local and central government. The activities in which local government is engaged create benefits for some but not all citizens and, similarly, sometimes create costs for some but not all citizens. This may redistribute overall well-being from disadvantaged groups to advantaged groups or vice versa. Thus, we consider it unrealistic to suggest that local government does not have an influence on income and wealth redistribution.[42]

The Shand Inquiry is correct in observing that local government activities affect the distribution of income and wealth. It is also correct in observing that the effect of council activities on the distribution of income could either benefit or harm disadvantaged groups on the one hand or advantaged groups on the other. It may be significant that the Shand Inquiry refrained from addressing whether, overall, local government helps or hinders disadvantaged groups.

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[41] The difficulty in analysing the distributional effects of central and local government policies centres on the problem of determining what would have been the outcome in the absence of the policy.

[42] Shand, Horsley and Cheyne (2007), *op cit*, p 184.

The Shand Inquiry did not address the normative question of whether councils should engage in explicit income and wealth distribution, including whether they should have the power to make cash transfers. Moreover, the Shand Inquiry did not explain why it thought "overall responsibility for wellbeing" in New Zealand is shared between central and local government. This seems to exclude entirely personal responsibility, such as the choices people make about their education, training, work and family and the contributions of businesses and the voluntary sector.

The redistributive role of the government, recognised in section 3.1, is a limited one. This flows from social goals, discussed in section 3.2. It is almost exclusively the responsibility of central government in New Zealand at present. Where local government plays a role, its programmes are mainly funded, in whole or part, by central government (for example, the rates rebate scheme) or were previously subsidised by central government (for example, housing for the elderly).

There is no known argument or support for the redistributive role of government to be taken over by local government. Local government's role, if any, is likely to be minor relative to that of central government, at least for the foreseeable future.

There are also good reasons why local government should not engage in explicit income redistribution, aside from the delivery of central government programmes and remission of rates and charges on hardship grounds. With the exception of matters relating to procedural fairness, local authorities are generally poorly placed to judge equity issues on an informed and objective basis for the following reasons:

- Councils generally have very limited information about the income or wealth of ratepayers and residents:
  - Councils hold information on the value of rateable land but generally have no other information on the financial circumstances of ratepayers. The value of rateable land is unlikely to indicate the overall wealth of ratepayers. Councils do not know the value of other assets or liabilities. Two ratepayers may each own a property worth, say, $300,000. The first property may have been mortgaged for $250,000, and thus the equity in the property is just $50,000. The second property may not be mortgaged at all, and thus the equity invested is $300,000, six times that of the first. The first property may be owned by a business, which is subject to a higher rate in the dollar than the second property, which is owned by an individual.

    As a further illustration, assume that one of the $300,000 properties is owned by a professional couple with no children who earn a combined income of $150,000 a year. The other property is owned by an elderly person living alone in her family home who has an income of $25,000 a year, comprising New Zealand Superannuation plus some income arising from modest investments, and is ineligible for the rates rebate scheme.
  - Councils may obtain additional information about housing and some similar programmes, but they do not have information and administrative processes to take responsibility for income distribution generally.

  - Councils tend to focus on the impact of their policies on broad ratepayer or resident groups. The members of each group are often not in the same or similar positions. The analysis of equity should be focused on individuals or households, or on groups of individuals or households, that are in similar circumstances.
  - Councils tend to focus on the initial incidence of rates and other policies rather than their ultimate incidence, which may be impossible to determine. Rates imposed on firms, for instance, will be passed forward to their customers, where market conditions allow, or backwards to employees. Individuals ultimately pay all rates and other taxes.

- Redistribution by councils may not advance overall redistribution goals. Redistribution in relatively poor council areas could assist people on very low incomes but make other people who are not well off, from a national perspective, worse off.
- Council redistributive programmes may impose costs on ratepayers that would otherwise fall on taxpayers. This may happen, for instance, with council housing.
- Councils generally lack expertise in the area of income and wealth distribution, and it is unlikely to be efficient for councils to acquire the skilled resources that would be required.

Accordingly, councils should not be permitted to use their rates regime to explicitly redistribute income among ratepayers. This is consistent with the proposals outlined in *Democracy and Performance* (2007). In that report, the Local Government Forum proposed that councils would be permitted to apply an additional rate to a subset of ratepayers to fund a particular project (or projects) or a significant activity (or activities) provided that affected ratepayers consented to the additional spending before it was committed. Targeted rates would be permitted on a similar basis. Councils would also be permitted to apply a lower general rate to all ratepayers in a defined area where clearly specified services available to ratepayers in general were not available to those in the affected area (for example, services available to rural ratepayers and ratepayers on islands). In other circumstances, the general rate would normally apply to all ratepayers, and differential rates would be abolished as recommended by the Shand Inquiry.[43, 44]

The explicit redistribution of income should be limited to the provision of a safety net. However, in New Zealand, this is a role for central rather than local government.

3.6 Rates rebate scheme

The Shand Inquiry was required to examine the sustainability and affordability of rates and the impact of the rates rebate scheme changes in 2006 and other government assistance packages for families. It made 13 recommendations on the rates rebate scheme:

43 Local Government Forum (2007), *op cit*, p 32.

44 Shand, Horsley and Cheyne (2007), *op cit*, p 117.

- Five related to the collection of statistics and the dissemination of information about the scheme, its promotion and monitoring and the assessment of its impact on the affordability of rates. One such recommendation was that "a robust evaluation be conducted to ascertain the level of understanding among target populations about the rates rebate scheme and the benefits of applying" for the rebate. These recommendations may reflect the reported low take up by eligible ratepayers and the absence of appropriate information to demonstrate that the benefits of the scheme outweigh related costs.
- Two recommendations related to the provision of information on the treatment of war pensions in assessing a ratepayer's eligibility for the scheme and the consistency of assessments of rates rebates applications from recipients of war pensions.
- One recommendation was that consideration be given to the administration of the scheme through the Inland Revenue Department in a similar way to rebates for charitable donations. The administration of the scheme by central government alone would be consistent with its redistributive role and may well be more efficient. However, the Inland Revenue Department's capacity to administer a scheme that, unlike charitable donations, has no connection with central government taxation is doubtful. The requirement to administer a range of taxes, family income assistance, Child Support and the Kiwisaver scheme has put the Inland Revenue Department's systems and processes under substantial stress. The Ministry of Social Development (Work and Income) or the Department of Internal Affairs may be a better candidate.
- The balance of recommendations were to expand the scheme. In summary, they were that:
  - the rates rebate and income thresholds be indexed to the average rates increase;
  - occupants of retirement homes and occupiers of papakainga (often a cluster of homes on Maori land) be eligible for a rebate of rates;
  - eligibility for a rebate of rates be clarified for homes subject to a family trust; and
  - water supply and waste water charges levied by a territorial authority or a council-controlled organisation be made eligible expenditure for which a rates rebate may be claimed.[45]

Rather than expand the rates rebate scheme, the Local Government Forum thinks that it should be reviewed with a view to its abolition for the following reasons:

- Councils should be required to confront, and be accountable to electors for, the consequences of their rating decisions, including their impact on people who have low or modest incomes. The scheme tends to diminish such accountability by alleviating ratepayers' concerns at the expense of taxpayers.

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45 *Ibid*, pp 23–24.

- The scheme tends to duplicate council policies relating to the postponement and remission of rates. The alleviation of hardship on a temporary or permanent basis should be addressed by such policies.
- The scheme overlaps with central government's main support arrangements, such as welfare benefits, the Accommodation Allowance and Working for Family Tax Credits.
- The forecast cost of the scheme ($77 million in 2008/09) is significant. It is likely to be expensive to administer at both central and local government level compared with some other assistance arrangements. Although some councils make a commendable effort to advise ratepayers of the scheme, it is speculated that participation falls short of the total number of ratepayers who could qualify under the current criteria. This may be one reason why the scheme's cost in 2007/08 fell well short of the budget allocated. If the government wishes to spend $77 million a year in alleviating hardship, it is likely that it could do so more effectively in other ways.

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CONCLUSION

The Local Government Forum's key conclusions are summarised below:

- Almost all actions taken by government affect the distribution of income and wealth among individuals.
- Many distributional effects that arise from government decisions are incidental to the undertaking of its two main functions of maintaining order and facilitating the provision of public goods and services.
- Central and local government undertake programmes, impose taxes or make regulations that are explicitly aimed at redistributing income and wealth. However, central government has prime responsibility for income and wealth redistribution in New Zealand. Local government has traditionally played a minor role in explicit income and wealth redistribution.
- The only way to raise average material living standards over time is through income growth. The top priority should be to boost overall output and incomes. Any distributional concerns that arise should then be addressed.
- Collectively, the Local Government Act 2002, central government and social trends appear to be encouraging some councils to extend their social activities, which may involve the redistribution of income and wealth.
- Local government should not engage in explicit income redistribution, except for the delivery of central government programmes and remission of rates and user charges on hardship grounds, for the following reasons:
  - Aside from matters relating to procedural fairness, local authorities are generally poorly placed to judge equity issues on an informed and objective basis.
  - Redistribution by individual councils may not advance overall national redistribution goals.
  - Council redistributive programmes may impose costs on ratepayers that would otherwise fall on taxpayers.
  - Councils generally lack expertise in the area of income and wealth distribution, and it is unlikely to be efficient for councils to acquire the information and skilled resources that would be required.
- Differential rates should be abolished, but councils should be permitted to apply a different level of rates to particular taxpayers in certain circumstances, such as where a subset of ratepayers agree in advance to fund a particular project or where specific services are not available to certain ratepayers.
- The rates rebate scheme should be abolished.