NZIER
NEW ZEALAND INSTITUTE OF ECONOMIC RESEARCH

The future of the Fire Service Levy

Summary report

NZIER report to the Insurance Council of New Zealand

9 May 2014

Context

The Insurance Council of New Zealand (ICNZ) commissioned two reports from NZIER to identify alternatives to the current levy on insurance to fund the fire services in New Zealand. The first report focused on residential property and vehicles and the second report focused on commercial property.

In both reports we have used established public finance principles to evaluate the current insurance-based Fire Services Levy and contrast this with a property-based levy (collected along with Territorial Authority property rates) and a fixed levy as part of vehicle licence fees (or a variable levy through fuel taxes and Road User Charges) for light motor vehicles.

We have examined the winners and losers from the proposed changes and the administrative feasibility of the move from an insurance based to a property value base for funding fire services.

What we found

The historical link between fire insurance and fire services has long since broken down – the fire service levy based on fire insurance is a relic of a bygone age

The earliest fire brigades in New Zealand were formed by insurance companies in order to reduce their exposure to risk. Over time, however, the insurance industry role was phased out as local government (initially) and then central government (in 1976) took over responsibility for the provision and funding of urban fire services. The Fire Services Levy in its current form was introduced as a "temporary fix" in 1993. A number of factors have contributed to the breakdown of the historical link between fire insurance and fire services, including the change in scope of fire services to include a full range of non-fire emergency services and the increased focus of fire-fighters on preservation of life rather than preservation of property.

Review after review has concluded that the existing fire service levy is deeply flawed and unsustainable

The current arrangements for funding the fire services were introduced as a 'temporary fix' in 1993. We have identified twelve reports produced since 1993 and almost all recommend moving away from the current levy to at least partial use of alternative bases, including greater use of general tax revenue funding. Based on advice from officials and private sector advisors, both of the previous administrations have agreed to move away from a fire insurance based levy. What has been lacking has been the political will to introduce the amending legislation.

Australia has moved away from insurance based funding

Australian States are successively moving from insurance-based levies to property-based levies to fund their fire and emergency services. The last mainland state (New South Wales) with an insurance-based levy has completed its public consultation and is observing the outcome of the recent change to a property-based levy in Victoria before implementing similar changes. The two Australian Territories fund their fire and emergency services from government consolidated revenue.

Starting from scratch, an insurance-based Fire Service Levy is the worst option for funding fire services – the best approach is general taxation

Using established public finance principles to evaluate the current insurance-based Fire Services Levy (FSL), our analysis has identified that the first best option is having the New Zealand Fire Service (NZFS) funded entirely from general taxation. The timing may not be right for this option given the government's commitment to fiscal stringency. However, this is the most efficient and least distortionary option.

The next best option is to apply a mixed model that includes some general taxation combined with levies on rateable values of property

If that option is not considered acceptable, then as a second best we recommend a mixed funding model. This would involve a move from a fire insurance base to a property base (for commercial buildings and household dwellings) with levies collected through local authority rates, and to an equivalent base for light motor vehicles with levies collected through vehicle registration, including:

- flat fees on domestic property collected through rates)
- variable levies on the full rateable value of commercial property collected through rates
- a flat levy on light motor vehicles collected as part of motor vehicle registration
- an increasing share of public funding provided over time to cover non-fire and non-vehicle related emergency services, the Crown share of costs for the protection of state property, and other commercial property.

These changes could be phased in over time.

What is to be done?

There are at least two possible approaches to reform of fire service funding. Changes could be introduced as one comprehensive package, once the fiscal position allows, or could be phased in over time. The advantage of one comprehensive reform is that the fiscal position is continuing to improve steadily which would permit the move to general tax funding (the first best option). The risk with this option is that the history of stalled reforms in the last two decades does not give any confidence that a comprehensive package would proceed. In the meantime the levy base will continue to be eroded and evaded. The second-best option would be to phase in changes, creating a mixed system, as outlined below.

Take the first step into the modern age – focus on light motor vehicles

Phase 1 – Replacement of the levy on light motor vehicle insurance with a flat per vehicle charge collected as part of the motor vehicle registration (to come into effect as soon as a practical legislative vehicle becomes available).

A second phase should focus on residential dwellings (and contents)

Phase 2 – Replacement of the levy on domestic insurance with a flat fee on dwellings. The role of local authorities would change from part funder to levy collector. Domestic household contents could be eliminated as a separate category for the levy, with the present contribution being collected as part of the flat fee on dwellings. Amending legislation will need to address these changes and the integration of the two fire systems, and move them onto a common funding system. A redraft of the Fire Service Act would provide a suitable legislative vehicle for

all of these changes, and there may also need to be amendments to Acts governing rating powers of local authorities.

A third phase should focus on commercial property

Phase 3 – Replacement of existing with a levy applied to either the capital value or the value of improvements of properties:

- for non-commercial property, a single rate levy on property value up to a fixed cap (either $200,000 value of improvements or $500,000 capital value)
- for commercial property, a dual-rate abating levy, with an initial rate no higher than the current insurance-based levy rate per unit of value, and the abatement point set so as to balance the benefits across mid-range to higher value properties in an equitable manner (we provide examples).

The current levy on other commercial property ($38m) could be replaced by general tax funding.

A fourth phase should focus on greater government funding

Phase 4 – Greater public funding should be provided over time to cover non-fire, non-vehicle emergency services and the Crown share of costs for protection of state property phased in as the fiscal situation allows.

How would this impact upon property owners?

The result would be fairer as all property owners would contribute to funding the fire services, not just those who currently have insurance policies on their property. The broadening of the revenue base would reduce the average cost per property owner.

Up to a million property owners would pay less as the burden is spread

The results show that moving to an uncapped levy or a fixed-rate levy would each generate net savings in cost for around 1 million of the current 1.6 million residential property owners, relative to the cost of the current form of capped levy. However, the adverse impact from a variable levy is loaded on higher value properties, while the adverse impact of a fixed rate levy falls on lower value properties. In either case, and with other property-based funding options, owners of properties that are not currently insured would face the full cost of the new property-based levy.

The existing rates relief remission and postponement policies could to cover the hardship for those who would be unable to pay the levy. A change from an insurance-based levy to a property-based charge using the existing collection agencies would also reduce the costs of administration and compliance verification.

Vehicle based funding would be spread over an additional 100,000 owners, reducing costs for the 2.3 million current contributors

For light motor vehicles (under 3.5 tonnes), a move from the current levy based on fire insurance contracts to a flat fee per vehicle collected as part of registration fees would result in a cost reduction for owners of the estimated 2.3 million vehicles with fire insurance. Owners of approximately 100,000 additional vehicles would begin to contribute to funding the emergency response capability of the fire service.

Fully insured commercial property owners will be better off

For those who are fully insured, owners of lower valued properties will be no worse off and owners of higher valued properties will be better off than under the current regime, while raising the same amount of revenue

Implementation

It is feasible for a property based levy to be collected by territorial authorities, as a deemed rate. A number of District Councils already collect the rates for regional councils in this way. The transitional costs of changing to a property based regime are manageable, and the ongoing collection and compliance costs are likely to be lower than current costs.