Political Economy of New Zealand Water Reform

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Outline

• Creating new markets can be hard – especially for “fugitive” resources with strong externalities (like water).

• Political economy questions are even harder:
  – Who gets what, and who pays?
  – Should “losers” from change be compensated:
    ▪ By whom, for what, to what extent ...?
  – Who holds the pen on reform, and how should new arrangements be governed?

• I’ll try to address some aspects of these, in 10 minutes ...
Basic Dynamics of Institutional Change

• Water reform represents major institutional change (cf QMS, ETS):
  – Practically everyone affected, some parties/groups with very significant interests, emotive, cultural dimensions/issues ...
• Usually only achieve such major change at “critical junctures”:
  – The status quo becomes sufficiently intolerable;
  – New technologies lower the costs of change, or increase its payoffs (making the potential “pie” bigger);
  – “Institutional entrepreneurs” see/create opportunities for change – e.g. major legal breakthroughs; and/or
  – “Veto players” can be bought off, turned, or neutralised ...
Question 1 – Who Gets What, and Who Pays?

• Probably uncontroversial that users should pay:
  – To the extent *trading systems* are profit-based or break-even, this will come via trading charges (versus water price itself);
  – But what about the costs of any new *property rights* regime?
• Much more challenging – what about *returns to underlying resource owner(s)* – whoever they may be (Crown says it isn’t):
  ▪ Resource rents, royalties, or rights auctions proceeds; and/or
  ▪ Taxes – on abstraction, or emissions (e.g. nitrates)?
• Changes to water arrangements will likely combine *bitter pills* (e.g. payments to “owners”, reallocations) with *sugar coatings* (e.g. trading efficiencies, quality/environmental gains) – unevenly ...
Question 2 – Compensation?

• Many parties are “invested” in the status quo:
  – Certainly new arrangements could upset their interests, *but what (legitimate) promises have been made not to do so?*

• Clear case for winners to compensate losers *if* promises made:
  – Probably hard to do directly, so *re-distribution system needed*.

• Even if legitimate promises have been made, clear case for compensating only *net* losses:
  – Remember the sugar coatings:
    - New arrangements won’t just improve the returns from status quo activities – *they will create new opportunities too* ...
Question 3 – Governance

One-off?

**Tier I Governance** – Who Gets What, and Who Pays? Who has Control?

Ongoing, Irregular activity

**Tier II Governance** – Overseeing Trade-offs (Social/Cultural, Economic and Environmental), and Regulation of Market/Taxation

Ongoing, Regular activity

**Tier III Governance** – Overseeing Executive of Market (or Administrator of Taxation)

Day-to-day operation

Market (or Taxation System) Operation*

* Ownership possibilities – Companies (investor- or user-owned), iwi, not-for-profit, community/trust, local or central government, etc.
• When new arrangements seek to change long-term investments and development pathways, credible future rules are key:
  – E.g. uncertainty re future ETS settings creates option to wait (and to lobby) – any Tier II (or Tier I) uncertainty will do likewise.
• “Independent Central Bank” model provides a useful guide:
  – Productivity Commission recommended this for transition to low-emissions economy – will need this for water too (e.g. Tier II).
• Some groups advocate only advisory independence, retaining power to lobby:
  – Likely to be self-defeating as everyone else can lobby too, meaning everyone is back to where they started (with no certainty).
Take-Homes

• Tier I and II governance arrangements will be critical to success of any new water arrangements.

• Thorny ownership questions remain – with implications for:
  – Who should receive any resource rents (etc); and
  – Who may need compensating, and who has the resources (or any obligations) to compensate.

• Everyone wins if any new arrangements are long-term credible:
  – This needs everyone to tie their own hands to some degree – committing to a rule, rather than trying to rule.