



Political Economy of New Zealand Water Reform

Presentation at The New Zealand Initiative Members' Retreat

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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?

Nests

Ongoing, Irregular activity

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

Nests

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.

Question 3 – Governance (cont'd)

- 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.