Grant Duncan and Simon Chapple

What is a vested interest?

Abstract

The term 'vested interest' is often used with a negative connotation, with regard to powerful and wealthy firms or groups who exploit their insider position or block policy changes that others believe would benefit the social interest, the latter potentially including future generations. But the term vested interests also covers members of the public who have rights to participate in public debate. So, how should we understand 'vested interests' for the purpose of improving and democratising policymaking processes?

Keywords vested interest, social interest, collective action, Cabinet Manual, stakeholders

Individuals, groups and organisations have many valid interests. A home owner has a genuine interest in maintaining the utility and market value of the property. A student has an interest in clear guidance from a teacher before an exam. A grocery and its customers have a common interest in food safety standards. Bringing about or maintaining certain states of affairs that favour our own interests is frequently necessary, reasonable or legitimate. And pursuit of self-interest is acceptable in a free and democratic society if it causes no unfair disadvantage or injury to others. Self-interested actions may even contribute (albeit unwittingly) to the social interest. As Adam Smith put it metaphorically, economic actors may be 'led by an invisible hand' to contribute to ends that go well beyond what they intended. A merchant may do more for the nation's economic productivity by buying from abroad when prices there are lower than by favouring local suppliers, and hence 'By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it' (Smith, 1999 [1776], p.32). 'Frequently' does not mean 'necessarily', however. And Keynes showed us the other side of the coin: 'It is not a correct deduction from the Principles of Economics that enlightened self-interest always operates in the public interest' (Keynes, 1963, p.312). Self-interested actions can adversely affect the social interest. This situation is often where the term 'vested interest' comes in, used with a negative connotation. Vested interests may also be lawful, valid and rational interests, however, while people who hold vested interests are members of the public with an equal right to be heard. We should identify the kinds of circumstances in which vested interests may be harmful to the social interest, and seek to prevent their undue influence over policymakers.

To vest originally meant to clothe (James, 2014). Metaphorically, it also means to put someone in lawful possession

Grant Duncan is an associate professor of politics at Massey University, Auckland. He has previously published on a variety of topics in public policy and in political theory, including political trust.
Simon Chapple is director of the Institute for Governance and Policy Studies at Victoria University.

of a property or power (for example, 'by the powers vested in me'). A *vested* interest implies possession of private economic assets, social status or political power, which may be lawful, but may also prefer policy decisions that promote the holder's own ends at the expense of others, or block change that may be beneficial to others. While a vested interest generates private gain, it is often implied that others suffer as a consequence of its political influence or market power.

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It is worthwhile to consider two contrasting examples of the use of 'vested interest' found in New Zealand policy discourse. The 1967 royal commission of inquiry report into accident compensation in New Zealand is known as the Woodhouse Report, after the commission's chair, Sir Owen Woodhouse. In justifying a guiding principle of 'community responsibility', Woodhouse wrote:

> If the well-being of the work force is neglected, the economy must suffer. For this reason the nation has not merely a clear duty but also a vested interest in urging forward the physical and economic rehabilitation of every adult citizen whose activities bear upon the general welfare. (Royal Commission of Inquiry, 1967, p.20)

In this case, a collective social duty and a vested interest coincide around the general welfare; the public interest and vested economic interests are not opponents in a zero-sum game. The Woodhouse Report persuaded us that the goals of social wellbeing and of economic prosperity may be compatible. That was one of the premises that formed the universal no-fault accident compensation scheme (ACC).

Uses of 'vested interest' with negative connotations are found in a recent column by Sir Michael Cullen, writing as the chair of a taxation policy working group, after the government's decision not to adopt its recommendation for 'extended capital income taxation' (a capital gains tax). The term 'vested interests' appears five times, including in the title. According to Sir Michael, 'the vested interests opposed to any change were well organised, funded, not too careful with the truth at times and, of course, fully supported by a tribe of right-wing shock jocks on private radio'; they purportedly stood in the way of 'the pursuit of a fairer society' (Cullen, 2019). We take no stand here on the merits of a capital gains tax. But critical concerns about the ability of vested interests to block policy change which may be socially beneficial lead us to ask how to best manage them in a democratic society.

In public economics, if a change in circumstances could lead to a net gain to society, winners can potentially compensate losers and society may be considered better off overall (this is the familiar Kaldor-Hicks-Scitovsky test for a public policy gain: see Scitovsky, 1951). Action to create or prevent change, leading to a net loss on the Kaldor-Hicks-Scitovsky test, may be taken by a vested interest to promote their interests, at odds with the social interest.

In English common law, 'public policy' is sometimes invoked when judges set aside contracts causing mischief or harm to the common good. Otherwise lawful actions by private citizens may be deemed 'to violate a rudimentary public interest' (Ghodoosi, 2016, p.690). An example might be a restraint of trade clause in a contract that has the effect of creating a monopoly. Though it be willingly agreed by the parties, a court may deem it unenforceable on grounds of public policy. For present purposes, and for university studies in 'public policy', however, we normally nowadays define public policy much more broadly as (to quote a textbook example) 'the sum total of government action, from signals of intent to the final outcomes' (Cairney, 2012, p.5).

In economics and in law there are well-established principles by which the public interest trumps private interests. In a democratic society, ideally governments are thought to act as promoters of the social interest. We might see it as contrary to public policy for a private person, group or firm to take advantage of their market power, their influence over policymaking processes, their personal contacts or their high profile in the media to pursue self-interested goals in ways that are not in the social interest.

The social interest

At the height of the New Public Management reforms of the period 1984–96 it was argued, especially by public choice theorists, that the public interest promoted by government action was an illusion. It was claimed that only individuals can meaningfully have interests and that these are best converted into the social interest via private market interactions, as if led by a Smithian invisible hand.

The New Public Management reforms assumed that 'public interest' is a smokescreen behind which vested interests were advanced. Public service professionals would supposedly be disinclined to put into effect the policies of their democratically elected masters, and they would act in their own interests, unless incentivised by quasi-market rewards and sanctions. On the other hand, rational utility maximisation within a market leads firms and entrepreneurs to seek efficiencies and to be responsive to consumers due to the incentives inherent in competition, the price mechanism and the threat of bankruptcy. Creating incentive structures within the public sector mimicking the market was an overarching goal (for an explanation of such theory, see Boston, 1991).

Moreover, it was long recognised by economists that people with common interests will, under certain circumstances, associate together as industries, professions or pressure groups to advance their collective but private interests, including efforts to influence governments in favour of their members. Such groups are likely to be successful in advancing their vested interest where the gaining group is relatively small and easy to coordinate and each individual entity gains a lot from private collective action, and where the losing group is large and costly to coordinate and each individual of its many members loses only a little (see the first three chapters of Olson, 1971 on the logic of collective action).

With the decline of New Public Management, the notion of 'public interest' has returned. It is now accepted that people may act pro-socially and willingly 'to make a difference' in the interests of the community, as a professional and ethical commitment, or as required under their employment agreements and the law. Under the new Public Service Act 2020, 'the fundamental characteristic of the public service is acting with a spirit of service to the community' (s13). To claim, then, that there is a 'public interest' is not merely a rhetorical ruse to maximise budgets; rather, it is to recognise common values and aims that are openly expressible in law or administrative policy.

In contrast to public interest, then, the term 'vested interest' is often used in the Cullen sense of a negative connotation. It is the potential for harm to the social interest caused by the influence of vested interests that most concerns us here. So, here 'vested interest' refers to a person, group or firm that wields sufficient economic or political influence to shift decision-making processes in directions that would favour themselves and do injury to the social interest. Here a vested interest is a type of political or economic interest, or related interest group, which has a stake in maintaining or producing a state of affairs that may not coincide with, or may even harm, the public interest, and which enjoys an advantage over others in achieving its objectives. It becomes a problem for public policy when it blocks social or economic improvements, or pushes through policy changes that benefit the group with the vested interest at the expense of others' legitimate needs or interests. A vested interest needn't necessarily be a formally organised firm or association. It may include a class of persons with similar interests who coordinate tacitly or informally. There are, on the other hand, identifiable firms, associations and pressure groups that combine resources to influence policymaking in deliberate ways that benefit themselves rather than the wider society. Collective actions by large agricultural interests to frustrate efforts to reverse freshwater degradation are an example. But this doesn't necessarily mean that all of their members' interests are being well served, or that all members support the actions being taken on their behalf. Organisations and groups have their internal divisions and dissent, as well as experiencing free-riders. While people with common interests may indeed combine their efforts to advance their interests, when examining vested interests we need to be wary of over-simplifying or exaggerating their purposes.

Vested interests are often defending advantages that have been acquired over a long time, to which they have become accustomed and that are factored into their business investment plans. Hence, swaying policymaking in particular directions may reflect the vested interests' aversion to a reduced value of those assets or to new costs of doing business, as compared with the potential for innovation and new sources of investment returns that may come with embracing change. The estimated value of losses contingent upon policy reforms may appear to outweigh the harder-to-calculate value of gains that could potentially or actually occur in the future. In cases where vested interests seek to preserve the status quo, it is normally easier to give an account of what they stand to lose due to regulatory changes than of the future losses that would allegedly be inflicted on a vaguely defined public interest if many others are involved, and especially if future generations are affected. In cases such as privatisation of public assets, vested interests may well be lobbying for change, rather than preventing it, or giving advice to government on sales, even as they seek to profit by purchasing a share of those assets and selling later at a healthy profit.

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As elected representatives and public servants are expected to act in the public interest, they should be aware of and carefully manage or mitigate their relationships with vested interests. A vested interest nonetheless participates legitimately in a policymaking process if it publicly declares its interests, is prevented from taking advantage of its market power or political influence, and respects other participants in public debate and policy formulation. A vested interest is, however, not an enlightened interest. But, provided the rules of the public policy game are fair, transparent and enforceable, vested interests can play a valid role in public deliberative processes and elections.

Collective action problems

Not all firms in an industry will see it as in their interests to spend time and money on lobbying government for assistance or creating or preventing changes in regulations for their own advantage. This is in spite of the fact that lobbyists may be at work promoting the interests of that industry. In the case of the state, however, citizenship comes with compulsory taxation, rather than voluntary membership fees, on the grounds that services provided to one citizen must be available to all as a public good (Olson, 1971). If we think of policy-related consultation with affected persons, groups and industries as a kind of public service in any democracy, then an opportunity to be consulted should be available to all those affected by a decision, as a public good. It is in the interests of good policymaking for all interest groups to be heard in order that positive and negative consequences of policy change (or of no change), some of which may otherwise be unknown to policymakers, can be anticipated and balanced. But economically powerful vested interests who generate rents from their advantages have greater means to pay for researchers, lawyers and lobbyists to put forward more convincing cases to policymakers.

Moreover, vested interests may be strongly invested in the status quo, as an assumed background against which they have made their business plans. Loss aversion bias means that people tend to experience greater pain from a loss than pleasure experienced from a gain of equal economic value. Producers and consumers may hold a bias towards the status quo, especially when a prior investment or sunk cost is at stake (Kahneman and Tversky, 1979; Samuelson and Zeckhauser, 1988). If we seek radical changes in behaviour in order to address the obesity epidemic or climate change, we are up against not only rationally calculable economic barriers (that is, some people suffer losses, for instance through new taxes or reduced demand), but likely also hard-to-shift psychological biases against change, especially when the consequences and potential benefits of change are uncertain and/or well into the future. Powerful economic actors may prefer gratification in the next quarter over wellbeing for all in the long term. They may be motivated rationally by results for themselves or shareholders, but, especially when outcomes are uncertain, they may be as prone as anyone else to irrational biases when considering the common good, future generations and other species. And their louder voices can drown out the less powerful.

For example, a couple who own their home freehold may reasonably calculate that it is in their economic interests to buy an investment property to rent. Once sufficiently large numbers of investors follow suit, however, their collective voice may act as a vested interest that resists taxes on capital gains and the removal of tax incentives that have favoured them in the past. Lobbyists may loudly object to such policies, ignoring the social consequences of renting to people who would like also to be home owners but can't afford to buy, and ignoring the risk of a market correction or even a credit crisis. They thus resist policy changes that reduce the incentives for investors to purchase another property.

Probably the biggest single collective action problem that humanity faces is climate change. There are local and global vested interests in fossil fuels, manufacturing, transport and agriculture that stand in the way of change, and that, for psychological and material reasons, resist the adoption of a long-term strategic outlook. The fear of losses in asset values, a commercial preference for certainty over uncertainty, and biases that favour the status quo discount the potential benefits of embracing climate-related innovations and behavioural changes, even if one has accepted rationally that anthropogenic climate change is occurring. One may claim that it is someone else's responsibility to make the first moves, for example. In this case, 'the public good' pertains to a global public, and the collective action problem involves independent sovereign nations, each with its own vested economic and political interests.

The present question, then, is not just 'who benefits?', but 'who evades short-term costs and/or pushes for short-term gains at the expense of long-term common interests?' We should ask how vested interests operate in particular circumstances, and how policymaking processes can be improved so as to contain their influence; or, better still, how to align vested interests with the public interest, as Woodhouse did.

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The *Cabinet Manual* and the Public Service Commission's code of conduct

In public governance, there may be a conflict of interest when an elected or career public official is (or is perceived to be) involved with or influenced by a vested interest. Politicians and officials are people with interests like every other citizen, but ideally they set personal interests and their relationships with vested interests aside and act impartially in the public interest while doing their day jobs. Hence, there are rules and ethical guidelines laid down for ministers in the *Cabinet Manual* and for public servants in Te Kawa Maataaho/the Public Services Commission's code of conduct.

The *Cabinet Manual* sets out expectations for ministerial conduct. No one gets prosecuted for ignoring its 'guidance'; although, in *Field v R* the former minister ought to have been aware of its contents and hence ought to have known that what he was doing was wrong. The *Cabinet Manual* is not, and does not need to be, authorised by Parliament. As adopted and updated by successive governments, it has simply evolved. It records, but does not formally codify, constitutional conventions. It 'provides guidance' on Cabinet collective responsibility and on conflicts of interest. It purports not to prescribe rules, and yet describes itself as 'authoritative'. It is often cited in the media, however, as a 'rule book' – even as 'the all-important ministerial book of rules' (Walls, 2020). Writing down conventions and guidelines is likely to have an unintended effect, therefore, as people look to the written 'guidance' for exactly that, guidance. In the court of public opinion, the *Cabinet Manual* is likely to be treated as a set of rules for ministerial conduct, and it may acquire a prescriptive political (if not legal) force over time (Duncan, 2015).

The *Cabinet Manual*'s 'guidance' is admirably practical and clear. On the topic of interactions with organisations that we might describe as 'vested interests', paragraph 2.83 says:

> It is a valid and appropriate aspect of a Minister's role to engage with representatives of non-government and commercial organisations. Care should be taken, however, to avoid creating a perception that representatives or lobbyists from any one organisation or group enjoy an unfair advantage with the government. (Cabinet Office, 2017, p.32)

This is a new clause included in the 2017 edition, and the phrase 'enjoy an unfair advantage' is well chosen.

However, a significant inside track for vested interests in the policy process is granted via the use of 'stakeholder' consultation. Stakeholders are subsets or groups of citizens to be consulted by policymakers on a given policy issue. On what basis are stakeholders selected? And to which stakeholders do decision makers pay most attention? (De Bussy and Kelly, 2010, p.290). Stakeholders are given a semi-official role in the *Cabinet Manual*: 'A key consideration in developing workable and effective policy is assessing the need for, and the timing of, consultation with Māori (including relevant iwi, hapū, and whānau), the public, and *relevant stakeholder groups*' (Cabinet Office, 2017, p.76, emphasis added). Cabinet guidelines mandate a 'process for consultation with interest groups' and indicate that departments preparing Cabinet policy papers are responsible for ensuring that 'appropriate … stakeholder consultation is undertaken' (Department of the Prime Minister and Cabinet, 2017). Given resource constraints, there is a risk that big players will be agencies' primary stakeholders. Those who lack resources for research and lobbying and who are not a part of relevant networks risk being overlooked as 'stakeholders' in matters that affect their interests.

The purposes of the Public Service Act 2020 include a statement of core public service values and a requirement for minimum standards of integrity and conduct to be set by the public service commissioner. The commission's *Standards of Integrity and Conduct* set 'standards of behaviour expected of State servants' (Public Service Commission, 2010, p.3). On trustworthiness, they require state servants to 'ensure our actions are not affected by our personal interests or relationships'; 'never misuse our position for personal gain'; 'decline gifts or benefits that place us under any obligation or perceived influence' (Public Service Commission, 2007). While it is necessary to maintain links with outside organisations, state servants are alerted to the risk of 'capture by interest groups and the possible perception of undue influence' (Public Service Commission, 2010, p.7).

The *Standards of Integrity and Conduct* emphasise the need to ensure that disadvantaged members of the community have fair and equitable access to services. They have less to say directly about the mitigation of vested interests, who are, by definition, among society's most privileged. And one has to stretch the meaning of 'services' to include access to policymaking processes. The code warns against taking advantage of, or seeking to gain from, one's position as a state servant, for example in relation to private investments or businesses, in order that job performance is not affected by personal interests and that inside knowledge is not used for personal gain. Gifts, hospitality and offers of secondary employment are particularly sensitive. They could imply or create a mutual obligation with a vested interest, and hence their undue influence or unfair advantage. But the code of conduct does not directly address the management of vested interests.

Ministers and public servants involved may act perfectly appropriately as individuals, but wealthy and well-connected vested interests, acting as identified stakeholders via non-transparent processes, may still be exploiting their advantages.

The New Zealand state sector does take steps to manage and to mitigate the influence of vested interests over ministers and state servants. The Office of the Auditor-General provides a comprehensive guide to managing conflicts of interest (Controller and Auditor-General, 2020). That corrupt practices are generally well constrained in New Zealand, and wrongdoing can result in prosecution, helps to account for this country's top ranking on Transparency International's Corruption Perceptions Index. But the undue influence of vested interests is not necessarily a matter of clear-cut malfeasance, such as bribery.

Moreover, the various guidelines mentioned above tend to focus on individuals' avoidance or management of conflicts of interest, and only implicitly on powerful corporate interest groups or lobbyists and their potentially undue influence over policymaking processes at the expense of less well-resourced and less advantaged groups. Ministers and public servants involved may act perfectly appropriately as individuals, but wealthy and well-connected vested interests, acting as identified stakeholders via non-transparent processes, may still be exploiting their advantages. Powerful private stakeholders and their hired lobbyists are not required to deliver clarity regarding their involvement in policymaking processes, nor are they required to declare publicly their interests in policy change or the status quo, and yet it is generally accepted that they have greater rights via the *Cabinet Manual*.

The insulation of policymaking and policymakers from undue economic and political pressures of vested interests does not necessarily assure us of good government, in the senses of efficient, effective, equitable and responsive government. Even without endorsing his push for smaller government, we should pay at least some heed to Niskanen's scepticism about believing 'that honest government is good government' (Niskansen, 1971, p.193). This article addresses not only honest government, however, but also supports governmental processes that are fair, inclusive and democratic, and that prevent undue influence from powerful vested interests. But the codes and guidelines for public governance reviewed above tend to focus more on the honest conduct of individual ministers and state servants. They could be read as guidance on 'butt-covering' rather than guidance for democratic governmental process. There is little that is explicitly aimed at the management and mitigation of vested interests. The term 'stakeholder' is only loosely specified.

Conclusion

As we recover from the impacts of Covid-19, we still face significant problems, such as social and economic inequality, the obesity epidemic, dirty water, online extremism and climate change. None of these challenges can be met without collective action and effective policy and law. And among the barriers to this collective action, there will always stand those vested interests that intervene to protect an advantage they currently enjoy over others, even if changes to policy and law would lead to long-term social and economic benefits. The challenge is that these vested interests, as members of our communities, are also legitimate interests who deserve a fair hearing in democratic policymaking processes. Their participation should be transparent, however, and should not predetermine decision making. It is important for decision-making guides such as the *Cabinet Manual* to move on beyond simply a focus on honest conduct and more strongly focus on management and mitigation of vested interests.

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